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1989

## Comment letters on on the Proposed SAS, The Confirmation Process

American Institute of Certified Public Accountants. Auditing Standards Board

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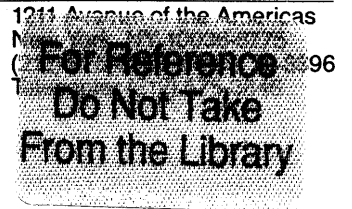
American Institute of Certified Public Accountants. Auditing Standards Board, "Comment letters on on the Proposed SAS, The Confirmation Process" (1989). *Statements of Position*. 721.

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Comment letters - The Confirmation Process  
**AICPA**

American Institute of Certified Public Accountants



January 2, 1991

File Ref. No. 1120

To the Auditing Standards Board:

Re: **Exposure Draft of proposed SAS, The Confirmation Process**

Here are the comment letters received to date on the proposed SAS, The Confirmation Process. I expect to receive additional comments since the comment deadline is February 1, 1991.

<u>Name</u>	<u>Location</u>
1. George Chebba, CPA	Bangor, Maine
2. Rob Jordan, CPA Jordan, Myers, CPAs	Florence, South Carolina
3. Reginald D. Brooks, CPA	Phoenix, Arizona
4. John W. Cook, CPA Georgia State University	Atlanta, Georgia
5. Roger D. Clark, CPA Davis, Clark & Co.	Dallas, Texas
6. Roy E. Dellinger, CPA Dellinger & Deese, CPA	Charlotte, North Carolina
7. Bernard A. Bernsen, CPA	San Antonio, Texas
8. J. Michael Inzina, CPA Hill, Inzina & Co.	Bastrop, Louisiana
9. Charles A. Hawes, CPA Stephen, Kutas & Co., P.C.	Lansing, Michigan
10. Stephen A. Degnan, CPA Harry, Evans & Degnan	San Fransisco, California
11. Earl Hall, CPA	Yakima, Washington
12. James W. Brackens, Jr., CPA	Richmond, Virginia

Auditing Standards Board  
January 3, 1991  
Page two

<u>Name</u>	<u>Location</u>
13. Robert A. Pearcy, CPA	Texarkana, Arizona
14. Dan Blemche, CPA	Gary, Indiana
15. Sherman L. Rosenfield, CPA	Miami, Florida
16. Neil Rischull, CPA Zell & Ettinger, CPAs	Brooklyn, New York
17. Joseph M. Tanis, CPA Bond, Beebe, Barton & Muckelbauer, P.C.	Washington, DC
18. Kell B. Rabern, CPA Rabern, Larson & North, P.S.	Seattle, Washington
19. Robert A. Thomas, CPA	Indianapolis, Indiana
20. Carlos Quiruz, CPA	San Francisco, California
21. J. LaRock, CPA LaRock & LaRock. P.C.	Las Cruces, New Mexico
22. Steven E. Pearson, CPA	Hampton, Iowa
23. Alan K. Clark Smith, Adcock & Company	Atlanta, Georgia
24. J.A. Smith, CPA	Moulton, Alabama
25. Francis J. McKean, Jr., CPA	St. Louis, Missouri
26. Bruce D. Norling, CPA	Boston, Massachusetts
27. Paul Fitzgerald, CPA Kelley & Fitzgerald, P.C.	Waterbury, Connecticut
28. William A. Albright, CPA Davis, Clark & Company	Dallas, Texas
29. Robert Barkett, CPA	Cleveland, Ohio
30. Abraham Akresh, CPA	Wynnewood, Pennsylvania

Auditing Standards Board  
January 2, 1991  
Page three

<u>Name</u>	<u>Location</u>
31. Loren D. Shepherd, CPA Shepherd & Company, Inc.	Englewood, Colorado
32. Steven V. Dudas, CPA	Waterbury, Connecticut
33. Timothy Coffey Arizona Society of CPAs	Phoenix, Arizona
34. F.A. Corcell Goff, Carlin & Cagan	Worcester, Massachusetts
35. Harold M. May, CPA	St. Petersburg, Florida
36. Floyd Oleck, CPA	New Haven, Connecticut
37. Submitted Research Paper Author Unknown	Unknown

Sincerely,



Douglas P. Sauter  
Technical Manager  
Auditing Standards Division

DPS/lf  
Attachments

c: Use of Confirmations Task Force  
Mr. Thomas Weirich, SEC

1211 Avenue of the Americas  
For Reference 3396  
Do Not Take  
From the Library

February 6, 1991

File Ref No. 1120

To the Auditing Standards Board:

Re: **Exposure Draft of proposed SAS, The Confirmation Process**

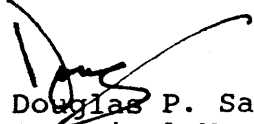
Here are additional comment letters received to date on the proposed SAS, The Confirmation Process.

<u>Name/Affiliation</u>	<u>Location</u>
38. Carl Gross, CPA Altschuler, Melvoin & Glasser	Chicago, Illinois
39. Michael W. Wassinger, CPA McDermott & Miller, P.C.	Hastings, Nebraska
40. Arthur Andersen & Co.	Chicago, Illinois
41. Howard Groveman Grant Thornton	New York, New York
42. Hugh J. Posner Society of Louisiana CPAs	Metairie, Louisiana
43. Florida Institute of CPAs	Tallahassee, Florida
44. Coopers & Lybrand	New York, New York
45. William F. Drimer, CPA Clifton, Gunderson & Co.	Milwaukee, Wisconsin
46. Harvey E. Schock, Jr., CPA Product Assurances Consulting	Haddonfield, New Jersey
47. Douglas Carmichael, CPA Baruch College	New York, New York
48. James M. Holloway, CPA South Carolina Assoc. of CPAs	West Columbia, South Carolina
49. Crowe, Chizek & Company	South Bend, Indiana

<u>Name/Affiliation</u>	<u>Location</u>
50. Douglas R. Norton Auditor General	Phoenix, Arizona
51. Douglas Blensly California Society of CPAs	Glendale, California
52. Stanley G. Robertson, CPA Schipper, Kintner & Robertson	Lansing, Michigan
53. Kurt R. Sjoberg Office of the Auditor General	Sacramento, California
54. J. Dwight Hadley Office of the State Comptroller	Albany, New York
55. Dennis R. Kroner, CPA Philip Rootberg & Co.	Chicago, Illinois
56. Maryland Society of CPAs Auditing Standards Committee	Baltimore, Maryland
57. Stuart H. Harden, CPA Silva, Harden & Co.	Fresno, California
58. Robert E. Royer, CPA	Indianapolis, Indiana
59. Kenneth E. Larash, CPA Grabush, Newman & Co.	Baltimore, Maryland
60. Michael J. Cohen, CPA New Jersey Society of CPAs	Roseland, New Jersey
61. Thomas H. McTavish, CPA Office of the Auditor General	Lansing, Michigan
62. Stanley F. Dole, CPA	Grand Rapids, Michigan
63. James F. Camp, CPA Camp & Associates, P.C.	Birmingham, Alabama
64. Paul M. Kurisko, CPA Office of the State Auditor	Trenton, New Jersey
65. L. Karl Denton, CPA Denton, Netherton & Co.	Denver, Colorado
66. Anatole Hraintsor, CPA	Pasadena, California

- |  |                          |
|--|--------------------------|
| 67. Margaret Kelly, CPA<br>State Auditor of Missouri     | Jefferson City, Missouri |
| 68. Charles S. Hafer, CPA<br>Hafer & Gilmer, CPAs        | Unknown                  |
| 69. Richard F. Strawn, II, CPA                           | Sacramento, California   |
| 70. E. John Larsen, CPA<br>University of Southern Calif. | Los Angeles, California  |
| 71. Unknown  |                          |
| 72. Michael H. Hoenig, CPA<br>Hoenig & Associates        | Cheyenne, Wyoming        |
| 73. George D. Funk, CPA<br>Moss Adams                    | Seattle, Washington      |
| 74. Willis A. Smith                                      | Ridgewood, New Jersey    |

Sincerely,



Douglas P. Sauter  
Technical Manager  
Auditing Standards Division

DPS/lf  
Attachments

121  
New  
(2)  
Te  
For Reference  
Do Not Take  
From the Library

March 3, 1991

File Ref. No. 1120

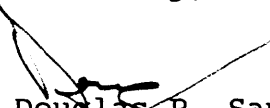
To the Auditing Standards Board:

Re: **Exposure Draft of proposed SAS, The Confirmation Process**

Here are additional comment letters received to date on the proposed SAS, The Confirmation Process.

<u>Name/Affiliation</u>	<u>Location</u>
75. Lela D. Pumphrey Association of Government Accountants	Alexandria, Virginia
76. Ernst & Young	Cleveland, Ohio
77. J. M. Fried, Jr.	New Orleans, Louisiana
78. Steven F. Sawatski Illinois CPA Society	Chicago, Illinois
79. Judith H. O'Dell, CPA Beucler, Kelly & Co.	Wayne, Pennsylvania
80. Jerry D. Sullivan Public Oversight Board	New York, New York
81. Walter M. Primoff, CPA New York State Society of CPAs	New York, New York
82. William D. Hall, CPA	Batavia, Illinois

Sincerely,

  
Douglas P. Sauter  
Technical Manager  
Auditing Standards Division

DPS/lf

cc: Use of Confirmations Task Force



March 6, 1991

File Ref. No. 1120

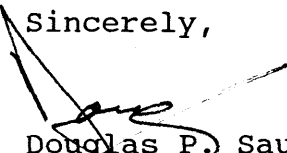
To the Auditing Standards Board:

Re: **Exposure Draft of proposed SAS, The Confirmation Process**

Here is an additional comment letter received to date on the proposed SAS, The Confirmation Process.

<u>Name/Affiliation</u>	<u>Location</u>
83. KPMG Peat Marwick	New York, New York

Sincerely,



Douglas P. Sauter  
Technical Manager  
Auditing Standards Division

DPS/lf  
cc: Use of Confirmations Task Force

EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: George Chibba, CPA - BANGOR, MAINE 12.5.90

Comments: \_\_\_\_\_

It is inconceivable to me — after all these years — that the AICPA — still feverently clings to the illusory belief that negative confirmations — by some sort of dynamic mysticism — confirm an account balance, and therefore is one of the unassailable pillars of the attest function. A negative confirmation is a mis-nomer as is fatally-wound negative confirmations belong on the ash heap of shocking and embarrassing mistakes. Sooner or later they will prove — in a court of law — that the discipline and has been — for too many years — incapable of the task of discerning right from wrong. We will look, rightfully so, like a bunch of nincompo that were out to a long lunch — trying to make no a yes and a white - black, when common sense proves just the opposite. Negative confirmations shouldn't be permitted. They should be outlawed!  
**NEGATIVE CONFIRMATIONS DON'T CONFIRM DIDDLE !!!**

*George Chibba*

*Bangor, Maine*

Instructions for Response Form

This self-mailer may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.

EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 237

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *Rob Jordan Jordan & Ayers CPAs*

Comments: *Strongly oppose. We don't need this*

Lined area for additional comments.

Instructions for Response Form

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# EXPOSURE DRAFT

## PROPOSED STATEMENT ON AUDITING STANDARDS

### THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Reginald D. Brooks, CPA

Comments: Paragraph 32 singles out accounts receivable confirmations and states that the confirmation of accounts receivable is a generally accepted auditing procedure. It also states that because third party evidence provides higher quality audit evidence, there is a presumption that accounts receivable balances will be subjected to the confirmation process during an audit unless certain conditions are present.

These guidelines are equally pertinent to other accounts such as cash, petty cash, inventory at third parties, securities in trust or at a broker, life insurance policies, notes receivable and accounts payable. Why then, conclude in paragraph 33 that auditors must only document reasons for overcoming the confirmation presumption for accounts receivable. If reasons for not confirming accounts receivable must be documented, so should reasons for not confirming other accounts. This should be so stated.

You could indicate why confirmation of accounts receivable is being specifically addressed (and not other accounts), and that the guidance contained in paragraph's 32 and 33 apply to other accounts as well.

#### Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *John W. Cook, Georgia State University, Atlanta, GA*

Comments: *The last two sentences of paragraph 27 could be reworded to more clearly express their effect. Something like the following expresses more directly what is meant, I believe.*

*"Oral confirmations are acceptable only when they regard information that is insignificant, and <sup>they</sup> should be documented in the workpapers."*

*The question then arises why oral confirmations should ever be accepted, for the confirmation is probably not needed if the information is not significant. Perhaps the whole matter of oral confirmations needs to be omitted or at least reworded to reflect clearly when they may be used.*

### Instructions for Response Form

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990

Comment Date: February 1, 1991

Name and Affiliation: Roger D. Clark CPA  
Davis, Clark & Co Dallas, Texas

Comments:

1. Statement is unnecessary since everything already exist in previous standards.

2. Para 21 + 22 and their implications that auditor generally is unjustified in use of negative confirmations are not supportable based on any empirical evidence. In my opinion, the authors of these two paragraphs suffer from the fallacy common to CPA's that a piece of paper in the workpaper file is always better than no piece of paper.

Roger D. Clark

Instructions for Response Form

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990

Comment Date: February 1, 1991

Name and Affiliation: Roy E. Dellinger, Managing Partner  
DELLINGER & DEESE, CPAs, CHARLOTTE, NC

Comments:

I AM IN FAVOR OF THIS PROPOSED STATEMENT  
IT REAFFIRMS WHAT MOST CPA'S ARE DOING  
NOW IN CONFIRMATION WORK. HOWEVER IT  
CLARIFIES CERTAIN AREAS, SUCH AS THE  
(AND LIMITATION)  
USE OF NEGATIVE CONFIRMATIONS AND THE  
OPTION NOT TO CONFIRM ACCOUNTS RECEIVABLES  
IN CERTAIN CIRCUMSTANCES.

SUGGESTION - I WOULD FAVOR SOME  
ADDITIONAL COMMENT ON THE SCOPE OF  
ACCOUNTS RECEIVABLE CONFIRMATION AND  
SAMPLING OF THE POPULATION NOT CONFIRMED  
(MOST FIRMS SEEM TO IGNORE SAS #39)

Instructions for Response Form

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

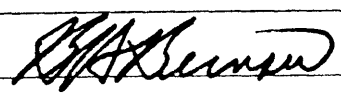
Name and Affiliation: Bernard A. Bernsen, Member, AICPA

Comments: Gentlemen:

Paragraph 19 reads, in part, "The auditor should evaluate relevant information provided on negative confirmations that have been returned to the auditor to determine the effect such information may have on the audit".

Had this standard been drafted for the American Medical Association, paragraph 19 would no doubt read "The doctor should evaluate relevant information provided on the X-Rays returned from the lab to determine the effect such information may have on the health of the patient".

If one reviews the progression of the accounting profession over the past twenty-five years, we see that the more pronouncements are set forth, the more audit failures and the less quality control. Our object as a profession should be to address important issues of the day, not to clutter our minds with insignificant drivel such as this pronouncement. Accordingly, I recommend that this proposed statement be trashed, or, at a minimum, paragraph 19 be deleted on the basis of being meaningless.



B. A. Bernsen, CPA

235 Summit Tower San Antonio, TX 78228

Instructions for Response Form

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: J. MICHAEL INZINA ; HILL, INZINA & Co., BASTROP, LA

Comments: I AM BASICALLY IN AGREEMENT, HOWEVER I HAVE SOME SERIOUS CONCERNS ABOUT SEVERAL PORTIONS OF THE PROPOSED STATEMENT

(1) PARAGRAPH 20 STATES, AS ONE OF THE CONDITIONS FOR USING NEGATIVE CONFIRMATIONS, THAT "A LARGE NUMBER OF SMALL BALANCES IS INVOLVED". THIS WOULD SEEM TO LICENSE VIRTUALLY ANY SAMPLING APPLICATION

(2) ALTHOUGH MITIGATED SOMEWHAT BY PARAGRAPH 32, PARAGRAPH 2 DOES NOT CONSIDER INSTANCES WHERE ANALYTICAL PROCEDURE RISK IS LOW

(I.E., EFFECTIVE ANALYTICAL PROCEDURES ARE AVAILABLE, AS IS THE CASE IN A UTILITY, FOR EXAMPLE). (3) I HAVE A REAL DIFFICULTY WITH THE

SENTENCE IN PARAGRAPH 20 THAT STATES THAT "AUDITORS OF... FINANCIAL INSTITUTIONS, UTILITIES... MAY MEET THESE CONDITIONS". AS MENTIONED IN (2) AN

EFFECTIVE ANALYTICAL PROCEDURES AND THE ALTERNATIVE PROCEDURES RELATED TO SUBSEQUENT COLLECTION ARE QUITE EFFECTIVE IN THE UTILITY, BUT ARE GREATLY DIMINISHED IN

FINANCIAL INSTITUTION AS A RESULT OF THE SUBSTANTIALLY LONGER COLLECTION PERIOD. IN ADDITION TO THAT, UTILITY RECEIVABLES ARE TYPICALLY A MINOR ASSET, AND

IN A FINANCIAL INSTITUTION ARE USUALLY THE SINGLE LARGEST ASSET CATEGORY. I THINK CONSEQUENTLY THAT THIS SENTENCE SHOULD BE DELETED OR SERIOUSLY MODIFIED.

(4) PARAGRAPH 21 IS NOT NEARLY STRONG ENOUGH REGARDING THE WEAKNESS OF NEGATIVE REQUESTS. SECONDLY, I DISAGREE THAT IT PROVIDES ANY REAL EVIDENCE

RESPECTING THE EXISTENCE ASSERTION. I BELIEVE THAT THE PROFESSION ASSIGNS FAR TOO MUCH WEIGHT TO NEGATIVE CONFIRMATIONS, AND THINK THEIR USE SHOULD BE LIMITED TO RARE SITUATIONS. (5) PARAGRAPH 32 SHOULD

Instructions for Response Form

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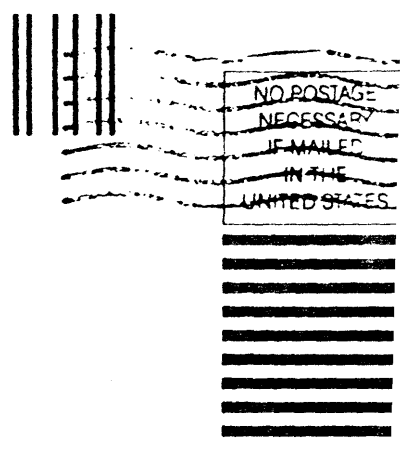
(over)

PROVIDE FOR NOT BEING  
A MAJOR ASSET)  EVEN IF CONTROL RISK IS HIGH, BUT ANALYTICAL PROCEDURES  
ARE HIGHLY EFFECTIVE (VIZ, THE UTILITY SITUATION WHERE TURNOVER IS HIGH) I  
BELIEVE THE PARAGRAPH WOULD ALLOW, BUT IT SHOULD BE MORE EMPHATIC.

No postage necessary Please fold this form so that Business Reply Panel  
appears on the outside. tape along edge and mail

PLEASE FOLD HERE

FILE 2371



**BUSINESS REPLY MAIL**  
FIRST CLASS PERMIT NO. 72 NEW YORK, N.Y.

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Auditing Standards Division  
1211 Avenue of the Americas  
New York, New York 10109-0004



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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Charles A. Hawks, CPA - Stephen Kutys & Co., P.C.

Comments: I don't disagree with any of the statements made in this SAS draft. However, I disagree with the need for it to be issued. It seems that all of the points covered should be used by the auditor in following other authoritative guidance and sound judgement. If peer reviews find that the confirmation process is not being properly implemented, compliance should be encouraged by other means; not by issuing yet another SAS.

### Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: STEPHEN A. DEGNAN, HARRIS, EVANS & DEGNAN

Comments: The proposed SAS is very well written and appears comprehensive.

I would add at the end of paragraph 28 the following:

The auditor should consider, when appropriate, directly contacting the non responding third party using the telephone. Any communication should be followed up with written correspondence.

### Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: EARL HALL, EARL HALL CPA

Comments: IN CONFORMANCE WITH PROPOSED STATEMENT AS IT  
ELUCIDATES OUT POTENTIAL AMBIGUITIES IN AU 331 AND UPDATES  
FOR TECHNOLOGICAL ADVANCES.

I WOULD LIKE TO SEE AU SEC 331.01 REMAIN INTACT  
BOTH OLD + NEW STATEMENTS SAY (CONFIRMATION) OF RECEIVABLES  
IS A GENERALLY ACCEPTED AUDITING PROCEDURE + AUDITOR  
MUST DOCUMENT REASONS FOR NOT PERFORMING.

PARAGRAPH 32 OF PROPOSAL SHOULD BE WRITTEN AS A NEW  
PARAGRAPH TO AU 331, ELIMINATING SECOND SENTENCE, WHICH IS IN  
AU 331.01. PARAGRAPH 33 SHOULD BE ELIMINATED AS IT IS ALM  
VERBATIM TO THE REQUIREMENT IN AU 331.01.

A POTENTIAL PROBLEM TO AMENDING AU 331.01 AS THIS  
STATEMENT PROPOSES IS THAT IT COULD THEN BE CONSTRUED TO BE  
REQUIRING INVENTORY OBSERVATION EVEN WHEN IMMATERIAL TO THE  
FINANCIAL STATEMENTS OR IN OTHER CIRCUMSTANCES WHEN THE  
AUDITOR MAY BELIEVE INVENTORY OBSERVATION IS NOT NECESSAR:

Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: JAMES W. BRACKENS, JR., CPA Sole Practitioner

Comments: OVERALL, THIS SAS ACCOMPLISHED THE OBJECTIVES  
(ADDRESS ITEM THE BOARD DOES NOT FEEL PRACTITIONERS  
ALWAYS CONSIDER) OF THIS STATEMENT. HOWEVER, WHY,  
IN PARAGRAPH 32, ARE ACCOUNTS RECEIVABLE SINGLE  
OUT? WHY NOT CASH, NOTES RECEIVABLE, NOTES PAYABLE  
AND ACCOUNTS PAYABLE AS WELL (SOME OF THESE ARE USED  
IN EXAMPLES, BUT NOT ADDRESS IN THE SAME MANNER)?  
IT SEEMS TO BE INAPPROPRIATE TO VIRTUALLY REQUIRE  
CONFIRMATION ON ACCOUNTS RECEIVABLE, WITHOUT GIVING THE  
SAME TREATMENT TO OTHER BALANCE SHEET ACCOUNTS  
THAT ARE ALSO SUBJECT TO THIRD PARTY VERIFICATION.  
EITHER ADDRESS ALL SUCH ACCOUNTS, OR DELETE THE  
EXPLICIT REFERENCE TO ACCOUNTS RECEIVABLE.

### Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation:

Comments: *If any CPA needs additional guidance about the use of confirmations that CPA does not need to be doing an audit. The AICPA is <sup>to</sup> set our standards not to be a babysitter.*

*Lolita A Peary*

### Instructions for Response Form

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *Dan Blomck CPA - Hof Ins*

Comments: *Appears to be a good SAS*

Lined area for additional comments.

Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

FILE 2371

70  
1, 1991  
Sherman L. Rosenfield, CPA  
8124 S. W. 86th Terrace  
Miami, Florida 33143

(advisor to small, local firms. author of a handbook on QC)

Name and Affiliation:

Comments:

In ¶ 28, the word "generally" should be deleted. An acceptable insert, instead, might be "in almost all cases". However, ~~Second~~ Second Requests should really be a requirement

Additional guidance should be included, in the SAS, on summarizing the results of the confirmation process (including alternative procedures in conjunction with ¶ 31. Give an example (such as a table)

In ¶ 27, discuss if statement may be issued before the hard copy is received. If so, what good are oral or fax responses?

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: JOSEPH M. TANU, CPA. - PRINCIPAL  
BOND, BEEBE, BARTON + MUCKELBAUER, P.C.  
WASHINGTON, D.C. 20015

Comments: I BELIEVE THE EXPRESSION OF EXISTING STANDARDS IN THIS AREA [ THAT THIS PROPOSAL WOULD SUPERCEDE (I.E. SAS NO.1, SECTION 331 AS CITED IN DRAFT) IS ADEQUATE AND THAT THIS EFFORT IS SUPERFLUOUS.

I FIND IT HARD TO IMAGINE THAT PROBLEMS IDENTIFIED IN PEER REVIEW, ETC. COMMAND SUCH GUIDANCE TO PROVIDE CURES. I FIND PARTS OF THE PROPOSED STATEMENT LAUGHABLE . . . . OR IS IT INSULTING (I'M NOT SURE WHICH) . . . . SEE PARAGRAPH 17 FOR EXAMPLE . . . . IS SUCH GUIDANCE REALLY NECESSARY? I BELIEVE NEW STATEMENTS ON AUDITING STANDARDS SHOULD BE ON IMPORTANT ISSUES THAT BEG AUTHORITY DIRECTION. "GUIDANCE" SHOULD BE LEFT TO THE JOURNAL OF ACCOUNTANCY, OR SIMILAR AGENCIES.

I URGE THE BOARD TO RECONSIDER THE NEED FOR SUCH SIMPLISTIC PROMULGATION . . . . I URGE THE BOARD TO WITHDRAW THE THOUGHT AND SUBSTANCE OF THIS PROPOSED STATEMENT.

Joseph M. Tanu  
12/4/90

# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: KELL B. RABERN, CPA , RABERN, LARSON & NORTH, P.S., SEATTLE

Comments:

THIS IS A DISCUSSION FAR TOO BASIC TO WARRANT  
A NEW SAS. THESE MATTERS SHOULD ALREADY  
BE WELL UNDERSTOOD AND APPLIED WITHOUT  
QUESTION BY AUDITORS. THERE IS NOTHING  
NEW HERE AND IT IS AN EMBARRASSMENT  
TO THE PROFESSION TO SUGGEST THAT WE  
NEED SUCH BASIC REMEDIAL EDUCATION.

IF PEER REVIEWS HAVE, IN FACT, REVEALED  
"PROBLEMS" WITH AUDITORS' USE OR MISUSE  
OF CONFIRMATIONS, THE SOLUTION SHOULD  
NOT BE ANOTHER SAS. THE SOLUTION  
SHOULD BE REMEDIAL EDUCATION OR  
GREATER INITIAL EDUCATION PRIOR TO ENTRY  
INTO THE PROFESSION. THE SOLUTION  
SHOULD BE APPLIED ONLY TO THE FIRMS OR  
PRACTITIONERS FOUND SUBSTANDARD. I CANNOT  
BELIEVE THERE IS GENERAL AND  
PREVALENT MISUSE / ABUSE SUCH THAT  
THIS SAS IS WARRANTED.

HEAR A LONG DOTTED LINE

### Instructions for Response Form

This self-mailer may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Robert A. Thomas, CPA Indianapolis, IN

Comments:

#27 Best method to restrict risks of facsimile responses is to omit CPA's facsimile number from confirmation requests.

#28 Consideration to audit efficiency should be given. Experience with health care providers (ie. hospitals and nursing centers) tells us that although combined assessment of inherent and control risk may not be low, subsequent receipts testing is as effective or more effective as compared to confirmations. This is due to the large percentage of business relative to government and other large third party payors.

Robert A. Thomas, CPA  
12-2-90

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Carlos Quiroz, CPA  
465 CALIFORNIA STREET S.F. CA  
MEMBER OF AICPA, CAL SOC of CPAs

Comments: Confirmation is one of several  
tests available in an audit.  
Presumption of confirmations being  
sent in all audits is an ABE  
Meddling into Audit process /  
Auditor judgement function which  
should be avoided. Why not  
presume a "test of  
subsequent collections" instead  
GET THE MESSAGE? Micromanage  
of audits is inappropriate.

### Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: J. La Roche, La Roche & La Roche PC

Comments: Good background material but very vague guidelines. No discussion of mixed positive-negative confirmation to provide broad baseline of data with increased assurance on selected material accounts.

Guidelines would be more useful if other assets & liabilities were identified which confirmations may be useful for, when they would be useful or not useful, and how GAAP views their use or need. For example, if this statement is on the general confirmation process, it should mention standard bank confirmations and when they are required or desirable. When would a note be confirmed versus a "statement of account" balance from monthly statement being acceptable.

Without restating SAS 39, at least a brief mention of it's relationship to confirmations should be included.

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *Steven E Pearson CPA; self-employed.*

Comments: *The profession is suffering from  
standard, ~~over~~ overload; this thing  
should be shelved.*

*Steven E Pearson, CPA  
PO Box 61  
Hampton IA 50441  
515-456-4829*

Instructions for Response Form

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS

FILE 2371

## THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *Alan K. Clark, partner, Smith, Adcock & Co., Atlanta*

Comments: *Most of the Draft is redundant with other, prior guidelines. The new items are the problem: Confirmation procedures can be deleted or reduced if risk is low. With all the current problems of failed thrifts, CPA lawsuits, etc., why are you allowing procedures to be less? Only the 1st 2 exceptions of #32 should be applicable. #3 is allowing a subjective evaluation to outweigh the hard facts of confirmation.*

*#13 - AICPA should encourage Banks to fill in all the blanks. I was personally familiar with a theft from an institution that was allowed for several years but would have been caught earlier if the old custom of not supplying the account numbers on the bank confirmation had been followed. As it happened, the thief had opened up a bank account that was not on the books, and it was not confirmed by the bank.*

*Overall, you are allowing subjective evaluation of the level of inherent and control risks (which most CPAs do not understand anyway) to replace the hard facts of confirmation. That is a wrong move as affects the credibility of the profession.*

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**ALAN K. CLARK**  
CERTIFIED PUBLIC ACCOUNTANT

Instructions for Re:  
This self-mailer may be used for comments or suggestions that is of concern or interest to you. For convenience, the summary that accompanies

ALAN K. CLARK, P.C.  
SMITH, ADCOCK AND COMPANY  
90 WEST WILUCA ROAD, N.E.  
ATLANTA, GEORGIA 30328

OFFICE (404) 252-2208  
FAX (404) 255-0841  
CITY (404) 252-1100

# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *J. A. Smith, CPA  
512 LAWRENCE St.  
MOUNTAIN. AZ 85620*

Comments: \_\_\_\_\_

*REGARDING PARAGRAPH 32, "CONFIRMATION OF A/R", THE STATEMENT THAT "THERE IS A PRESUMPTION THE AUDITOR WILL REQUEST CONFIRMATION OF A/R" IS SOMEWHAT MISLEADING.*

*IT APPEARS TO ME THAT IN THE AUDIT OF ANY ENTITY WHOSE A/R TURN OVER WITHIN A REASONABLE PERIOD (i.e. 30-60 DAYS), THE MOST PERTINENT AUDIT STEPS TO DETERMINE VALUATION AND EXISTENCE IS TO EXAMINE CASH RECEIPTS, AND THAT A STATEMENT SUCH AS REFLECTED IN THE ABOVE PARAGRAPH ONLY SERVES TO CONVINCER MANY THAT DIRECT CONFIRMATION IS A NECESSITY, EVEN THOUGH SUCH CONFIRMATIONS ACTUALLY PROVIDE MINIMUM ASSURANCE AS TO EXISTENCE AND PRACTICALLY NO ASSURANCE AS TO VALUATION OR ULTIMATE COLLECTIBILITY.*

*J. A. Smith  
11-27-90*

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: FRANCIS J. McKEON, JR. CPA  
7777 BONHOMME  
ST. LOUIS, MISSOURI 63105

Comments: \_\_\_\_\_

I certainly hope that all auditors are already employing these techniques and observing these guidelines.

This breaks no new ground but I do support it 100%.

Francis J. McKeon, Jr.

Thanks to the AICPA for pulling these together in a very readable document.

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# EXPOSURE DRAFT

## PROPOSED STATEMENT ON AUDITING STANDARDS

### THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Bruce D. Nowling, CPA - Owner of F

Comments: Agree with proposed statement without change

#### Instructions for Response Form

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Paul Fitzgerald, CPA - Kelley & Fitzgerald, P.C.  
Waterbury, CT 06710

Comments:

Your statements under paragraphs 17, 21 and 28 are unrealistic and reflective of your propensity for requiring extra work when none is necessary.

In #17 you say "non-responses (to positive confirmations) do not provide audit evidence about the financial statement assertions being addressed."

I believe that they certainly do. Did you ever receive a confirmation request stating you owed a sum of money, which you did not owe, to which you did not respond? A non-returned positive confirmation is a negative confirmation.

In #21, unreturned negative confirmations, as their instructions usually state, are definite evidence that the account is substantially correct. I think that unreturned confirmations, which if unreturned must have been delivered, are definite and explicit evidence of the existence and valuation of the receivable, in most cases.

In #28, the second and third request recommendation is unproductive, in most instances, because, for various reasons, addressees are prevented by company policy from responding. However, as stated earlier, they would almost certainly respond if the amount was fraudulent or non-existent.

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**DAVIS, CLARK AND COMPANY**  
**CERTIFIED PUBLIC ACCOUNTANTS**

*A Professional Corporation*  
2705 SWISS AVENUE  
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**WILLIAM A. ALBRIGHT, C.P.A.**  
**PAULA K. BERRY, C.P.A.**  
**ROGER D. CLARK, C.P.A.**  
**JOHN MARTIN DAVIS, JR., C.P.A.**  
**HERBERT B. KENNON, C.P.A.**  
**RHONDA A. REGO, C.P.A.**  
**C. DENNIS TARPLEY, C.P.A.**

**WILLIAM H. CLARK, Retired**  
**JOHN MARTIN DAVIS, SR., Retired**  
**JAMES M. MULLINO, Retired**

December 19, 1990

Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division File 2371  
AICPA 1211 Avenue of Americas  
New York, New York 10036-8775

Subject: Proposed Statement on  
Auditing Standards the  
Confirmation Process

Dear Sir:

The above mentioned proposed statement would appear to be unnecessary as guidance regarding confirmations and their relationship to reliance on internal controls already exists in current standards.

Paragraphs 20-22 seem to imply that negative confirmations are not appropriate except for certain specialized industries. In my opinion, positive or negative confirmations are appropriate no matter what the industry depending on the characteristics of the engagements.

Sincerely,

William A. Albright

1b



# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: **ROBERT BARKETT AICPA MEMBER**

Comments: **EXCELLENT DRAFT THAT ADDS DIMENSION TO THE CONFIRMATION PROCESS AND CLEARLY ADDRESSES THE LIMITED ASSERTIONS IN CONFIRMATIONS ON PARAGRAPH 10.**

**I DO NOT PREFER NEGATIVE CONFIRMS EVEN WITH THE REASONS ENUMERATED IN PARAGRAPH 20. I FIND IT DIFFICULT TO DETERMINE HOW AN AUDITOR COULD ASSESS WHETHER RECIPIENTS OF REQUESTS WOULD BE UNLIKELY (OR LIKELY) TO GIVE THEM ADEQUATE CONSIDERATION. I RECOMMEND DELETION OF ITEM 20 (C)**

*Robert Barkett*

### Instructions for Response Form

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Abraham David Akresh, CPA  
1209 Weymouth Road  
Wynnewood, PA 19096  
215-642-1742

December 5, 1990

American Institute of CPAs  
Auditing Standards Division  
1211 Avenue of the Americas  
New York, NY 10036-8775

Attention: Douglas P. Sauter  
Technical Manager

Re: File 2371

Gentlemen:

I am pleased to comment on the Exposure Draft of the proposed Statement On Auditing Standards, "The Confirmation Process". I support issuance of this SAS because it greatly clarifies existing guidance on the confirmation process.

However, I believe the guidance could be improved, especially in the area of negative confirmations. There has been significant research that indicates that negatives provide almost no useful information and might mislead the auditor. If the auditor's use of negatives is challenged in a lawsuit, the opposing counsel will bring up the research results and leave the auditor in an indefensible position. Juries will not understand negatives. Accordingly, the Board should tell auditors not to use negatives, rather than try to describe the few situations where they might provide some very limited evidence.

If the Board decides to keep negatives, it should consider changes to paragraphs 20 and 21. Paragraph 20 indicates that negatives may be used when the auditor has no reason to believe that the recipients are unlikely to give them consideration. I believe the auditor needs to do something positive to satisfy himself that recipients consider the information. For example, he has received responses in the past when there are errors, he knows something about the respondent's business, he has directed the request to a knowledgeable party (see paragraph 25). If the auditor has done nothing, he will be using an ineffective procedure without sufficient basis for it.

Mr. Douglas P. Sauter  
December 5, 1990  
Page 2

It is not clear why auditors of financial institutions, utilities and retail organizations may (or might) meet the conditions for using negatives. Audits of financial institutions are now high risk. Auditors shouldn't be using procedures that might be ineffective on high risk audits (especially on high risk accounts such as loans).

The example of demand deposits at the end of paragraph 20 should be changed. The example is not clear as to what assertion is being tested. Since control risk is low, there should be no need for any confirmation of liabilities. The Savings and Loan Guide should be clarified on this issue (see Laventhol & Horwath's comment letter on the Guide).

The SAS should make it clear that if the auditor finds any misstatements using negatives, he should significantly increase his testing. The SAS should be clear that the auditor should not compute likely misstatement based only on negatives.

#### Other Issues

Paragraph 31 -- should be modified to indicate that the auditor should consider the need for adjustment of the financial statements (in addition to the sufficiency of evidence).

Paragraph 32 -- Should be modified to relate only to the existence assertion for receivables; should be clear that confirmation of sales transactions is acceptable.

The last sentence of the paragraph (third bullet) is out of place. Perhaps a separate paragraph is necessary. In addition, the reference to the applicable assertion should be changed to existence.

Sincerely,



Abraham D. Akresh  
CPA

EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *LOREAN P. SHEPHERD SHEPHERD AND COMPANY INC.*

Comments:

*I certainly wish someone would explain to  
the people the differences between an  
auditing standard and auditing procedure.  
I consider this detailed explanation of confounding  
requests to be totally unnecessary  
since meaning to the professional of any  
auditor also has been working for a  
competent auditing firm for over six months  
and are invited to potential litigants  
and lawyers to use our own documents  
against us in litigation. How would  
I consider just "shutting up?"*

*Half of the provisions you are  
putting out are unnecessary and the  
other half are classic case of "red herring".  
I see no necessity for the publication of  
this document at all.*

*John Shepherd*

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Timothy Coffey, Auditing Standards Committee.  
Arizona Society of Certified Public Accountants

Comments:

The committee reviewed the proposed statement and had no direct comments as to suggested changes. The committee did question the statement in paragraph 3 of the cover letter from Mr. Neebes and Mr. Guy pertaining to special provisions made in the proposed statement for small businesses. The committee was unable to identify seperate provisions in the proposed statement made specifically for small businesses. It is the committee's suggestion that any special provisions be keyed or indexed to highlight the proposed statement's effect on the audit of small businesses.

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: F.A. CORCELL GOFF, CARLINE CAGAN WORCESTER, MA.

Comments: PARAGRAPH 32 STATES THAT CONFIRMATION PROCEDURES NEED NOT BE APPLIED IF:

"THE USE OF CONFIRMATIONS WOULD BE INEFFECTIVE AS AN AUDIT PROCEDURE."

THIS WOULD BE DUE TO INADEQUATE RESPONSE OR RESPONSE ARE INADEQUATE. IN SUCH CASES, YOU WOULD APPLY ALTERNATIVE PROCEDURES. UNFORTUNATELY, THIS WOULD BE DUE TO CLIENT PREPARED DOCUMENTS. (THESE DOCUMENTS COULD VERY EASILY BE FALSIFIED).

IT SEEMS TO ME THAT, IN AN EFFORT TO REDUCE TIME AND EXPENSES ON AN ENGAGEMENT, ACCOUNTANTS MIGHT BYPASS THE CONFIRMATION PROCESS. THIS COULD EVEN HAPPEN IN SITUATIONS WHEN "NO-CONFIRMATION" IS NOT WARRANTED.

THEN TOO, HOW VALID ARE SUBSEQUENT COLLECTIONS. IT ONLY PROVES AN AMOUNT WAS PAID. AND, THIS MAY NOT NECESSARILY AGREE OR PERTAIN TO A YEAR END BALANCE.

FURTHER, THERE MIGHT BE SIZABLE AMOUNTS OF DISPUTED CHARGES, LATE PENALTIES, INTEREST, PRICE, QUANTITY AND OTHER TYPE DISCOUNTS THAT SHOULD BE ADJUSTED. YOU WOULDN'T FIND THIS OUT IF YOU DON'T ATTEMPT TO CONFIRM BALANCES, ETC. RETURNED CONFIRMATIONS WOULD ALSO INDICATE THE POSSIBILITY OF FICTITIOUS DEBTORS. (REMEMBER EQUITY FUNDING!)

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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *MARCUS M. MAY, CIA  
Tax Practitioner*

Comments: \_\_\_\_\_  
\_\_\_\_\_ *In my opinion the proposed  
Statement on Auditing Standard -  
The Confirmation Process is well  
written and should be published.* \_\_\_\_\_  
\_\_\_\_\_ *Marcus M. May* \_\_\_\_\_  
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# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS

FILE 2371

## THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: FLOYD OUECK C.P.A.

Comments: I FEEL THE EXPOSURE DRAFT ELABORATES ON PROCEDURES THAT ACCOUNTANTS HAVE BEEN DOING FOR YEARS. MORE REQUIREMENTS WILL ONLY LEAD TO MORE LEGAL EXPENSE IF DRAFT PROPOSALS ARE NOT PERFORMED. AT PRESENT THE LEGAL CONFIRMATION DOES NOT GIVE US ANY SUBSTANTIAL INFORMATION, USUALLY IS RECEIVED WAY AFTER THE AUDIT AND IS COSTING THE CLIENT MONEY. THE NEW BANK CONFIRMATIONS ARE PUTTING LEGAL BURDEN ON THE BANKS TO BE RESPONSIBLE TO US ON ACCURACY OR TELL US IF ASSETS LIST IN WE DON'T PUT THEM DOWN ON THE CONFIRMATION. A/P CONFIRMATION THE RESPONSE RATE IS SO LOW THAT SUBSEQUENT TESTING IS MANDATORY. M/R CONFIRMATIONS USUALLY COME BACK WITH INCORRECT INFORMATION BECAUSE THE CUTOFF IS NOT TAKEN INTO ACCOUNT IN THEIR RESPONSE, MAKING US STILL CHECK SUBSEQUENT ENTRIES. ALSO ON SMALL CLIENTS OR ONLY A YEAR CLIENTS WE CAN NOT DO INTERIM WORK THEREFORE NOT ALLOWING SUFFICIENT TIME TO SEND OUT & RECEIVE BACK CONFIRMATIONS BEFORE F/S HAVE TO BE ISSUED. WE KNOW WHAT HAS TO BE DONE SINCE WE ARE C.P.A.'S GIVING US THE BURDEN OF THE DOUBT THAT WE WILL MAKE THE RIGHT CHOICES WITHOUT MORE RESTRICTIONS AND POSSIBLE LITIGATION IF AUDIT PROCEDURE IS NOT CARRIED OUT TO THE LAST LETTER

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IS IT TIME FOR NEW AUDIT GUIDELINES  
ON THE USE OF ACCOUNTS RECEIVABLE  
CONFIRMATIONS

EXECUTIVE SUMMARY

- **HOW RELIABLE** are accounts receivable confirmations as audit evidence? The reliance traditionally placed on confirmation evidence may be unfounded. The Auditing Standards Board Task Force on Confirmations is considering revisions to current confirmation standards and guidelines.
- **CONFIRMATION EVIDENCE** is biased. The procedure detects more overstatement errors than understatement errors. The nature and extent of bias is best determined under the controls of a field experiment.
- **FIELD EXPERIMENT RESULTS** show that confirmation evidence is not very strong as a secondary source of evidence regarding the valuation and completeness assertions.
- **AUDITING STANDARDS** should be revised to highlight weaknesses in the confirmation procedure and to prevent over-reliance on confirmation evidence.

Accounts receivable confirmations have long been considered a strong form of evidence by auditors because the procedure involves direct communication with independent sources outside of the entity being audited. However, is the reliability traditionally placed on confirmation evidence justified? Several studies have concluded that such reliance may be unfounded. As a result, in 1988, the Auditing Standards Board formed a task force on confirmations that is currently evaluating existing guidelines and drafting new guidelines on the use of confirmations. In this article, the background for the accounts receivable confirmation procedure is reviewed and evidence on confirmation reliability is presented. Suggestions are then offered on the future use of the confirmation procedure.

#### Auditing Standards on Confirmations

Confirmation of accounts receivable was an optional audit procedure in the United States that was not widely used at the time the McKesson-Robbins fraud was discovered in 1938. The McKesson-Robbins fraud involved the recording of fictitious sales and receivables, among other things, that remained undetected for over a decade. The SEC launched a major investigation to determine the adequacy of audit procedures generally in use at that time. The accounting profession responded by issuing Statement on Auditing Procedures Number 1, Extensions of Auditing Procedure, which recommended confirmation of receivables "wherever practicable and reasonable."

Throughout the early 1940s, a number of modifications and revisions were made to auditing standards involving confirmation. The most significant modification was Statement on Auditing Procedure Number 12 (SAP12), entitled Amendment to Extensions of Auditing Procedure. Auditors were required to disclose any case in which confirmation of receivables

with debtors was not performed. The effect was to make confirmation a de facto mandatory procedure.

The disclosure requirement of SAP 12 was rescinded in 1974. However, confirmation of receivables became an ingrained procedure in United States audit practice. Section 331 of Statement on Auditing Standards Number 1 dictates current U.S. audit procedure regarding confirmation. Section 331 contains a discussion of factors that affect the timing and extent of use of confirmations as well as a brief discussion of the positive and negative confirmation forms and the situations most conducive to the use of each. Also considered is the problem of nonresponse to positive-form confirmations and the need to employ alternative procedures "to provide evidence as to the validity and accuracy of significant non-responding accounts."

In addition to codified auditing standards on confirmation, the AICPA Auditing Standards Division issued an Auditing Procedure Study in 1984 entitled Confirmation of Accounts Receivable. The study lists the objectives involved in an audit of accounts receivable arranged according to five categories of financial statement assertions.

Confirmation is considered a primary source of evidence regarding the existence assertion, and a secondary source of evidence regarding the completeness and valuation assertions.

The 1984 Auditing Procedure Study also contains cautionary advice on the use of accounts receivable confirmations. Two major concerns were: (1) the tendency of confirmees to report more of the errors that overstate the balance than errors that understate the balance, and (2) inaccuracy of responses and inadequate rates of response. Fifteen suggestions are provided for improving response rates and response accuracy, but none of these suggestions address or correct for the potential reporting bias of confirmees that

results in discovery by auditors of more accounts receivable overstatement errors than understatement errors.

The Canadian Institute of Chartered Accountants (CICA) went even further in cautioning auditors on the use of confirmations. The CICA issued an audit technique study in 1980 that recommended use of the positive-form confirmation request. However, according to the guide, "many auditors question [the] value [of] direct communication with debtors." The primary criticisms were the problems of non-response and unreliable evidence. The CICA study noted that "reliance on a test consisting only of replies means that the test is determined by the responding and non-responding debtors instead of the auditor, and it may no longer be representative or appropriate."

The CICA study also expressed concern with respondent apathy and "say yes" behavior, which results in unreliable evidence. "Say yes" behavior occurs when customers confirm balances as correct without actually checking their records. "The danger of using the communication technique in these circumstances is that the auditor may use it just to conform with professional standards and not to add audit assurance."

#### Why Research Confirmation Reliability?

Why should we conduct research on the reliability of confirmation evidence? Auditors have long suspected that confirmation evidence is biased. They have noted from actual practice that confirnees are more likely to report overstatement errors than understatement errors, and most auditing textbooks caution that the procedure is "better" at detecting overstatement errors. The following example will illustrate why research on confirmation reliability is important.

Suppose that duplicate billing errors occur more frequently than any other type of error involving accounts receivable. This would mean that overstatement errors are more prevalent than understatement errors in accounts receivable accounts. If that is true, then the reason the confirmation procedure is more effective at detecting overstatement errors is simply because more overstatement errors are present, and not due to any reporting bias by confirmees. Thus confirmation reliability can only be assessed under the controls possible in a carefully designed research experiment.

An experiment provides the following benefits:

1. The experimenter controls the size of the errors.
2. The experimenter controls which accounts are seeded with errors.
3. The experimenter controls the frequency of overstatement and understatement errors.
4. Other factors that may affect reliability can be studied, such as account balance size, account balance age, and transaction volume.
5. The underlying cause of any reporting bias can be isolated, making corrective action possible.

For these and other reasons, the author conducted a comprehensive study of confirmation reliability, using trade accounts receivable in an industrial setting.

### Prior Evidence on Confirmation Reliability

A few studies have been performed to assess the reliability of confirmation evidence by seeding confirmation request forms with errors. Three findings of interest from these studies are:

- Overall rates of detection and reporting of errors to auditors were quite low – generally less than 50%.

- Customers tended to report more errors that were unfavorable to them (overstatements of accounts receivable) than errors that were favorable to them (understatements of accounts receivable).
- Detection and reporting of errors was generally better when the positive form was used as compared to the negative form of confirmation request.

The evidence from these studies was used by the AICPA and the CICA in drafting current audit guidelines on confirmations. However, auditors may wonder if the concerns raised about confirmation reliability are valid. The evidence from prior studies was limited in scope due to the populations sampled. Two of the studies were conducted at a university credit union and three were performed at banks. Few, if any, of the confirmees were commercial companies. Presumably, the use of accounting departments, bookkeepers and accounts payable personnel by commercial companies will enhance error detection. In contrast, many individual consumers do not maintain any accounting records, which makes verification more difficult. Furthermore, prior studies generally involved interest-bearing accounts. Confirmees may have confused interest earned (or charged) with errors seeded by the researchers. Also, confirmees in these studies probably were not used to receiving confirmation requests, particularly the positive form, which may have contributed to the low rates of error detection found.

#### Evidence on Confirmation Reliability Using Trade Accounts Receivable

A field experiment was performed during the annual audit of a steel warehousing operation in New Jersey. The customers of the warehouse represented a broad spectrum of industries, and most were small to medium-sized commercial companies located in New York, New Jersey and Pennsylvania. A few of the customers were quite large and listed in

the Fortune 500. In many respects, the customers were typical of those found on most audits of manufacturers, and thereby provided a "rich" audit environment for the study of confirmation reliability.

Positive-form confirmation requests were sent to all of the customers with debit balances, using the same form that had been used by the auditors in prior years. Return envelopes were supplied directing all replies to the auditors. Customers were unaware that they were involved in an experiment. The only difference between this experiment and actual audit use of the confirmation procedure is that confirmation request balances were altered for nearly 80% of the accounts. An equal number of overstatement and understatement errors were randomly assigned to accounts. In addition, the size of the errors varied, with adjustments of plus or minus 20% for large errors and 3% for small errors. The remaining accounts were not seeded with errors, serving as both a control group for the experiment and as the sample used by the auditors for the annual audit.

[Insert Exhibit 1 about here]

The results of the experiment are summarized in Exhibit 1. Confirmation reliability should be assessed in terms of specific management assertions. Confirmations are considered a primary source of evidence regarding the existence assertion. Approximately two-thirds of the customers replied to the confirmation request, a response rate comparable to other years. Yet, nearly one-third of the customers failed to reply to first or second requests. Alternative audit procedures were therefore necessary for a significant number of accounts to gain satisfaction regarding existence.

Confirmations are considered a secondary source of evidence regarding the valuation assertion. Yet in this experiment, only 47.2% -- less than half of the errors -- were detected

and reported to the auditors. Using confirmation evidence to assess error rates would result in severe underestimation of the actual number of errors. Furthermore, reporting bias of the type suggested in auditing literature was detected. Customers were more likely to report overstatement errors than understatement errors. Also, customers were more likely to detect and report large errors than small errors.

Confirmations are also considered a secondary source of evidence regarding the completeness assertion. Yet in this experiment, less than 42% of the large understatement errors were detected and reported to the auditors. Thus confirmation evidence is not very strong in terms of completeness.

One other result was significant in terms of the reliability of the confirmation procedure. Standard confirmation request wording instructs customers to report any exceptions directly to the auditors. In this experiment, nearly 5% of those customers receiving requests with altered balances called the company under audit to investigate exceptions. All of these calls were handled by the experimenter, who posed as an accounts receivable clerk for control purposes. Several callers asked specifically what they should write on the confirmation form. Although the percentage of customers who called is low, the potential for undetected fraud is greater than if customers refrained from calling the company.

Several other factors were analyzed, but not found to be significant in explaining confirmation response and detection of errors. These factors include account balance age, account balance size and transaction volume. Although account balance age was not significant there were very few accounts that were past due in the population – only 17 customers had balances that were two or more months past due. The response rate for these customers was only 35%, about half the rate for the rest of the population.



### Should Confirmation Standards Be Revised?

This study raises serious questions about the reliability of the confirmation procedure. Unlike prior studies, the results come from a rich audit environment, based on trade accounts receivable in an industrial setting. The following can be concluded regarding specific management assertions:

- Confirmations are biased as a secondary source of evidence regarding the valuation assertion. Overstatement errors are more likely to be reported to auditors than understatements.
- Confirmations are not very strong as a secondary source of evidence regarding the valuation assertion. Less than half of the errors are reported to auditors due to "say yes" behavior and response bias.
- Confirmations are not very strong as a secondary source of evidence regarding the completeness assertion. Understatements of accounts receivable are less likely to be reported to auditors.
- Even though confirmations are the primary source of evidence regarding the existence assertion, much additional audit work is required. Overall response rates are lower than desirable.

Despite the above shortcomings, the confirmation procedure has one great benefit – the evidence is relatively inexpensive. Thus, in considering revised standards, the Auditing Standards Board should weigh the cost of alternative procedures relative to the benefits.

Providing auditors with a choice of procedures is recommended because costs will vary depending upon a client's cash, accounts receivable and sales systems. For example, at the company where the field research was performed, it was very easy (and inexpensive) to observe subsequent cash receipts when the mail arrived and was opened by the client. In these circumstances, a customer's check provides evidence of existence that is just as reliable as confirmation evidence, and far more reliable in terms of valuation.

Auditing standards should be revised to highlight the weaknesses in the confirmation procedure and thereby prevent over-reliance on confirmation evidence, particularly regarding the valuation and completeness assertions. Also, revised standards should make it clear that confirmation of accounts receivable is not a mandatory procedure. A menu of alternative procedures in lieu of confirmation of accounts should be provided, thereby removing any doubt about a de facto confirmation requirement.

**EXHIBIT 1**  
**Summary Results of a Field Test**  
**of Confirmation Reliability**

Overall rate of response	68.6%
Response rate from significantly past-due accounts	35.3%
Overall rate of error detection	47.2%
Detection of large overstatement errors	53.2%
Detection of large understatement errors	41.9%
Detection of small overstatement errors	46.9%
Detection of small understatement errors	46.7%
Customers receiving requests with errors who phoned the client instead of the auditors	4.6%

For Reference  
Do Not Take  
From the Library

April 5, 1991

File Ref. No. 1120

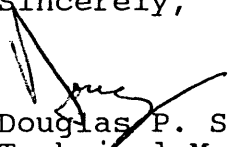
To the Auditing Standards Board:

Re: **Exposure Draft of proposed SAS, The Confirmation Process**

Here are additional comment letters received to date on the proposed SAS, The Confirmation Process.

<u>Name/Affiliation</u>	<u>Location</u>
84. Paul Caster University of Southern California	Los Angeles, California
85. Richard D. Johnson National State Auditors Association	Des Moines, IOWA

Sincerely,

  
Douglas P. Sauter  
Technical Manager  
Auditing Standards Division

DPS/lf  
Attachments

cc: Use of Confirmations Task Force

24

FILE 2371

# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS

## THE CONFIRMATION PROCESS

November 13, 1990

Comment Date: February 1, 1991

Name and Affiliation: Paul Caster, Assistant Professor, USC

Comments: In my opinion, the exposure draft does not go far enough in warning

auditors about just how unreliable confirmation evidence has been shown to be. My research on accounts receivable confirmations has demonstrated that confirmees detect and report less than half of all errors in the accounts. Also, the reporting is biased such that confirmees are more likely to report overstatement errors than understatement errors and large errors than small errors. There is also a strong tendency for "say yes" behavior, i.e., confirming as correct a balance without actually checking the records and verifying the balance.

All of these weaknesses in confirmation reliability should be addressed in the exposure draft. Paragraph 25 could be expanded to point out the tendency for respondents to "say yes" and to report more errors that are unfavorable to them than favorable. Paragraph 31 should contain similar warnings to auditors when evaluating responses. The exposure draft should explicitly mention these potential biases in confirmation responses. Finally, paragraph 33 should be eliminated. It unnecessarily ties auditors hands, considering how unreliable accounts receivable evidence has been shown to be.

### Instructions for Response Form

This self-mailer may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.

# National State Auditors Association

25

March 13, 1991

## OFFICERS AND EXECUTIVE COMMITTEE

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**WILLIAM L. MILES**  
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Division of Audits  
Oregon

Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division  
File 2371  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036-8775

Dear Mr. Sauter:

The National State Auditors Association (NSAA) is pleased to submit the following comments on the American Institute of Certified Public Accountants' (AICPA's) proposed Statement on Auditing Standards (SAS) entitled, "The Confirmation Process." We certainly appreciate the opportunity to respond to this proposed SAS. It should be noted that the following comments are not intended to represent a single response for all NSAA members individually. The views of some members may not be fully in concert with all of the comments presented here. Individual State Auditors may wish to respond to this proposed SAS separately.

Overall, the State Auditors agree with the content of the proposed Statement and believe that it is comprehensive and well written. We believe the guidance in the proposed Statement is more complete and informative than the current guidance in AU Sections 331.03-.08. Among the areas in which the exposure draft (ED) provides new or expanded guidance are:

1. The relationship of confirmation procedures to the auditor's risk assessments and the use of confirmations to address specific financial statement assertions.
2. The proper design of confirmation requests to meet audit objectives, including factors that affect the reliability of the requests.
3. Special risks associated with confirmation responses received through nontraditional media and considerations for alternative procedures when responses to positive requests are not received.
4. Evaluation of the results of confirmation procedures.

The discussion of the relationship of the confirmation procedures to the auditor's assessment of audit risk and the

Mr. Douglas Sauter  
AICPA Auditing Standards Division  
March 13, 1991

guidance on what the auditor should do when confirmations are not received should be particularly helpful. Also, we were especially glad to see guidance on facsimile responses since this is an area which the current standards do not specifically address and one where guidance is needed. We do not expect the proposed Statement to result in any significant implementation problems; rather, it should assist State Auditors in using confirmation requests more effectively. We do, however, offer the following comments and critiques in hope of further improving the document.

### Assertions Addressed by Confirmations

Paragraph 12 discusses the confirmation process and its relationship to the completeness assertion. The example used is accounts payable. This is the only reference in the ED to accounts payable confirmations and could be confusing because accounts payable, at least in audits of governmental entities, are not usually subjected to the confirmation procedures that are applied to other accounts, such as accounts receivable. Generally, payables are confirmed when internal controls are inadequate and other forms of evidence (such as detailed vendors' invoices) are not available or the auditor is concerned that liabilities may be overstated. Although the point of the paragraph is that the testing must come from the appropriate population, the point could be more relevant if the example was from accounts receivable or some other account that is usually subject to confirmations.

### Form of Confirmation Request

Paragraphs 16 to 21 discuss positive and negative confirmations. The ED should be very clear that it is permissible to use both types of confirmations on the same audit, so long as the guidance of paragraphs 18 and 19 is followed.

Also, paragraphs 19 through 21 discuss the use and analysis of negative confirmation requests; however, these paragraphs do not address the required working paper documentation. Although we presume that the auditor would adequately document the confirmation process in accordance with the third standard of field work, we noted that specific guidance is included in other paragraphs of the proposed Statement. For example, paragraph 27 addresses documentation of oral confirmations and paragraph 33 addresses documentation of how the auditor overcame the presumption of confirmation of accounts receivable. Therefore, for consistency within the document, we believe that paragraphs 19 through 21 should also address the working paper documentation required for the negative confirmation process.

### Prior Experience

The last sentence of paragraph 22 currently reads "For example, if the auditor has experienced poor response rates to properly designed confirmation requests in prior audits, the auditor may consider obtaining audit evidence from other sources." We are uncertain whether the Board intends that the auditor consider obtaining audit evidence from other sources in lieu of or in addition to confirmation requests. To improve the clarity, we suggest that the last portion of that sentence be revised, depending on the Board's intent, to read either "...may instead consider obtaining audit evidence from other sources" or "...may consider obtaining additional audit evidence from other sources."

### Performing Confirmation Procedures

The last three sentences of paragraph 27, which address facsimile and other nontraditional media responses, read "In addition, the auditor should consider requesting the purported sender to mail the original confirmation directly to the auditor. Oral confirmations should be documented in the workpapers. If the information in the oral confirmation is significant, the auditor should request the parties involved to submit written confirmation of the specific information directly to the auditor." The experience of some of the State Auditors indicates that an increasing percentage of respondents are utilizing facsimile and other nontraditional media to respond to confirmation requests. Therefore, to provide more definitive guidance for circumstances in which a facsimile response should be followed by return of the original confirmation and to improve clarity, we suggest that the above three sentences be combined into two sentences that read "Oral confirmations should be documented in the workpapers. If the information in the facsimile or the oral confirmation is significant, the auditor should request the parties involved to mail written confirmation of the specific information directly to the auditor."

One other point that needs to be considered in paragraph 27, is the need to preserve the facsimile response when it is not followed up with the original copy being returned to the auditor. Some fax copies are not readily preserved and are subject to deterioration. The article "Assessing the Risks of Fax Confirmations" by Pearson and Sauter, March 1990 *Journal of Accountancy* suggests that fax confirmations be preserved by photocopying them for the working papers.

Paragraph 28 currently consists of one sentence, which reads "When using positive confirmation requests, the auditor should generally follow-up with a second and sometimes a third request to those parties from whom replies have not been received." Because poor confirmation response rates are typical in practice, we suggest that the narrative in this paragraph be expanded to provide the auditor with additional definitive guidance on follow-up requests, addressing pertinent issues such as (1) appropriate time frames before/between follow-up actions, (2) appropriate forms for follow-up requests, (3) when telephone follow-up may be appropriate, and (4) when third requests may be appropriate. Experience of some State Auditors indicates that telephone follow-up is usually more efficient and effective than written second requests.

### Evaluating the Results of Confirmation Procedures

The references to "alternative procedures" as "other procedures" in the second and third sentences of paragraph 31 are somewhat confusing since the end of the third sentence also refers to "other tests of details or analytical procedures." For this reason, we suggest the following revisions:

In performing that evaluation, the auditor should consider (a) the reliability of the confirmations and alternative procedures; (b) the nature of any differences, including the implications--both quantitative and qualitative--of those differences; (c) the evidence provided by alternative procedures; and (d) whether additional evidence is needed. If the combined evidence provided by the confirmations and alternative procedures is not sufficient, the auditor should request additional confirmations or extend other tests of details or analytical procedures. [emphasis added]



Mr. Douglas Sauter  
AICPA Auditing Standards Division  
March 13, 1991

### Confirmation of Accounts Receivable

We were pleased to read paragraph 32 which, in effect, acknowledges that confirmation is not necessarily the best audit procedure for the types of receivables mostly found in government, such as receivables from taxes or from benefit overpayments. Nevertheless, we question the need for paragraph 33, which requires the auditor to document why he or she decided to use a procedure other than confirmation of accounts receivable.

The general presumption of the proposed statement is that confirmations are an inherently superior audit procedure because they involve external parties. This logic may be true in theory, but it is not necessarily borne out in practice. The auditor may encounter a host of problems in confirming certain statement assertions, as you properly recognized. For this reason, the statement should not reflect a presumption of superiority. Rather, confirmation should be recognized as one of the audit procedures that may be the best procedure in some, if not most, circumstances.

The objective of the audit process is to reduce the audit risk to an acceptable level. The audit risk is influenced by the inherent risk and the control risk, which in turn influence the acceptable detection risk. The auditor's selection of an audit procedure should be directly influenced by his or her assessment of those risks. If documentation of the decision process is desirable, the auditor should be required to document why he or she selected a specific procedure rather than why he or she did not select a specific procedure. For this reason, we believe that paragraph 33 should be modified, if not eliminated.

Also, paragraph 32 states that the confirmation of accounts receivable is a generally accepted auditing procedure and illustrates three specific circumstances in which the auditor may elect not to confirm receivables. Because we interpret this language to imply that these three circumstances are all-inclusive and not merely examples of potential circumstances, we believe the guidance is too restrictive. In many audit engagements, particularly when the field work cannot be performed until several weeks after the end of the fiscal year, it is much more efficient to perform alternative audit procedures (such as examination of subsequent cash receipts), as provided for in Paragraph 30. Based on the Board's policy to always consider the cost/benefit relationship of the proposed guidance, we suggest that a fourth specific circumstance be added to paragraph 32, such as "The use of confirmations, due to the timing of the engagement or other circumstances, would be inefficient as an audit procedure." As an alternative, we suggest that the second illustrated circumstance in paragraph 32 ("The use of confirmations would be ineffective as an audit procedure") be expanded to also address the concept of inefficiency.

### Editorial Comments

In addition to our comments above, we offer these editorial suggestions:

1. para. 16 - 1st sentence - "Confirmation request:" should be "Confirmation requests:"
  - 2nd sentence - "is in agreement" should be "agrees."

Mr. Douglas Sauter  
AICPA Auditing Standards Division  
March 13, 1991

2. para. 20 - 1st sentence - part (b) - "balances is" should be "balances are."
  - 2nd sentence - 1st word - "Auditors" should be "Audits."
  - 3rd sentence - "The auditor should give consideration to performing..." should be "The auditor should consider performing..."
3. para. 34 - 1st sentence - "statement" should be "statements."

\* \* \* \* \*

As always, NSAA is pleased to present these comments and we look forward to providing a response on similar issues in the future. As stated earlier, the State Auditors generally agree with the contents of the proposed SAS. The comments presented in this response are intended to assist the AICPA's Auditing Standards Board in making this SAS a more clear, comprehensive and efficient document. If you desire further information or have any questions in this matter, please contact Relmond P. Van Daniker, Executive Director of NASACT, at (606) 276-1147 or myself at (515) 281-5835.

Sincerely,



Richard D. Johnson  
President

February 4, 1991

Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division  
American Institute of CPAs  
1211 Avenue of the Americas  
New York, NY 10036

Via Facsimile

File Reference 2371  
Exposure Draft (ED) - Proposed Statement of Auditing Standards  
The Confirmation Process

We are pleased to submit our response to the request for comments on the above Exposure Draft.

Depending upon how it is interpreted the proposed standard may have a significant effect on a broad segment of current audit practice. The effect may not necessarily be cost effective. Further, the summary in the exposure draft does not necessarily highlight the potential impact on current practice for certain new requirements, for example, the consequences of not applying alternate procedures to all non responding confirmations. Our comments on this and other matters are as follows:

Paragraph 29 in the ED allows the auditor flexibility and judgment in determining the extent of alternative procedures to perform when it states "the auditor... should employ alternate procedures to the nonresponses to obtain the evidence necessary to reduce audit risk to an acceptably low level." However, this flexibility and judgment is negated by the implication that for nonresponding confirmations for which alternative procedures are not performed, the auditor must project such account balances as a 100% misstatement to the total population.

Existing AU 331.05 and .08 and corresponding references to footnote 1 of those paragraphs allows for flexibility and judgment by referring to "applying procedures to significant (as defined in footnote 1 of AU 331) nonresponding accounts" without any implication to consider the remaining accounts misstatements or that all nonresponding accounts must be subject to alternate procedures.

As a general rule, confirmations are an effective and efficient procedure to gather evidence, however, alternate procedures performed to confirmation requests are usually a time consuming and inefficient process. This is particularly true in an audit where control risk is assessed at the maximum and softer alternate procedures such as analytical procedures might not be considered sufficient evidence. Alternate procedures such as subsequent cash, shipping document, etc. currently are and should be permitted to continue to be applied by the auditor until he or she forms an opinion that sufficient evidence has been gathered to reduce the risk that the account balance is materially misstated to an acceptably low level.



The above comments notwithstanding, the paragraph 29 requirement to project as 100% misstatements those nonresponding confirmation requests is made regardless of whether or not the selection of items to be confirmed is a sample under SAS 39. Particularly when sampling is not the basis for the selection of items to confirm, there should not be a requirement to project nonresponses to the total population as misstatements.

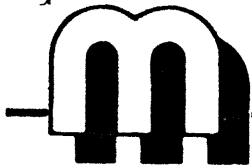
Paragraph 28: "Should generally" is somewhat onerous and perhaps confusing as it means "must sometimes"; perhaps the better language is "should consider".

Paragraph 20: Condition (a) refers to where "the assessed level of control risk is low", this concept does not appear in SAS 55 or any other SAS. It appears only in an AICPA Guide.

Carl Gross of our Firm would be pleased to answer any questions you may have on our comments.

Sincerely,

*Attschuler, Melvoin & Grosser*



January 28, 1991

Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Div.-File 2371  
1211 Avenue of the Americas  
New York, NY 10036-8775

RE: Proposed Statement on Auditing  
Standards

Dear Mr. Sauter:

The Confirmation Process:

Paragraph 25: "The requirement that the accountant confirm directly with the official responsible for the client's account of a financial institution".

It is felt that the institution's personnel responding to the confirmation is: 1) an independent party, and 2) has privy to relevant information regarding the nature of the client. The contacting of an "official" may in fact result in representations of that party in lieu of the institution. The reliance on oral conversations may result in more exposure to the accountant. This would then negate your concerns regarding the bias of parties contacted.

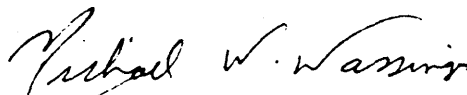
Paragraph 32: "Cases that the auditor would not confirm accounts receivable are listed".

It is felt that beyond it being ineffective for your stated reasons, it may be irrelevant and/or inefficient based on the auditor's professional judgement. It is felt that the auditor's judgement be allowed to function, rather than having to utilize your limited examples to operate within.

Thank you for your consideration.

Sincerely,

McDERMOTT & MILLER, P.C.

  
Michael W. Wassinger, CPA

616 WEST 5TH STREET  
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40

ARTHUR ANDERSEN & Co.

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CHICAGO, ILLINOIS 60602  
(312) 580-0069

January 29, 1991

American Institute of  
Certified Public Accountants  
Auditing Standards Division  
1211 Avenue of the Americas  
New York, New York 10036-8775

Re: File 2371

Gentlemen:

This letter is in response to your request for comments on the proposed Statement on Auditing Standards (SAS) entitled, "The Confirmation Process."

OVERALL COMMENT

Generally, we support the guidance contained in the proposed SAS not only because it reaffirms the importance of the substantive audit procedure described therein, but also because it demonstrates in a meaningful way (a) how the auditor applies the concepts embodied in the risk model and (b) the need to focus on the specific financial statement assertions in developing an appropriate audit plan. A thorough understanding of this SAS should improve the confirmation process and contribute to a more risk focused audit approach by practitioners.

We do, however, have the following suggestions for your consideration which we believe would facilitate a better understanding of the final pronouncement.

SPECIFIC COMMENTS

Paragraph 32 in the proposed SAS sets forth three conditions, the presence of any one of which may overcome the presumption that the auditor will request the confirmation of accounts receivables during an audit. While we agree with the first and third, we are concerned that the second condition (i.e., the use of confirmations would be ineffective) might be interpreted too loosely by some practitioners.

When accounts receivable are material and the auditor's combined assessment of inherent and control risk is high, we believe every effort should be made to obtain reliable responses to confirmation requests. Sometimes this can be accomplished by confirming individual items rather than merely the account balance and contacting the appropriate party within the client customer's organization that a response is needed (as pointed out earlier in the exposure draft).

Consequently, we suggest that the second bullet in paragraph 32 be revised to emphasize this point as follows,

- "o The use of confirmations would be ineffective as an audit procedure (the determination being made after giving proper consideration to the design of the form of confirmation request and directing it to the appropriate individual within the client customers' organization [see paragraphs 23 and 25]) or,".

Separately, with the expanded guidance in paragraphs 32 - 33 on confirmation of accounts receivable, we suggest that footnote 17 ("Circumstances...may make it impossible for the auditor to accomplish these procedures") in SAS 58 be revised to conform with that guidance. As presently written, footnote 17 could be interpreted as holding the auditor to a higher standard for omitting confirmation of accounts receivable than the proposed SAS would require.

Paragraph 16 identifies and briefly describes the blank form as one type of positive confirmation but provides no guidance as to when its use might be appropriate. The primary use of the blank form is to address the completeness assertion and the risk of understatement. For example, when an auditor decides to confirm accounts payable, oftentimes the blank form of confirmation request is used.

Consequently, we suggest that paragraph 16 acknowledge the usefulness of the blank form in those circumstances. This could be accomplished by adding the following sentence at the end of paragraph 16, "The use of the blank form is particularly effective when the auditor wishes to address the completeness assertion and/or the risk of understatement in an account balance, such as accounts payable."

Paragraph 18 states that, "Although there is a risk that recipients of any positive form of confirmation request may sign and return the confirmation without considering it, the use of blank forms mitigates this risk." This statement implies that the auditor should always consider the use of blank forms. We believe that such a consideration is necessary only when, based on current or past experience, the auditor concludes that there exists a risk that recipients will sign and return the confirmation without verifying the information set forth therein. Accordingly, we suggest that the first sentence be revised to read as follows, "When the auditor concludes, based on current or past experience (e.g., unreturned confirmations that contained information known beforehand to be in error), that there is an unacceptable risk that recipients of the positive form of confirmation request are likely to sign and return the confirmation without considering it, the auditor should consider the use of blank forms to mitigate this risk."

We find the discussion in paragraphs 20 and 21 relative to negative confirmation requests somewhat confusing. For example, the third sentence in paragraph 20 followed by a sentence which begins, "In such cases,..." does not follow logically. Furthermore, the wording of these paragraphs, in our view, unduly discredits any validity to the negative form of confirmation by using such words as "rarely provide significant evidence," and "do not provide explicit evidence that...."

We would suggest that paragraphs 20 and 21 be revised to read as follows:

"20. Negative confirmation requests may be used for certain types of entities when (a) the assessed level of control risk is low, (b) a large number of small balances is involved and (c) the auditor has no reason to believe that the recipients of the requests are unlikely to give them adequate consideration. For example, in the examination of demand deposit accounts in a financial institution, it may be appropriate for an auditor to include negative requests with the customers' regular statements when control risk is assessed as low and the auditor's past experience indicates that the recipients consider such requests. In all cases, the auditor should consider performing other substantive procedures to supplement the use of negative confirmations.

"21. Returned negative confirmations may provide evidence about the financial statement assertions. For example, when the auditor sends a large number of negative confirmation requests, the auditor normally would expect to receive some responses indicating misstatements if such misstatements are widespread. Furthermore, unreturned negative confirmation requests can provide evidence concerning certain aspects of the existence assertion. For example, negative confirmations may provide some evidence of the existence of third parties if they are not returned with an indication that the addressees are unknown. However, unreturned negative confirmations do not assure the auditor that the intended third party received the confirmation request and verified whether the information contained therein is correct."

The AICPA has recently changed in a significant manner the confirmation of account balance information with financial institutions. Given the importance of this change, we suggest that this subject, including confirming separately other information by direct inquiry with a responsible bank officer, be discussed more extensively than merely making a reference to the new form (see paragraph 13).



The proposed SAS is organized in a way that treats the performance of alternative procedures as separate from the confirmation process (see the description of the process set forth in paragraph 4). Since the performance of alternative procedures always depends upon the response rate to positive confirmation requests, we suggest that (a) the definition of the confirmation process in paragraph 4 be expanded to add another bullet that describes alternative procedures as part of that process, (b) paragraph 14 be modified to add, at the end the second sentence, the words, "and any alternative procedures performed," and (c) the heading above paragraph 29 be changed to a subheading under the "Confirmation Process" heading. Also, since the definition of the confirmation process in paragraph 4 includes the evaluation phase, the heading above paragraph 31 should be similarly revised.

Paragraph 9, in discussing how the auditor might respond to low assessed levels of inherent risk and control risk, implies that a less effective test is always less costly than a more effective audit procedure. Since this may not be true in every instance, we would suggest that the parenthetical "but costly" and "and less costly" phrases be deleted.

Furthermore, in order to re-enforce the importance of the requirement to confirm accounts receivable, we suggest that the example in this paragraph be changed. An alternative might be something along the following lines, "For example, if inherent and control risks over unrecorded liabilities are assessed as low, the auditor might perform substantive procedures other than confirmation, such as inspecting subsequent payments and applying relevant analytical procedures..."

Paragraph 8 states, in part, that "In some cases, the evidence provided by confirmation will not be sufficient and additional substantive procedures will be necessary." However, it is unclear as to what factors the auditor should consider in deciding whether additional substantive tests are necessary. We suggest that this paragraph be revised to read as follows:

"8. The auditor should assess whether the evidence provided by confirmations reduces audit risk for the related assertions to an acceptably low level. In making that assessment, the auditor should consider the materiality of the account balance and his or her inherent and control risk assessments. When the auditor concludes that confirmation alone is not sufficient, additional substantive procedures should be performed. For example, if inventories are held at public warehouses, the auditor ordinarily would obtain direct confirmation from the custodian and, depending on the materiality of such inventories and the auditor's risk assessments concerning the existence assertion, may perform additional procedures such as observing physical counts of the inventories."

Paragraph 29 describes the performance of alternative procedures. It also provides guidance as to when omission of alternative procedures may be acceptable. For clarity of wording, we suggest that this guidance (the second

Auditing Standards  
Division

- 5 -

January 29, 1991

sentence in paragraph 29) be revised to read as follows: However, the omission of alternative procedures may be acceptable when (a) the auditor concludes that the financial statements would not be materially misstated even if the nonresponses in the aggregate were projected to the population as 100 percent misstatements and (b) the nonresponses have not revealed any unusual qualitative factors or systematic characteristics, for example, that all nonresponses pertain to year-end transactions."

Paragraph 24 discusses, in part, the need to confirm any oral modifications to agreements. It also states that the auditor should make appropriate inquiries concerning the existence and details of such modifications when there is a moderate or high degree of risk. We agree with these statements but would suggest such inquiries be directed only when the risk exists that there may be significant oral modifications. Accordingly, we would suggest that the fifth sentence in paragraph 24 be revised to read as follows, "When the auditor believes there is a risk that there may be significant oral modifications he or she should...."

Finally, paragraph 3 in the proposed SAS cites SAS 11 and SAS 12 as two other pronouncements that presumably deal with confirmation procedures. However, SAS 11 does not discuss confirmation; therefore, the reference to it should be deleted. On the other hand, SAS 45 (Section 334, "Related Parties") and Section 543, "Part of Audit Performed by Other Independent Auditors," both contain a discussion of confirmation work and should be referenced here.

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We would be pleased to discuss any questions you might have concerning our comments and suggestions.

Very truly yours,

*Arthur Andersen & Co.*

MT/7247w

(41)

January 31, 1991

Mr. Douglas P. Sauter  
Technical Manager, Auditing Standards Division  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775

**Grant Thornton** 

Accountants and  
Management Consultants

The U.S. Member Firm of  
Grant Thornton International

Re: File 2371: Proposed Statement on Auditing Standards - The Confirmation Process

Dear Mr. Sauter:

In general, our firm supports the proposed Statement on Auditing Standards. However, we believe that the guidance on the use of negative confirmations is unduly restrictive in several respects.

1. We believe that the criteria that allow the use of negative confirmations should be directed to the account balance being audited, regardless of the type of entity. Thus, we believe the references in paragraph 20 of the exposure draft to certain types of entities should be removed. Instead, examples of various types of account balances that may meet the criteria (e.g. deposit liabilities of financial institutions and customer receivables of utilities) should be presented.
2. We do not believe that an auditor should be required to assess control risk as low (and thus be required to perform tests of controls) in order to use negative confirmations. We know of no place in the auditing standards where a specific control risk assessment is required for a type of procedure to be performed. In addition, the SAS No. 55 Audit Guide uses the term "low" solely for illustrative purposes.

Prior to a conforming change made for SAS No. 55, AU paragraph 331.05, which relates to receivables and inventories, stated, in part, that the negative form of confirmation, "is useful particularly when internal control surrounding accounts receivable is considered to be effective." We believe that a criterion based upon this concept is preferable to the criterion in the exposure draft. Such revised criterion might read, "when (a) the design and operation of the internal control structure policies and procedures surrounding the account balance is considered to be effective." This suggested language is consistent with SAS No. 55. We believe that an auditor may consider the internal control structure to be effective based upon his or her understanding of the nature of the client and the client's industry, and his or her understanding of the internal control structure required by SAS No. 55.

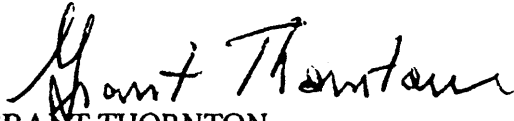
Additionally, the auditor may consider the effectiveness of analytical review and other substantive procedures being applied to the account balance, and the assessment of inherent risk for the account balance in determining whether to use negative confirmations.

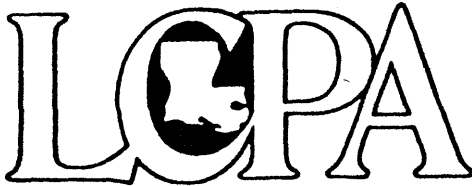
3. We are troubled by the example presented at the end of paragraph 20 of the exposure draft. The example infers that the auditor must form a reason to believe that the recipients will consider the negative requests based upon the auditor's past experience. We believe this to be inconsistent with the criterion presented near the beginning of the same paragraph.
4. We agree that unreturned negative confirmations do not provide explicit audit evidence. We believe such confirmations provide indirect evidence as to various financial statement assertions, depending upon the circumstances. Because the auditor has no reason to believe that the recipients of the confirmation request are unlikely to give them adequate consideration, he or she has an indirect indication as to the correctness of the financial statement assertion(s) the confirmation request was designed to test. Therefore, we believe it inappropriate to generalize that unreturned negative confirmation requests *rarely* provide significant evidence concerning financial statement assertions other than certain aspects of the existence assertion.

Additionally, we find no reference in the existing auditing literature to the concept of "significant evidence," and believe such concept should not be introduced in a SAS on confirmations.

If you have any questions concerning the foregoing, please do not hesitate to call myself, Edward Nusbaum or Barry Barber in our New York office.

Very truly yours,

  
GRANT THORNTON  
Howard Groveman  
National Director of Accounting and Auditing



**Society of Louisiana  
Certified Public Accountants**

January 29, 1991

Mr. Douglas P. Sauter, Technical Manager  
AICPA Auditing Standards Division, File 2371  
AICPA, 1211 Avenue of the Americas  
New York, New York 10036-8775.

Dear Mr. Sauter:

The Accounting and Auditing Standards Committee of the Society of Louisiana Certified Public Accountants appreciates the opportunity to respond to the exposure draft entitled "Proposed Statement on Auditing Standards - The Confirmation Process" dated November 13, 1990.

The Committee received a total of twelve responses, of which six generally agreed with the exposure draft as written. The other six responses contained various comments which are summarized as follows:

Paragraph #

- 20 Second sentence should be deleted or modified since references have traditionally been interpreted as restricting the reference material only to those industries listed. An appropriate modification would be to add an additional comment -- "however, this listing is not all inclusive of appropriate applications".
- 21 Last sentence appears to negate any validity in the use of negative confirmations. Suggested wording -- "Since unreturned negative confirmations do not provide explicit evidence that the intended third party received the confirmation request and verified the information therein, negative confirmations should be used in conjunction with other audit procedures, designed to support the desired financial statement assertion.
- 28 As written the paragraph takes a procedure -- confirmation follow-up -- that might be preferable, and shifts it in the direction of being mandatory. The judgment as whether to follow-up should be left to the auditor. Should substitute the phrase "should evaluate the need to" in place of the phrase "should generally".

Mr. Douglas P. Sauter  
January 29, 1991  
Page 2

Paragraph #

29 Relating to the second sentence, the full comments are as follows:

"Although all conditions referenced in this sentence may be applicable, I feel that there could be circumstances that a 100% misstatement assumption could be incorrect and material. Specifically, if an account payable invoice is held out of the data processing activities and it is maintained by the client in such a fashion that appropriate cut-off procedures would not ascertain its existence, it is quite possible that a greater than 100% misstatement could be created provided that item was included in the non-responses to positive accounts payable confirmations. I would recommend that Paragraph 29 be modified to only include the first sentence and delete any additional references contained therein."

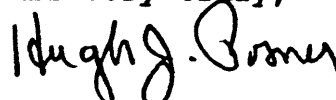
32 & 33 More emphasis and guidance should be given relative to alternative procedures when confirmation responses are inadequate.

A positive statement acknowledging that in certain circumstances confirmations may not be necessary. This would alleviate some of the confusion as to what would be sufficient justification for not performing confirmation procedures.

In addition to the comments above, one additional comment was received relating to adding certain specific information to be requested when designing the confirmation request. The additional information would be a request to confirm the aging of accounts receivable. This may not be possible in all situations due to the number of individual items that may make up the receivable balance; but if possible would provide the auditor with additional information to substantiate an appropriate reserve.

If you have any questions or additional information is needed, please do not hesitate to call.

Yours very truly,



HUGH J. POSNER, CHAIRMAN  
ACCOUNTING & AUDITING  
STANDARDS COMMITTEE

HJP/ebc

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FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314  
TELEPHONE (904) 224-2727 • FAX (904) 222-8190

February 1, 1991

Mr. Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division  
File Reference: File 2371  
American Institute of Certified Public Accountants  
1221 Avenue of the Americas  
New York, New York 10036-8775

Dear Mr. Sauter:

The Accounting Principles and Auditing Standards Committee of the Florida Institute of Certified Public Accountants has met and discussed the Exposure Draft, "Proposed Statement on Auditing Standards: The Confirmation Process".

We hope this letter of comment will be useful to the Auditing Standards Board in their deliberations about this proposed SAS.

The following comments were unanimously agreed to by the committee members present at our discussion.

GENERAL STATEMENT

In general, we believe the proposed SAS represents improved guidance and should be issued with some suggested revisions, as discussed below.

PARAGRAPH 5

1. INHERENT RISK: We feel that more emphasis should be placed on the need to consider external factors relating to the industry, by specific reference in this paragraph.

Mr. Douglas P. Sauter  
February 1, 1991  
Page Two

2. SAS 55: We feel that specific reference to SAS 55 should also be made, due to the specific guidance and requirements of that SAS.

PARAGRAPH 7

We feel this paragraph should specifically address or refer to the requirements and guidance in SAS 55 regarding "assessing control risk below the maximum".

PARAGRAPH 13

We feel that this paragraph might be expanded by completing the thought by stating that "the auditor should design, or utilize, a confirmation to elicit a response on completeness, if that is an objective of the confirmation. If so, then it should be sent to a party who is likely, and able, to respond with the information on completeness".

PARAGRAPH 20

1. We feel that this paragraph either needs additional clarification, or the phrase "for certain types of entities" should be deleted from the second and third lines of this paragraph, since negative confirmations are acceptable in those circumstances when (a), (b) and (c) exist.
2. ADDITIONAL USE OF TECHNIQUE: We suggest that this paragraph also include a statement along the lines of: "The auditor may wish to send out negative confirmations on small balances to supplement evidence obtained from positive confirmations".
3. SAS 39: A reference to SAS 39 would also be useful in this paragraph. For example, if negative confirmations are used, how should sample size be adjusted?
4. To clarify the intent of this paragraph, we believe it would be helpful to acknowledge that the split between positive and negative confirmations may be based on the "complexity of the transactions rather than the dollar balances involved". We feel that, possibly, too much emphasis might be given to account balances and not enough to the complexity of the individual transactions making up those balances.



5. INHERENT RISK: A reference to, and/or discussion of, inherent risk would be appropriate in this paragraph.
6. REWORDING OR CLARIFICATION: We feel that the last two sentences (starting with "In such cases. . .") should be reworded or clarified. The line beginning "misstatements if such. . ." could be reworded to "misstatements if contrary to the auditor's expectations such. . .".

PARAGRAPH 21

We suggest that the discussion of evaluating "returned" negative confirmations be expanded. We are concerned whether the users of this proposed SAS would feel that it would be appropriate to extrapolate the results of unreturned confirmations (SAS 39 and SAS 47) in evaluating the results of responses on negative confirmations.

PARAGRAPH 25

We feel that a reference to related party transactions (SAS 45 [AU334] and possibly FASB 57) should be included in this paragraph.

PARAGRAPH 26

The reference to SAS 9 should be updated for the new SAS on Using the Work of Internal Auditors.

PARAGRAPH 32

We were not able to specifically reference a definition of "generally accepted auditing procedure" in the literature. We feel this term should either be defined or deleted.

GENERAL COMMENTS

The Committee was favorably impressed with this document. More guidance in this area has been needed and this document does an excellent job of providing that additional guidance. The above comments are not intended as criticism. Instead, they should be viewed as suggestions for enhancing an already excellent document.

\* \* \* \* \*

Mr. Douglas P. Sauter  
February 1, 1991  
Page Four

We appreciate the opportunity to provide comments in response to this Exposure Draft. Representatives of our committee are available to discuss these comments with the Board or its representatives at their convenience.

Sincerely,

COMMITTEE ON ACCOUNTING PRINCIPLES AND  
AUDITING STANDARDS - FLORIDA INSTITUTE OF  
CERTIFIED PUBLIC ACCOUNTANTS

*Gary L. Holstrum* RPR

Gary L. Holstrum, PhD, CPA  
Chairman  
(813)974-4186

Task Force to Draft Comment Letter:

Richard P. Reid, CPA  
(305)591-8850

*RPR*

Richard H. Wiskeman, Jr., PhD, CPA  
(305)348-3477

GLH:nan

February 1, 1991

Mr. Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division  
1211 Avenue of the Americas  
New York, New York 10036-8775

RE: File 2371

Dear Mr. Sauter:

We are pleased to submit our comments on the proposed statement on auditing standards, The Confirmation Process.

We support the proposed statement. We believe, however, that paragraphs 19 through 21, which discuss the purpose and use of negative confirmations, though not inaccurate, provide insufficient guidance for the auditor.

Having read through the comment letters received to date, we noted that many responses suggest the elimination of the negative confirmation. We disagree with this suggestion, since we believe that the negative confirmation serves a purpose in the audit process. However, we suggest this purpose be discussed in greater detail in the document to give the auditor sufficient guidance regarding the appropriate use of the negative confirmation.

Attached are our suggested revisions to paragraphs 19 to 21 regarding negative confirmation requests for your consideration. In addition, we have enclosed a paper we developed on the subject of negative confirmation requests which underlie our suggested revisions.

If you have any questions regarding our comments, please contact James S. Gerson (212-536-2243) or A. J. Lorie (212-536-2119) in our National office.

Very truly yours,

Coopers & Lybrand

### Paragraph 19

The negative form requests the recipient to respond only if he or she disagrees with the information stated on the request. The auditor should evaluate relevant information provided by returned negative confirmations. Unreturned negative confirmations do not provide explicit evidence that the intended third party received the confirmation request and determined that the information contained on it was correct. As discussed in paragraph 22, unreturned negative confirmations may provide some evidence about financial statement assertions.

### Paragraph 20

Negative confirmations may generate responses indicating misstatements, and are more likely to do so if such misstatements are widespread in a large population and if confirmation requests are sent to a large proportion of the population. The financial statements of entities in certain specialized industries (such as financial institutions, utilities, and retail organizations) may contain accounts composed of a large number of small balances. In those cases, negative confirmations may identify a problem when none was expected and thereby assist the auditor in assessing the appropriateness of conclusions previously reached and in determining whether additional evidence is needed. Because the negative confirmation process does not provide evidence that requests to non-respondents were received and reviewed, misstatements that are found to exist by evaluating returned confirmations cannot be projected to the population from which the confirmation requests were drawn and cannot serve to determine the dollar amount of the aggregate account misstatement. Accordingly, responses from negative confirmations indicating misstatements require the use of additional substantive tests of details to determine the nature and amount of the misstatement.

### Paragraph 21

Negative confirmation requests may also be returned by the post office with an indication that the addressees are unknown. Negative confirmation requests that have been returned with such an indication may lead to questions about the existence of third parties and require auditor follow-up to determine the underlying cause.

### Paragraph 22

If zero or few negative confirmation requests are returned when the auditor has sent out a large number of requests drawn from a large population, the auditor may conclude that widespread misstatements probably do not exist. Evidence provided by the absence of responses to requests drawn from a large population is not conclusive that material misstatements do not exist, but it is indirect evidence to support such a belief.

## **The Purpose and Use of Negative Confirmation Requests**

The positive and negative forms of confirmation requests have traditionally been viewed as two types or variations of the same audit procedure, in that they share the same name and are believed by many to serve the same purposes. This paper analyzes the purposes of the two forms of confirmation requests and suggests possible uses for the negative form. The paper does not discuss the mechanics of how confirmation procedures should be applied or whether the authoritative auditing literature should require the use of confirmations.

The positive form of confirmation is the process of obtaining and evaluating a direct communication from a third party in response to a request for information related to one or more assertions embodied in one or more financial statement accounts. Obtaining and evaluating positive confirmations constitutes a substantive test of details of transactions and/or balances, and provides direct evidence about one or more of those assertions. Because positive confirmations provide evidence from third parties, that evidence provides greater assurance of reliability (and, thus, lower detection risk) than evidence secured solely within the entity.

The positive confirmation process provides audit evidence only when responses are received from the third-party recipients. Auditing standards, as amended by the proposed SAS, require that the auditor receive replies to all confirmation requests, apply alternative procedures to the non-responses, or treat non-responses as 100 percent misstatements. Therefore, the results of the positive confirmation process can be projected to the population from which the confirmation requests were drawn.

The negative form of confirmation asks the recipient to respond only if he or she disagrees with the information stated on the request. The auditor should evaluate relevant information provided by returned negative confirmations. Unreturned negative confirmations do not provide explicit evidence that the intended third party received the confirmation request and determined that the information contained on it was correct. As discussed below, unreturned negative confirmations may also provide some evidence about financial statement assertions, and the auditor should evaluate that evidence as well.

Negative confirmations may generate responses indicating misstatements, and are more likely to do so if such misstatements are widespread in a large population and if confirmation requests are sent to a large proportion of the population. In serving this purpose, using negative confirmations is akin to using analytical procedures as substantive tests (as compared to positive confirmations, which are substantive tests of details). Like an analytical procedure that points out a problem when none was expected, it can assist the auditor in assessing the appropriateness of conclusions previously

reached and in determining whether additional evidence is needed. Because the negative confirmation process does not provide evidence that requests to non-respondents were received and reviewed, misstatements that are found to exist by evaluating returned confirmations cannot be projected to the population from which the confirmation requests were drawn and cannot serve to determine the dollar amount of the aggregate account misstatement. Accordingly, responses from negative confirmations indicating misstatements require the use of additional substantive tests of details to determine the nature and amount of the misstatement.

Negative confirmations may also be returned by the post office with an indication that the addressees are unknown. Negative confirmations that have been returned with such an indication may also point out a problem and require auditor follow-up to determine the underlying cause, in much the same way that the auditor should respond to an analytical procedure that points out a problem when none was expected.

If zero or few negative confirmation requests are returned when the auditor has sent out a large number of requests drawn from a large population, the auditor may conclude that widespread material misstatements probably do not exist. Like evidence provided by an analytical procedure that does not indicate a departure from the auditor's expectations, evidence provided by the absence of responses to requests drawn from a large population is not conclusive that material misstatements do not exist, but it is indirect evidence to support such a belief.

In summary, if (a) the population under audit consists of a large number of individual items, (b) the auditor can efficiently send a large number of negative confirmation requests, and (c) the auditor expects to receive some responses indicating misstatements if such misstatements are widespread, then negative confirmation requests could provide some level of assurance that (a) no material misstatements exist (if no or only a few requests are returned), or (b) possibly material misstatements exist and further investigation is warranted (if requests are returned either by the third party or by the post office).

January 28, 1991

Mr. Douglas P. Sauter, Technical Manager  
AICPA Auditing Standards Division, File 2371  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775

Dear Mr. Sauter:

We would like to comment on paragraphs 20 and 32 in the Proposed Statement on Auditing Standards, *The Confirmation Process*.

Paragraph 20 lists conditions that must exist for an auditor to use negative confirmations. A presumption is made that the use of positive confirmations provides a greater level of audit assurance than the use of negative confirmations, and that certain conditions must exist to justify this reduced level of assurance. We agree that the level of assurance obtained from sending a negative confirmation is less than the level of assurance obtained from sending a positive confirmation. However, we object to the requirement that control risk be assessed at low in order to use negative confirmations. We believe factors other than the assessed level of control risk have an effect on an auditor's ability to use negative confirmations.

*Assessed level of inherent risk.*

The goal in designing and performing audit procedures on a specific account balance is to reduce audit risk to an acceptably low level. Audit risk is a function of three risk factors: inherent risk, control risk, and detection risk. Detection risk relates to the nature and extent of audit procedures. Since the level of detection risk varies inversely with the combined levels of *both* inherent risk and control risk, assessing inherent risk at low affects the nature and extent of audit procedures just as assessing control risk at low does.

Inherent risk might be assessed at low for various reasons, including the following:

1. The account balance may consist of a large number of small balances. It may be deemed unlikely that a large number of those balances is misstated, and, therefore, the risk that the account balance is materially misstated would be small.
2. The account balance may be relatively immaterial in relation to the financial statements taken as a whole.
3. Transactions affecting the account might not include complex calculations or otherwise be prone to error.

The nature and extent of substantive audit procedures is affected by both control risk *and inherent risk*. We feel that consideration of the assessed level of inherent risk should be discussed in Paragraph 20. If inherent risk is assessed at low, the use of negative confirmations should be allowable, regardless of the assessed level of control risk.

*Relative importance of sending negative confirmations as an audit procedure.*

Other substantive audit procedures are normally performed in conjunction with sending confirmations when testing one or more assertions for an account balance. Confirmation may be a relatively unimportant procedure if other tests of details and effective analytical procedures are also performed. In addition, confirmation procedures may include both negative and positive confirmations. The use of positive confirmations on large balances and negative confirmations on small balances is a common auditing practice which is not addressed in the Exposure Draft.

*Number of negative confirmations sent.*

An auditor may adequately compensate for the fact that negative confirmations are not as effective as positive confirmations, without assessing control risk at low, by increasing the number of negative confirmations sent over the number of positive confirmations that would otherwise be sent.

As it is written in the Exposure Draft, the first sentence of paragraph 20 effectively prohibits the use of negative confirmations unless the assessed level of control risk is low. The above factors may, in some circumstances, negate the need to assess control risk at low. These factors should be discussed in paragraph 20, and assessing control risk at low should not be a requirement for using negative confirmations.

Paragraph 32 lists three factors to consider in determining whether confirmation procedures will be performed on accounts receivable. If none of the three factors exist, it is presumed the auditor will request confirmation of accounts receivable.

The third factor states "The auditor's combined assessment of inherent risk and control risk is low, and that assessment, 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." We believe that, in certain circumstances, substantive audit procedures other than confirmation may be sufficient to reduce audit risk to an acceptably low level *regardless* of the assessed levels of inherent risk and control risk. For example, subsequent collection of most or all of the receivable balance may have occurred before completion of audit fieldwork. This can occur if:

1. The auditor is engaged to perform the audit a number of months (or years) after the balance sheet date.



Mr. Douglas P. Sauter

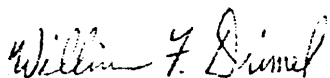
January 28, 1991

2. Credit terms are very short. We have audit clients with credit terms of net 7 days.

In these circumstances, vouching subsequent receipts is an effective and efficient procedure, regardless of the assessed level of inherent risk and control risk. Analytical or other substantive procedures may by themselves be sufficient to overcome the presumption that confirmation procedures are necessary. This fact should be addressed in Paragraph 32.

Very truly yours,

CLIFTON, GUNDERSON & CO.



William F. Drimel, C.P.A.  
Assistant Director of Audit and Accounting

Clifton,  
Gunderson & Co.

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: HARVEY E. SCHOCK JR. PRODUCT ASSURANCES

Comments:

See attached letter January 27, 1991.

Thank you

Instructions for Response Form

This self-mailer may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.

**Harvey E. Schock, Jr.**  
**Product Assurances Consulting**  
**30 Oak Ridge Drive**  
**Haddonfield NJ 08033-3507**  
January 27, 1991

Auditing Standards Division  
AICPA  
1211 Avenue of the Americas  
New York NY 10109-0004

Re AICPA Auditing Standards Board  
Comments on EXPOSURE DRAFT 2371  
TITLE: The Confirmation Process  
November 13, 1990, Due February 1, 1991.

It is recommended the following be considered.

Par. 4. It would be desirable editorially to revise the FIRST bullet from:

Selecting items from which confirmations are to be requested.

TO

Selecting items based on potential risk from which confirmations are to be requested.

REASON: The evaluation of potential inherent risk and control risk are obviously key in making the determination of "selecting". Although covered in Par. 5, 7, and other references, it is desirable to stress this activity as important basis of selection. This would appear to be important as the word "selecting" is not used as a heading in the balance of the Statement.

Par. 4. It would be desirable editorially to revise the FOURTH bullet from:

Obtaining response from the third-party.

TO

Perform confirmation procedures.

REASON: Performing of confirmation procedures may consist of more than using a third-party. For example, Note 1, Paragraph 26, states "does not preclude the use of internal auditors in the confirmation process."

Thank you for the opportunity of providing this input.

Cordially,



Product Assurances Consulting, per  
Harvey E. Schock, Jr.



Baruch College  
The City University of New York  
17 Lexington Avenue  
New York, New York 10010

47

January 25, 1991

Mr. Douglas P. Sauter, Technical Manager  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036-8775

Re: File 2371  
The Confirmation Process

Dear Doug:

The explanation of the auditor's approach to information about the respondent to a confirmation request seems to lower the standards of customary practice and ignore the lessons of litigation.

The proposed SAS acknowledges the importance of information about the confirmation request respondent in the following terms: "The respondent's competence, knowledge, motivation, ability, and willingness to respond, as well as the respondent's objectivity and freedom from bias with respect to the audited entity, all affect the effectiveness of the confirmation process" (paragraph 25).

In spite of the importance of the enumerated factors to the effectiveness of confirmation, the proposed SAS goes on to state: "Normally the auditor is not obligated to search for information relative to these factors." This position is difficult to reconcile with customary practice and the stated stimulus of the project -- problems identified in peer review, enforcement actions, and research.

The Equity Funding fraud provides a convenient relevant example of the importance of obtaining information about the respondent to a confirmation request. When the auditors

requested to confirm \$24 million of securities represented as being held in safekeeping by a well-known bank, company personnel involved in the fraud addressed the request to a mail drop set up under a name similar to the bank. These personnel received the request, signed the confirmation, and returned it to the auditors who accepted it as adequate evidence of the securities' existence.

The AICPA's "Report of the Special Committee on Equity Funding," had the following comment on that aspect of the fraud: "While this points up the need for auditors to ascertain that valid addresses are used, such a step is already a customary and integral part of confirmation procedures." Unfortunately, this customary and integral part of confirmation procedures is not mentioned by the proposed SAS on the confirmation process. It is apparently one of several factors that the proposed SAS takes the position is a matter of awareness rather than investigation.

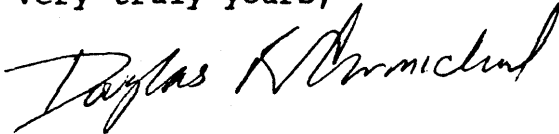
Another example relates to confirmation of securities in the possession of a custodian. AU Section 332.04, on investments, indicates that the existence, ownership and carrying amount of investments in securities should be corroborated "in appropriate circumstances by written confirmation from an independent custodian of securities on deposit, pledged, or in safekeeping." Note that the confirmation is to be obtained from an independent custodian. For example, when the custodian is a related party, confirmation from the custodian is tantamount to a management representation. The auditor undertakes to identify related parties by applying a variety of procedures. Once transactions with related parties are identified, additional procedures are necessary. AU Section 335.15, on related parties, suggests procedures such as inspecting evidence in possession of the other party to the transaction and reference to financial publications, credit agencies, or other sources to help establish the substance of the other party in appropriate circumstances.

Even when the custodian of securities is independent, additional procedures are necessary in certain circumstances. If the investment is material and the custodian is not well known, customary practice is to obtain evidence of the reputation and financial capability of the custodian. Procedures may include obtaining recent audited financial statements, inquiries of credit agencies, checking financial or trade publications, or actually visiting the premises and applying audit procedures, depending on the

circumstances.

The auditor should always consider whether there is sufficient basis for concluding that a confirmation request is being sent to a valid respondent from whom a response will be meaningful and provide competent evidential matter. If there is not a sufficient basis for that conclusion, the confirmation process is useless.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Douglas R. Carmichael".

Douglas R. Carmichael

DRC:cq



South Carolina Association  
of Certified Public Accountants  
570 Chris Drive  
West Columbia, SC 29169  
(803) 791-4181

(42)

January 25, 1991

Mr. Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division, File 2371  
AICPA  
1211 Avenue of the Americas  
New York, New York 10036-8775

Dear Mr. Sauter:

The Technical Standards Committee of the South Carolina Association of Certified Public Accountants has reviewed the Exposure Draft of the Proposed Statement on Auditing Standards "The Confirmation Process". We believe the proposed statement will provide useful guidance when applying the confirmation process in engagements performed in accordance with generally accepted auditing standards.

Our specific comments to the Exposure Draft ( the ED ) are in two areas.

(1.) We suggest revision of paragraph 29 - Alternative Procedures. The draft presently reads, in part - " the auditor may consider not performing alternative procedures to nonresponses if (a) the nonresponses in the aggregate, when projected as 100 percent misstatements to the population, would not affect the auditor's decision about whether the financial statements are materially misstated ..."

As written, the ED could be construed to mean that nonresponses are not errors. Such an interpretation is reasonable since the ED excludes other unadjusted differences found during the engagement from consideration regarding the auditor's decision about whether the financial statements are materially misstated. As written, we believe an interpreter could reasonably take the position that the ED guidance is intended to solely provide a materiality gauge as to the cost-effectiveness of performing further alternative procedures.

We believe that nonresponses to positive confirmations should be considered errors requiring dispositioning as part of the audit process. Specifically, nonresponses on which alternative procedures are not performed should be considered with all other unadjusted differences found during the course of the audit process.

We suggest changing the wording of the aforementioned sentence to read, " if (a) the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and when added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated..."

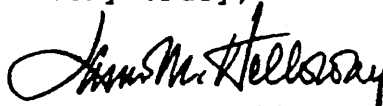
(2.) We suggest the Board reconsider the tone of the wording within the two paragraphs concerning the negative form of confirmation. As written, the guidance overly diminishes the value of the negative form of confirmation. We believe the negative confirmation to be an effective yet cost efficient procedure in many specific circumstances.

While we concur that the auditor should carefully consider the design of the negative confirmation and the likelihood of obtaining significant evidence when planning the engagement, we do not believe authoritative literature should cause the auditor to disregard the value of the negative confirmation due to the tone of the written guidance.

We concur with the remainder of the Exposure Draft as presently written.

Thank you for the opportunity to comment.

Very truly,



James M. Holloway, CPA  
Chairman, Technical Standards Committee  
South Carolina Association of  
Certified Public Accountants

cc: Members of the Committee  
C. John Wentzell, CPA  
Lollie B. Coward, SCACPA



49



Certified Public Accountants

January 22, 1991

Mr. Douglas P. Sauter  
Auditing Standards Division  
File 2371  
American Institute of CPAs  
1211 Avenue of the Americas  
New York, New York 10109-0004

Dear Mr. Sauter:

We are pleased to comment on a Proposed Statement of Auditing Standards, "The Confirmation Process." We feel several matters should be revised.

Paragraph 20. This paragraph indicates when negative confirmations may be used. One of the conditions required for their use is when "the assessed level of control risk is low." We feel this is an inappropriate condition for three reasons.

First, Statement of Auditing Standards No. 55 and its related audit guide specifically decline to specify any terms to use for making a control risk assessment below maximum or to specify how a given risk assessment may relate to such terms if used. Refer to footnote 4 to SAS 55 and paragraph 4-9 of the related audit guide. Accordingly, under SAS 55 different auditors may use varying concepts of control risk assessment such as "lower", "below the maximum", "minimum," "moderate," or various quantitative expressions, and an assessment using the term "low" may not be formed. Further, due to the lack of specific guidance on this topic in SAS 55 and its related audit guide, one auditor's "low" assessment may be another auditor's "moderate" or "high" assessment. This standard should not introduce a requirement to make a specific control risk assessment of "low", however that is to be defined, where SAS 55 did not.

Second, it seems inappropriate for negative confirmations to be allowed only when a control risk assessment is made at "low", or below the maximum. Such an absolute restriction contradicts other guidance in the auditing standards that discusses the audit risk model, and would require an amendment of the first sentence of AU 326.13 ("The nature, timing, and extent of the procedures to be applied on a particular engagement are a matter of professional judgment to be determined by the auditor, based on the specific circumstances.") Also, Figure 4-5 in the SAS 55 Audit Guide would need to be revised to indicate that the application of tests of details could not include negative confirmations to supplement analytical and other procedures except when certain control risk assessments were made.

Mr. Douglas P. Sauter  
January 22, 1991  
Page 2

We feel that negative confirmations, when coupled with analytical procedures and an inherent risk assessment, may provide enough evidence for the auditor to conclude on specific assertions even if the control risk assessment is at the maximum. In some audit situations, such as those described in (b) and (c) of paragraph 20, we feel an auditor may properly decide to use negative confirmations even if control risk is not assessed at "low." These confirmations may be viewed, perhaps, as primarily a discovery technique or as a supplement to extensive analytical review procedures. For example, an auditor may decide that auditing 10,000 accounts should be done on a primarily substantive basis without making a control risk assessment (for efficiency reasons) and that the substantive test would be equally effective by mailing either 100 positive confirmations or 10,000 negative confirmations. (The cost of the negative confirmations might be minor since the request could accompany a regular mailing to the customer.) This standard should not prevent the auditor from applying a given procedure to supplement other procedures when the auditor decides the additional evidence from such a procedure will be useful and efficient to gather, regardless of the level of the control risk assessment.

Third, negative confirmation procedures could, in some possible audit situations, be considered tests of controls. However, since this proposal requires a low assessed level of control risk to be done before using negative confirmations, it appears to define negative confirmations as substantive procedures, never as tests of controls. We do not think this proposed SAS should always exclude negative confirmations from possibly being considered as tests of controls. (Logically, if negative confirmations were to be considered a test of controls, then this proposal would only allow the negative confirmations to be used in a control risk assessment when the results reduced the control risk assessment to "low" but never when they reduced the assessment only to some intermediate point such as "moderate". Negative confirmations would have to be ignored unless the (resulting) control risk assessment was "low".)

Paragraph 20. We question why the terms "certain types of entities" and "specialized industries" appears in the discussion. The use of negative confirmations may be appropriate in specialized circumstances typically present in the industries cited, but these situations may also appear in other circumstances in other industries and may not be present in some companies within these specialized industries. To avoid users of this statement focusing on the specialized industries instead of on the peculiar circumstances, the circumstances should be stressed, not the particular industry where the circumstances often occur. Delete "certain types of entities."

Paragraph 20. The third sentence ("The auditor should give consideration...") appears to be misplaced, as it presents a thought unrelated to the preceding or following sentence. The fourth sentence ignores the third sentence and appears to relate to the second sentence. The third sentence would be better placed in paragraph 21.

Mr. Douglas P. Sauter

January 22, 1991

Page 3

Paragraph 20. The last sentence indicates that the auditor makes a low control risk assessment and has past experience that indicates the recipients consider the requests. If this point remains (see earlier comments on the "low" control risk assessment), more discussion is needed as to how an auditor is likely to determine that recipients will consider the requests since, in a low control risk assessment situation, there are likely to be few errors that would be reported and thus few responses. How does the auditor know if the lack of responses is due to the low control risk or due to low consideration by confirmees?

Paragraph 21. The discussion of "certain aspects of the existence assertion" appears to imply that the auditor assesses risk by component of an assertion. This may be an unintended, and certainly unneeded, extension of SAS 31. This sentence should be changed to: "... rarely provide significant evidence concerning financial statement assertions other than the existence assertion and rarely provide conclusive evidence regarding that assertion." This would then discuss the degree of evidence provided as to the assertion, rather than subdividing the assertion.

Paragraph 22. This paragraph indicates the auditor may consider information from prior audits or similar audits in determining the effectiveness and efficiency of using confirmations. This should be revised to allow the auditor to assess what he or she believes to be the current situation. An auditor may be doing their first audit of a cable television company--should that auditor be required to do confirmations because prior experience is not available to him or her, whereas another auditor doing their second audit of a similar company could take a different audit approach? The approach should depend on the circumstances of the company and its customers, not on how much experience the auditor has.

Paragraph 22. This paragraph focuses too much on prior experience. The close of this paragraph indicates the auditor may consider obtaining audit evidence from "other sources" when poor response rates have occurred in prior audits. Does this mean an auditor must confirm accounts audit after audit, until the auditor gets a poor response, at which point then the auditor is freed from the otherwise-effective restrictions and presumptions in this proposed statement? Why must the auditor keep having to do something until he once gets a poor response, and then be free to do other procedures instead? We think the auditor should be able to assess the existing circumstances of the company and its customers to determine the best audit approach, as well as to use prior experience.

Paragraph 22. This entire paragraph does not fit under the section "Designing the confirmation request" but instead should be placed in a section regarding "Deciding whether to use confirmations."

Mr. Douglas P. Sauter

January 22, 1991

Page 4

Paragraph 27. The discussion of "special risks" on facsimile responses notes the difficulty in determining the source of the response. We think the discussion of the need to verify facsimile confirmations is too detailed for a SAS and possibly could become dated. Further, while this discussion is valid, there is also a chance that a written confirmation could have been intercepted (such as through use of a fictitious address), signed by a client's employee, and then mailed to the auditor. If the discussion remains as to the difficulty of determining the validity and source of facsimile responses, it should also cover the possible difficulty with written responses.

Paragraph 27. Delete the words "treat the confirmations as valid audit evidence." That is not needed since the sentence already states "to reduce the risk associated...". Further, since the auditor may merely consider taking the precautions but need not actually take the precautions, then the difference between "valid audit evidence" and "invalid audit evidence" will be determined by whether the auditor thought about taking a precaution, not on whether he or she took the precaution. This should be deleted.

Paragraph 27. The last two sentences should be revised. They appear to read that all significant oral contacts should be covered by a written confirmation. If so, then oral confirmations should not be allowed since they don't count unless later received in writing. We think oral confirmations can sometimes be useful and timely, and that they should be allowed without the implication contained in this proposal that all "significant" ones should be in writing to be useful as evidence.

Paragraph 29. Why does the second sentence begin with "However"? Isn't the second sentence explaining that, if audit risk is already reduced to an acceptably low level, alternative procedures are not needed?

Paragraph 29. Condition (b) should be revised to an "or" condition, not an "and" condition. We feel that if the nonresponses aren't material when projected to the population as 100% misstatements, then the decision as to what procedures to perform to audit identified unusual qualitative factors or systemic characteristics is better left to the auditor in the circumstances, instead of prescribing that alternative procedures must be performed on the nonresponses. For example, with an identified qualitative problem regarding year-end sales, looking at all sales orders for year-end shipments may be a more efficient and effective procedure than performing alternative procedures on nonresponses to the year-end sales that happen to have been confirmed. This procedure may not be better, but the decision should be the auditor's. This proposal requires performing alternative procedures on the nonresponses which are stated to be not material even when projected as 100% errors, although the problem has apparently already been detected and the auditor may be aware that different procedures (looking at all the sales orders at year-end) are needed. Why must the auditor wrap-up the nonresponses in this fashion?

We suggest paragraph 29 be rewritten as follows:

When the auditor has not received replies to positive confirmation requests, he or she should apply alternative procedures to obtain the evidence necessary to reduce audit risk to an acceptably low level unless the nonresponses, when projected in the aggregate as 100% misstatements to the population, would not affect the auditor's decision about whether the financial statements are materially misstated. In addition, the auditor should consider any unusual qualitative factors or systematic characteristics identified in the nonresponses, such as that all nonresponses pertain to year-end transactions, to determine if additional procedures are needed to assess the impact of those factors or characteristics.

Paragraph 30. The discussion of confirmations as providing evidence regarding valuation assertions appears to contradict paragraph 11 where this proposal states typical confirmations are more useful for various assertions other than the valuation assertion.

Paragraph 31. In the last sentence, add a mention of tests of controls. It is also possible to extend tests of controls as well as the other tests noted.

Paragraph 32. In the third bullet, an assessed level of control risk of "low" is discussed. See the comments made above for paragraph 20 as to the problems with such an assessment level.

Paragraph 32. In the third bullet, this proposal suggests that both confirmations and other substantive tests of details are needed in many situations. The possibility of performing analytical procedures should also be added.

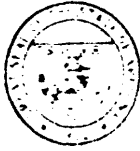
Paragraph 34. Since some short-period audits for periods beginning January 1, 1991 or later may have occurred by the date of publication of a final statement, the effective date of this statement should be revised so that it is not effective before it can be issued.

Please contact Jim Brown if you have any questions.

Very truly yours,



Crowe, Chizek and Company



(50)

DOUGLAS R. NORTON, CPA  
AUDITOR GENERAL

STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

LINDA J. BLESSING, CPA  
DEPUTY AUDITOR GENERAL

January 17, 1991

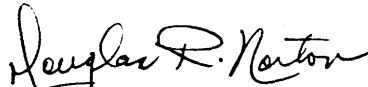
Mr. Douglas P. Sauter, Technical Manager  
AICPA Auditing Standards Division  
File 2371  
AICPA  
1211 Avenue of the Americas  
New York, New York 10036-8775

RE: Exposure Draft - Proposed Statement on Auditing Standards - The  
Confirmation Process

Dear Mr. Sauter:

Based on our review of subject document, we have no concerns about its effect or suggestions for its improvement. Rather, we encourage the issuance of this proposed SAS because it will provide, or further clarify, authoritative guidance for auditors concerning the confirmation process. The discussion of the relationship of the confirmation procedures to the auditor's assessment of audit risk and the guidance on what the auditor should do when confirmations are not received should be particularly helpful.

Sincerely,

  
Douglas R. Norton  
Auditor General

DRN/DIW/gf

cc: Kinney Poynter  
National State Auditors Association

51



California  
Society  
Certified  
Public  
Accountants

January 11, 1991

Douglas P. Sauter, Technical Manager  
AICPA Auditing Standards Division  
File 2371  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, NY 10036-8775

Dear Mr. Sauter:

The California Society of Certified Public Accountant's Accounting Principles and Auditing Standards (APAS) State Committee takes this opportunity to comment on the exposure draft of the Proposed Statement on Auditing Standards entitled "The Confirmation Process."

The APAS Committee is the senior technical committee of the California Society of Certified Public Accountants. The 1990/91 Committee is comprised of 40 members of which 20% are from national CPA firms, 55% are from local or regional firms, 15% are sole practitioners in public practice, 3% are in industry and 8% are in academia. The following comments represent the results of the Committee's deliberation on the proposed statement.

Basically we support the issuance of the proposed statement. However, we have the following comment to make about portions on it.

The first sentence of paragraph 20 states that "... the assessed level on control risk is low, ..." Other parts of the statement refer to both control risk and inherent risk. It would appear to us that this sentence should include inherent risk as well as control risk.

We believe that paragraphs 32 and 33 should be deleted from the statement. We believe these paragraphs send the wrong message to the auditor. To require the auditor to confirm receivables when it is not effective is wrong. The auditor should have the professional discretion of choosing the method of meeting the financial statement assertions as he or she would have with any other type of account balances. Highlighting

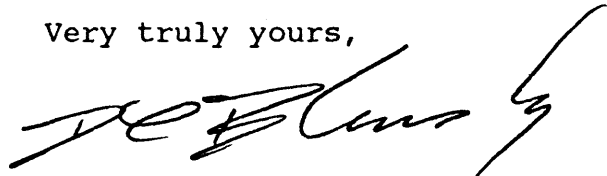
100 W. Broadway  
Suite 500  
Glendale, CA  
91210-0001  
(818) 246-6000  
FAX: (818) 246-4057

Douglas P. Sauter, Technical Manager  
January 9, 1991  
Page Two

accounts receivable over other items is not appropriate. To require the auditor to send out confirmations when it is not effective is taking time away from more efficient procedures. The auditor may give excess reliance on confirmations when it is not warranted. The auditor should not have to document the nonuse of confirmations just as he or she is not required to document the nonuse of audit procedures in other types of account balances. Confirmations are an audit tool that should be heavily considered by the auditor. It is not the only tool and the auditor should use his or her discretion in deciding which tool to use in a particular case and not have to document the reason in the case of nonuse.

We appreciate the opportunity to comment on the statement and will be available to further discuss the issues, if needed.

Very truly yours,

A handwritten signature in dark ink, appearing to read "D. Blensly", with a long, sweeping flourish extending to the right.

Douglas L. Blensly, Chairman  
Accounting Principles & Auditing  
Standards State Committee



# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *STANLEY G. ROBERTSON, PARTNER, SCHIADERS, KINTNER ROBERTSON PC  
A 13 PERSON FIRM IN ADRIAN, MICHIGAN*

Comments:

- I DO NOT BELIEVE THAT CONFIRMATION IS ANY LONGER AN EFFECTIVE AUDIT PROCEDURE.*
- 1) *WE ROUTINELY CONFIRM ALL BANK ACCOUNTS - IT HAS BEEN SEVERAL YEARS SINCE A CORRECT CONFIRMATION HAS BEEN RECEIVED.*
- 2) *ACCOUNTS RECEIVABLE AND PAYABLE CONFIRMATIONS ARE GENERALLY ONLY USABLE ON SMALL ACCOUNTS. LARGE ENTITIES REFUSE TO COMPLETE THEM.*
- 3) *ON BANK AUDITS WE SPEND A GREAT DEAL OF TIME RECONCILING CONFIRMATIONS RETURNED WITH ALLEGED DIFFERENCES.*

### Instructions for Response Form

This self-mailer may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.



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Telephone:  
(916) 445-0255

STATE OF CALIFORNIA  
**Office of the Auditor General**  
660 J STREET, SUITE 300  
SACRAMENTO, CA 95814

Kurt R. Sjoberg  
Acting Auditor General

January 15, 1991

Douglas P. Sauter, Technical Manager  
American Institute of CPAs, Inc.  
Auditing Standards Division, File 2371  
1211 Avenue of the Americas  
New York, New York 10109-0004

Dear Mr. Sauter:

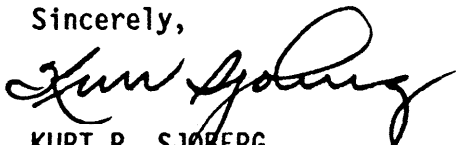
Our office would like to respond to your proposed statement on auditing standards titled "The Confirmation Process" (File 2371). The proposed statement is very well written and thought through. We were pleased to read paragraph 32, which in effect acknowledges that confirmation is not necessarily the best audit procedure for the types of receivables mostly found in government, such as receivables from taxes or from benefit overpayments. Nevertheless, we question the need for paragraph 33, which requires the auditor to document why he or she decided to use a procedure other than confirmation of accounts receivable.

The general presumption of the proposed statement is that confirmations are an inherently superior audit procedure because they involve external parties. This logic may be true in theory, but it is not necessarily borne out in practice. The auditor may encounter a host of problems in confirming certain statement assertions, as you properly recognized. For this reason, the statement should not reflect a presumption of superiority. Rather, confirmation should be recognized as one of the audit procedures that may be the best procedure in some, if not most, circumstances.

The objective of the audit process is to reduce the audit risk to an acceptable level. The audit risk is influenced by the inherent risk and the control risk, which in turn influence the acceptable detection risk. The auditor's selection of an audit procedure should be directly influenced by his or her assessment of those risks. If documentation of the decision process is desirable, the auditor should be required to document why he or she selected a specific procedure rather than why he or she did not select a specific procedure. For this reason, we believe that paragraph 33 should be eliminated.

We appreciate the opportunity to express our opinion on the proposed statement. If you have any further questions, please contact me or Curt Davis, deputy auditor general, at (916) 445-0255.

Sincerely,

A handwritten signature in black ink, appearing to read "Kurt Sjöberg". The signature is written in a cursive style with a large, looping initial "K".

KURT R. SJÖBERG  
Acting Auditor General



STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER  
ALBANY, NEW YORK  
12236

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EDWARD V. REGAN  
STATE COMPTROLLER

January 22, 1991

Douglas P. Sauter  
Technical Manager  
Auditing Standards Division, File 2371  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036-8775

Dear Mr. Sauter:

Overall, the guidance offered in the Exposure Draft "The Confirmation Process" is very well done and provides some excellent insights that will enable auditors to gather the best evidence possible.

The following comments on specific sections of the ED are suggested to clarify or expand upon the guidance presented.

1. Paragraph 12 discusses the confirmation process and its relationship to the completeness assertion. The example used is for accounts payable. This is the only reference in the ED to accounts payable confirmations and could be confusing because accounts payable are not usually subjected to the same confirmation procedures that are applied to other accounts, such as accounts receivable. Generally, payables are confirmed only when internal controls are inadequate, other forms of evidence (such as detailed vendors' invoices) are not available or the auditor is concerned that liabilities may be overstated.

The point of the paragraph is that the testing must come from the appropriate population. This point would appear more relevant if the example was for accounts receivable or some other account that is usually subject to confirmations.

2. Paragraphs 16 to 21 discuss positive and negative confirmations. The ED should be very clear that it is permissible to use both types of confirmations on the same audit, so long as the guidance in paragraphs 18 and 19 is followed.

3. The ED does not discuss confirmation procedures relating to notes receivable. Usually, notes receivable are subject to positive confirmations following the process for trades accounts receivable. In practice negative confirmations are rarely used.

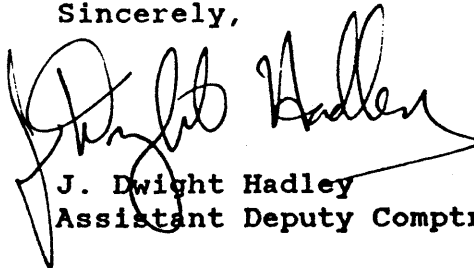
4. Paragraph 27 discusses the use of nontraditional media in responding to confirmation requests. One example cited is the use of facsimile machines. The guidance presented concerning the identification of the sender is very relevant.

One other point that should be added is the need to preserve the facsimile response when it is not followed up with the original copy being returned to the auditor. Some fax copies are not readily preserved and are subject to deterioration. Recent articles have suggested that it is acceptable for fax confirmations to be preserved by photocopying them for the working papers. This ED should confirm this procedure as an acceptable auditing documentation practice.

5. In paragraph 23, the audits of entities who do business with governments could be used as an example of where accounting systems often do not contain information in a form that would allow the governments to confirm account balances but where confirmation of specific transactions may be preferable. This concept needs to be cross referenced with paragraph 30. The guidance presented in paragraph 30 is only adequate to cover those instances where the auditor does not receive replies to the confirmation requests.

If we can expand upon any of the above comments or assist in any other manner, please feel free to let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Dwight Hadley". The signature is stylized and written over a large, hand-drawn arrow pointing to the right.

J. Dwight Hadley  
Assistant Deputy Comptroller

CC: P. Calder, GAAC  
A. Young, AICPA

# EXPOSURE DRAFT

## PROPOSED STATEMENT ON AUDITING STANDARDS

### THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: DENNIS R. KROWER PHILIP ROOTBERG & COMPA

Comments: The statement is fine as it is but there are two sets of circumstances not addressed in the statement. Where the auditor knows that a confirmation request will not be acknowledged such as confirmations to governmental agencies and the circumstances and the accounting system of the respondent does not allow for an accurate response. Many companies that use a voucher system for accounts payable can not respond to a positive or negative confirmation.

#### Instructions for Response Form

This self-mailer may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.

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FILE 2371

# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *MAAFA AUDITING STANDARDS COMMITTEE*

Comments: *THE COMMITTEE IS CONCERNED AUDITORS MAY INTERPRET PARAGRAPH 3.2 TO SAY THAT THEY DO NOT HAVE TO SEND CONFIRMATIONS ON ACCOUNTS RECEIVABLES*

*THE COMMITTEE ALSO BELIEVES THIS STATEMENT SHOULD ADDRESS THE EVALUATION OF THE RESULTS OF THE CONFIRMATION PROCESS*

### Instructions for Response Form

This self-mailer may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.

**Silva  
Harden  
&  
Co.**

**Certified Public Accountants  
A Professional Corporation**

2440 West Shaw, Suite 200  
Fresno, California 93711

Telephone: 209/431-6100  
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(57)  
George A. Silva  
Stuart H. Harden  
Michael L. Adolph  
Robert J. Upmeier  
Susan K. Thompson

January 14, 1991

Douglas P. Sauter  
Technical Manager  
Auditing Standards Division  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, New York 10036-8775

Re: The Confirmation Process  
File Reference Number 2371

Dear Doug:

We believe that the guidance in paragraphs 1 through 31 is important to auditors, but that paragraphs 32 and 33 should be deleted from the proposed SAS.

Paragraph 32 is redundant in that it repeats guidance previously presented within the proposed SAS. For example, a presumption that evidence obtained from third parties will provide the auditor with higher quality audit evidence than is typically available from within the entity is a notion already discussed in paragraph 6. The notion that confirmations need not be used if prior experience shows them to be ineffective is included in paragraph 22. The notion that confirmations may not be required where inherent and control risk are assessed as low, and sufficient evidence is gained by other substantive tests, is discussed adequately in paragraph 9. And finally, the notion that both confirmation procedures and other substantive tests might be necessary to reduce audit risk to an acceptably low level is discussed adequately in paragraph 8.

We believe that paragraph 33 will lead auditors to rely upon confirmation of accounts receivable even for assertions where an application of the guidance in paragraphs 1 through 31 might otherwise lead the auditor to select a more effective test. We believe that this may prove particularly troublesome in that not all assertions are adequately addressed by confirmation, as the proposed SAS discussed in paragraphs 10 through 13, and that auditors may place an unwarranted degree of reliance on the confirmation process in the audit of accounts receivable simply because of the importance placed upon this procedure.



We also believe that auditors will view the requirement of paragraph 33 as placing a greater emphasis on the confirmation of accounts receivable than currently exists in paragraph 1 of Section 331 of SAS No. 1. We find this placement of greater emphasis inappropriate in light of the considerable evidence provided to the Board as to the limited effectiveness of the confirmation process to audit some assertions in accounts receivable. Even though the audit may easily document how he or she overcame the presumption that accounts receivable should be confirmed, the fact that this emphasis may misdirect auditors to apply the inappropriate procedure is very troublesome.

Yours very truly,



Stuart H. Harden, CPA  
Shareholder

SHH/mb

EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: ROBERT E. ROYER

Comments: \_\_\_\_\_

\_\_\_\_\_

PLEASE STOP CHANGING STUFF!

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Instructions for Response Form

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(4)

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

THE CONFIRMATION PROCESS

November 13, 1990

Comment Date: February 1, 1991

NAME AND AFFILIATION: Kenneth E. Larash, CPA  
Grabush, Newman, & Co., P.A.  
515 Fairmount Avenue, Suite 400  
Baltimore, MD 21204

In reading the above exposure draft, several questions remain unanswered and need to be addressed.

1. GUIDANCE IS NEEDED IN PERFORMING ALTERNATIVE PROCEDURES FOR NON-REPLIES OF ACCOUNTS RECEIVABLE POSITIVE CONFIRMATIONS.

EXAMPLE: Positive confirmations are mailed to all customers in the audit sample. Only about one-half of the confirmations are returned. Most of the accounts are made up of a large amount of small invoices (say, for example, 20 invoices at about \$50 each).

QUESTION: Does the auditor have to perform alternative procedures on 100% of the invoices for the non-reply accounts? Can these procedures be performed on a test basis (e.g. 5% of the invoices comprising the balance)? If a test basis used, what is the criteria for determining the extent of such testing?

2. GUIDANCE IS NEEDED IN THE USE OF NEGATIVE ACCOUNTS RECEIVABLE CONFIRMATIONS.

EXAMPLE: In determining the extent of substantive tests to be performed on accounts receivable, an auditor arrives at a sample of 200 accounts to be confirmed using positive confirmations.

QUESTION: Can the auditor substitute negative confirmations for some of the positives in, say, a 2 for 1 or 3 for 1 substitution rate? Can this be done if the auditor still sends out a minimum number of positive confirmations? In the above example, would 100 positive confirmations and 300 negative confirmations be an acceptable alternative to 200 positives?



425 Eagle Rock Avenue  
Roseland, New Jersey 07068  
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New Jersey Society of Certified Public Accountants

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January 14, 1991

**Mr. Douglas P. Sauter**  
**Technical Manager**  
**AICPA Auditing Standards Division,**  
**File 2371**  
**American Institute of CPAs**  
**1211 Avenue of the Americas**  
**New York, New York 10036-8775**

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Dear Mr. Sauter:

The New Jersey Society of CPAs appreciates the opportunity to comment on the proposed statement on auditing standards, "The Confirmation Process". This letter was prepared by the Society's Auditing and Accounting Standards Committee and represents the consensus of the Committee, as opposed to the views of any individual Committee member.

The general discussion, particularly paragraphs 4-13 (and, to a lesser extent, paragraphs 14-31), verges on material that would be found in an auditing text. Because "standards overload" is to be avoided, the Committee suggests that the Board avoid putting textbook material into standards and consider if some of this material could be eliminated or reduced to an auditing interpretation.

The combination of confirmation theory (in paragraphs 4-31) and specific standards on accounts receivable (paragraphs 32-33) is awkward. If the Board decides that all of the exposure draft material should be retained in a standard, the Committee suggests that a new AU section on Confirmations might be more appropriate for the former, and that paragraphs 32-33 replace AU331.03-.08. We also suggest that AU331.06 be retained, perhaps by working it into the end of paragraph 21.

We appreciate your consideration of our comments.

Sincerely,  
*Michael J. Cohen*  
Michael J. Cohen  
Chairman  
Auditing and Accounting  
Standards Committee

(61)

STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
LANSING, MICHIGAN 48913  
(517) 334-8050



THOMAS H. MCTAVISH, C. P. A.  
AUDITOR GENERAL

January 9, 1991

Mr. Douglas P. Sauter, Technical Manager  
Auditing Standards Division, File 2371  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, New York 10036-8775

Dear Mr. Sauter:

We have reviewed the Exposure Draft of the proposed Statement on Auditing Standards, entitled The Confirmation Process, and submit the following five comments for consideration by the AICPA Auditing Standards Board. As evidenced by the nature and substance of our comments, we agree with the content of the proposed Statement and believe that it is comprehensive and well-written.

1. Paragraphs 19 through 21 discuss the use and analysis of negative confirmation requests; however, these paragraphs do not address the required workpaper documentation. Although we presume that the auditor would adequately document the confirmation process in accordance with the third standard of field work, we noted that specific guidance is included in other paragraphs of the proposed Statement. For example, Paragraph 27 addresses documentation of oral confirmations and Paragraph 33 addresses documentation of how the auditor overcame the presumption of confirmation of accounts receivable. Therefore, for consistency within the document, we believe that Paragraphs 19 through 21 should also address the workpaper documentation required for the negative confirmation process.
2. The last sentence of Paragraph 22 currently reads "For example, if the auditor has experienced poor response rates to properly designed confirmation requests in prior audits, the auditor may consider obtaining audit evidence from other sources." We are uncertain whether the Board intends that the auditor consider obtaining audit evidence

Mr. Douglas P. Sauter  
Page 2  
January 9, 1991

from other sources in lieu of or in addition to confirmation requests. To improve the clarity, we suggest that the last portion of that sentence be revised, depending on the Board's intent, to read either "...may instead consider obtaining audit evidence from other sources" or "...may consider obtaining additional audit evidence from other sources."

3. The last three sentences of Paragraph 27, which addresses facsimile and other nontraditional media responses, read "In addition, the auditor should consider requesting the purported sender to mail the original confirmation directly to the auditor. Oral confirmations should be documented in the workpapers. If the information in the oral confirmation is significant, the auditor should request the parties involved to submit written confirmation of the specific information directly to the auditor." Our experience indicates that an increasing percentage of respondents are utilizing facsimile and other nontraditional media to respond to our confirmation requests. Therefore, to provide more definitive guidance for circumstances in which a facsimile response should be followed by return of the original confirmation and to improve clarity, we suggest that the above three sentences be combined into two sentences that read "Oral confirmations should be documented in the workpapers. If the information in the facsimile or the oral confirmation is significant, the auditor should request the parties involved to mail written confirmation of the specific information directly to the auditor."
4. Paragraph 28 currently consists of one sentence, which reads "When using positive confirmation requests, the auditor should generally follow up with a second and sometimes a third request to those parties from whom replies have not been received." Because poor confirmation response rates are typical in practice, we suggest that the narrative in this paragraph be expanded to provide the auditor with additional definitive guidance on follow up requests, addressing pertinent issues such as (1) appropriate time frames before/between follow up actions, (2) appropriate forms for follow up requests, (3) when

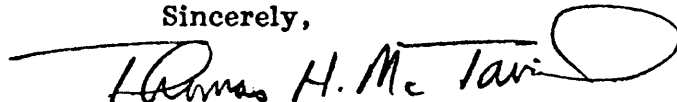
Mr. Douglas P. Sauter  
Page 3  
January 9, 1991

telephone follow up may be appropriate, and (4) when third requests may be appropriate. Our experience indicates that telephone follow up is usually more efficient and effective than written second requests.

5. Paragraph 32 states that the confirmation of accounts receivable is a generally accepted auditing procedure and illustrates three specific circumstances in which the auditor may elect not to confirm receivables. Because we interpret this language to imply that these three circumstances are all inclusive and not merely examples of potential circumstances, we believe the guidance is too restrictive. In many audit engagements, particularly when the field work cannot be performed until several weeks after the end of the fiscal year, it is much more efficient to perform alternative audit procedures (such as examination of subsequent cash receipts), as provided for in Paragraph 30. Based on the Board's policy to always consider the cost/benefit relationship of proposed guidance, we suggest that a fourth specific circumstance be added to Paragraph 32, such as "The use of confirmations, due to the timing of the engagement or other circumstances, would be inefficient as an audit procedure." As an alternative, we suggest that the second illustrated circumstance in Paragraph 32 ("The use of confirmations would be ineffective as an audit procedure") be expanded to also address the concept of inefficiency.

We appreciate this opportunity to comment on the proposed Statement on Auditing Standards. Should you have any questions, or desire further details on our comments, please contact me or Jon Wise of my staff.

Sincerely,



Thomas H. McTavish, C.P.A.  
Auditor General

cc: Wise

# EXPOSURE DRAFT

## PROPOSED STATEMENT ON AUDITING STANDARDS

### THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Stanley F. Dole, C.P.A.

Comments: I believe that the new bank confirmation form described in the October, 1990 CPA letter and referred to in Paragraph 13 of the exposure draft loses sight of what I believe to be the main purpose of sending a confirmation form to a bank, namely the attempt to discover unrecorded bank accounts or loans. If this is no longer a purpose, then I question if there is a purpose in the usual situation where there is no need to request confirmation of the terms of complex transactions. The only remaining purpose would seem to be to verify that the bank statements and loan statements in clients hands are not forged documents. I believe that it is generally agreed that the auditor is not expected to verify that documents given to him are not forgeries. In my practice I have never encountered forged bank documents, but I have encountered unrecorded bank accounts and loans. I realize that banks are not doing much of a job in searching for such but will do no job at all in that area if only asked to verify information furnished to them. As it is, probably a third of bank confirmation replies I receive are in error, some clerk merely inquiring of the computer as to the balance (often as of that day) and entering it. If the new form is to become the official form, I believe I will discontinue bank confirmation, except where I wish to confirm particular terms or arrangements. I do believe that the point is well taken that such information needs to be requested on a specific letter to a specific individual rather than a standard form.

STANLEY F. DOLE, C.P.A.  
1536 EASTLAWN, S.E.  
GRAND RAPIDS, MICH. 49506

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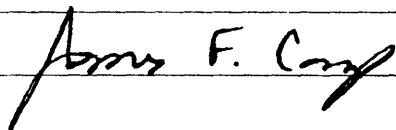
# EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: James F. Camp, CPA                      CAMP & ASSOCIATES, P.C.

Comments:

Paragraph 32:                      There should be a provision that confirmations are not required if the auditor can satisfy himself by analytical procedures or other substantive test of detail. For example, in auditing utilities for many years we typically used negative confirmation for accounts receivable. I've never had real comfort in this approach. Five or six years ago we quit using negative confirmations and we now rely on subsequent payments. By using subsequent payments and the reserve for bad debts, we are nearly always within the materiality level of the balances that remain. I personally think this is a much more effective method of auditing accounts receivable of utilities with less cost to the client.



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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: Paul M. Kurisko, Technical Director  
Office of the State Auditor

Comments: In general the exposure draft (E.D.) meets its stated objectives, however we wish to comment on the following two issues.

, The importance of confirmations as a generally accepted auditing procedure (GAAP) and the independent auditor's responsibility for justifying any deviation therefrom are stressed in the first paragraph of the current A.U. 331. We are concerned that the importance of the confirmation procedure may be diminished because of the placement of this information near the end of the E.D. in paragraphs 32 and 33.

. A.U. 331 currently addresses the treatment of inventories held in public warehouses as a separate item in paragraph 14. The E.D. incorporates this item as part of the confirmation section (paragraph 8). The current A.U. is clearer and more comprehensive and we believe that a continued separate paragraph is warranted and suggest that, if necessary, another example be used to illustrate instances where substantive procedures, in addition to confirming, should be used.

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: *L. KARL DENTON Denton, Netherton + Co, P.C.*

Comments:

*This appears to be one of the better guidelines issued.  
It certainly will be useful to us.*

*L. Karl Denton*

Instructions for Response Form

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606

EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

HERINTSOR

Name and Affiliation: Anatole Hrantsov C.P.A.

Comments:

Gentlemen:

Why are you re-inventing the wheel?

For decades, I have been confirming and performing other well established auditing steps and until now everything worked just fine.

Instead of the above why can't you do something useful (for a change) to us practitioners by cutting down the number of new pronouncements and simplifying and/or repealing some of them e.g. FASB 96

I OPPOSE THIS DRAFT.

Very truly yours

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# STATE AUDITOR OF MISSOURI

JEFFERSON CITY, MISSOURI 65102

MARGARET KELLY, CPA  
STATE AUDITOR

(314) 751-4824

January 9, 1991

Mr. Douglas P. Sauter  
Technical Manager  
Auditing Standards Division, File 2371  
American Institute of Certified  
Public Accountants  
1211 Avenue of the Americas  
New York, New York 10036-8775

Dear Mr. Sauter:

Enclosed are our comments on the AICPA's exposure draft of a proposed Statement on Auditing Standards, "The Confirmation Process."

If you have any questions regarding our comments, please contact Myrana Gibler, Audit Manager, of my staff at (314) 751-4213.

Sincerely,

A handwritten signature in cursive script that reads "Margaret Kelly".

Margaret Kelly, CPA  
State Auditor

Enclosure

**COMMENTS - AICPA EXPOSURE DRAFT - PROPOSED STATEMENT ON AUDITING STANDARDS,  
"THE CONFIRMATION PROCESS"**

The Missouri State Auditor's Office appreciates the opportunity to comment on the AICPA exposure draft.

We believe the guidance in the proposed Statement is more complete and informative than the current guidance in AU Sections 331.03-.08. Among the areas on which the exposure draft provides new or expanded guidance are:

1. The relationship of confirmation procedures to the auditor's risk assessments and the use of confirmations to address specific financial statement assertions.
2. The proper design of confirmation requests to meet audit objectives, including factors that affect the reliability of the requests.
3. Special risks associated with confirmation responses received through nontraditional media and considerations for alternative procedures when responses to positive requests are not received.
4. Evaluation of the results of confirmation procedures.

We do not expect the proposed Statement to result in any significant implementation problems; rather, it should assist our auditors in using confirmation requests more effectively.

Although we support the issuance of the proposed Statement, we noted two paragraphs that may require clarification:

1. paragraph 20 - The first sentence of the paragraph discusses conditions in which negative confirmation requests may be used. Based on that sentence, the first word of the second sentence apparently should be "audits" instead of "auditors" as follows: "Audits of financial statements of entities in certain specialized industries (such as financial institutions, utilities, and retail organizations) may meet these conditions."
2. paragraph 31 - The references to "alternative procedures" as "other procedures" in the second and third sentences of the paragraph are somewhat confusing since the end of the third sentence also refers to "other tests of details or analytical procedures." For this reason, we suggest the following revisions:

In performing that evaluation, the auditor should consider (a) the reliability of the confirmations and alternative procedures; (b) the nature of any differences, including the implications--both quantitative and qualitative--of those differences; (c) the evidence provided by **alternative** procedures; and (d) whether additional evidence is needed. If the combined evidence provided by the confirmations and

alterative procedures is not sufficient, the auditor should request additional confirmations or extend other tests of details or analytical procedures. [emphasis added]

We have also enclosed a marked draft indicating several suggested editorial revisions.

(60)

EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: CHARLES S. HAFER PARTNER HAFER & GILMAN CPAs

Comments:

I CAN NOT FIND ANYTHING  
THAT I DO NOT AGREE WITH IN  
THIS EXPOSURE DRAFT.  
I BELIEVE THESE PROCEDURES ARE  
GENERALLY BEING FOLLOWED IN THE  
PROFESSION.

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# EXPOSURE DRAFT

## PROPOSED STATEMENT ON AUDITING STANDARDS

### THE CONFIRMATION PROCESS

November 13, 1990  
Comment Date: February 1, 1991

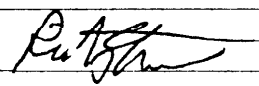
**RICHARD F. STRAWN II**  
**CERTIFIED PUBLIC ACCOUNTANT**  
**455 UNIVERSITY AVENUE, SUITE 100**  
**SACRAMENTO, CA 95825**

Name and Affiliation:

Comments:

THIS EXPOSURE DRAFT DOES NOT GO FAR ENOUGH. THE SUMMARY STATES THAT "THE PROPOSED STATEMENT PROVIDES GUIDANCE ABOUT ALL TYPES OF CONFIRMATIONS." IN AUDITS OF CERTAIN NONPROFIT ORGANIZATIONS, CHAPTER 4, MORE SPECIFIC ILLUSTRATIONS ARE PRESENTED OF DIFFERENT KINDS OF CONFIRMATION REQUESTS; IN CONSTRUCTION CONTRACTORS, AUDIT AND ACCOUNTING GUIDE, CHAPTER 10, GREAT EMPHASIS IS PLACED ON UNBILLED RECEIVABLES. THE EXPOSURE DRAFT IS TOO LIMITED. WHY CAN IT NOT REFER TO OTHER GUIDES, IN PARAGRAPH 15 FOR EXAMPLE?

ALSO, IN LIGHT OF THE S&L PROBLEMS AND THE EXPOSURE OF THE PROFESSION, DOES THE EXPOSURE DRAFT REALLY COMMUNICATE A SENSE OF URGENCY AND RESPONSIBILITY? IT IS MY UNDERSTANDING THAT CONFIRMING A LOAN DOES NOT REQUIRE ANY TESTING OF THE VALUE OF COLLATERAL. YOU CAN TELL THIS IS NOT AN AREA OF FAMILIARITY FOR ME. NONETHELESS, IF THAT IS SO, THEN THIS EXPOSURE DRAFT IS MERELY AN INTELLECTUAL EXERCISE, AND THAT MEANS THAT IT IS NOT HELPFUL TO THE AUDITOR OR TO THE PUBLIC. WE HAVE REAL PROBLEMS TO RESOLVE IN THE REAL WORLD. TO ME THIS EXPOSURE DRAFT ILLUSTRATES HOW NOT TO SOLVE THEM!



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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS  
THE CONFIRMATION PROCESS

FILE 2371

November 13, 1990  
Comment Date: February 1, 1991

Name and Affiliation: E. JOHN LARSEN, UNIVERSITY OF SOUTHERN CALIFORNIA

Comments: I support all aspects of the exposure draft except the following:

- 1) The sanctioning of "oral confirmations" in ¶ 27. In my view, confirmation involves written evidence; this view is supported by discussions of proper design of confirmations in ¶s 4, 11, 12, 13, 15, 23, 25. (How does an auditor "design" an oral "confirmation" request?)
- 2) The "weasel word" verbiage "... there is a presumption that the auditor will request the confirmation ..." in ¶ 32. Such language is incompatible with the second sentence of ¶ 32.

E. John Larsen 1/2/91

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EXPOSURE DRAFT  
PROPOSED STATEMENT ON AUDITING STANDARDS

THE CONFIRMATION PROCESS

November 13, 1990

Comment Date: February 1, 1991

Name and Affiliation:

UNHAPPY ~~INDIVIDUAL~~ PRACTITIONER

Comments:

WHY SEND TO INDIVIDUAL C.P.A.s

~~PART~~

YOU ARE TRYING TO ELIMINATE US FROM PRACTISING ANYWAY SO WHY WASTE MONEY ON POSTAGE. YOU ARE CONTROLLED BY THE "BIG 6" = WHO WANT INDIVIDUAL ELIMINATED FROM DOING AUDITS. - YOU ARE PRICING US OUT OF THE MARKET BECAUSE OF THE REQUIREMENTS YOU ARE PLACING ON US.

THE "6" IF INDIVIDUALS ARE ELIMINATED CAN CHARGE WHAT THEY WANT - I THINK IF YOU WILL CHECK 90% OF INDIVIDUAL ARE UNHAPPY WITH AICPA

Instructions for Response Form

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*Hoening & Associates*  
CERTIFIED PUBLIC ACCOUNTANTS

Equality State Bank Bldg., Suite 302  
P.O. Box 6137  
Cheyenne, Wyoming 82003-6137  
(307) 635-0361  
December 19, 1990

American Institute of CPA's, Inc.  
Auditing Standards Division  
File 2371  
1211 Avenue of the Americas  
New York, New York 10109-0004

Auditing Standards Board

Comments: I feel very strongly that the effectiveness of accounts receivable confirmations (by itself) is highly overrated, especially for the smaller clients. We are developing clones as auditors whose attitude is - confirmation returned; it agrees; it must be correct; do no further work.

There are a few things wrong with this:

- (1) Many times someone receives a confirmation - never checks it, signs and returns as if OK. The old philosophy on positive accounts receivable confirms that if it's wrong, recipients will correct (especially if it is too high), doesn't hold water anymore. People just don't care anymore and they don't take the time to check before returning the confirmation.
- (2) Recipient will sign a confirm, knowing it is incorrect, or maybe not knowing for sure, because they know it will buy them some time for payment. Seem strange? Happens more than I would have ever imagined. Client will say something like "We're having trouble collecting the Melmacian, Inc. account. Let us know what they confirm." Auditor tells client the amount confirmed and invariably client will ease off on collection, because they seem to get a great deal of comfort from the information the confirmation provided.

Another reason a recipient will sign an incorrect confirmation is they don't want the auditor searching around for the amount they really might owe.

- (3) Many times we will send out confirmations and the recipient will call up the client and say something like "I just got this confirmation from your auditors. Look up what I owe you so I can sign this and return it to them." This happens all the time.

For the first two, purposely send some incorrect confirmations and see what happens. For the third one, ask the client. They will usually tell you.

My comments are primarily directed to experience with small to medium audit clients. However, I know in the confirmations of loans receivable by financial institutions, finance companies, etc., people sign positive confirmations as correct because they have no idea what the true balance owed is. Does this really give someone audit comfort?

I feel that this statement, if adopted, would be another example of making it more difficult for the small practitioners to comply with GAAS. This has been the trend since SAS #52 was issued in April of 1988 and the plethora of statements that have followed.

While I don't necessarily object to the standards espoused by these statements, I object to the additional documentation required if you don't do some of these procedures. This puts added pressure on the small practitioner.

For example, in the proposed statement, it states that there is a presumption that the auditor will request confirmations of accounts receivable during an audit. If the auditor doesn't request confirmations in the examination of accounts receivable, the auditor must document as to why not. This will primarily affect the small practitioner with small audit clients.

I would feel much better about the proposed statement if it also contained a specific requirement that if confirmations are used as the sole means of obtaining audit evidence for accounts receivable, documentations must be made as to why some additional procedures were not also used. Confirmation by themselves do not work!

In conclusion, I object to the proposed statement because it creates as many problems as it solves, because of the additional documentation requirements. Also the proposed statement leaves the impression that the confirmation process, when properly designed, performed and evaluated is enough. I submit that in most cases it is not enough.

Respectfully submitted,



Micheal H. Hoenig, CPA



Comment:

As an overview, we assume the Board has given due consideration to whether this guidance should be in its present form (as a statement on auditing standards) rather than being issued as an audit guide, or possibly an auditing interpretation. If issued as proposed, it seems to us the Board has regressed somewhat to procedural guidance rather than conceptual guidance. For example, we consider Statements No. 31, 47, 53 and 56 to be in the category of conceptual guidance while this proposed statement and, for example, Statements 48 and 57, are procedural type guidance. We believe the Board should decide whether it should focus on conceptual guidance or procedural guidance. We believe statements on auditing standards should deal primarily with conceptual guidance, leaving it to the professional judgement of the auditor to decide what procedures would be appropriate to meet the objective stated in the conceptual guidance.

As to specific contents of the proposed statement, we believe the wording (if not the intent) of the various references to confirmation of accounts receivable could be improved. Specifically, we believe there is vagueness in the guidance provided in the third paragraph of the summary and paragraphs 32 and 33 for the following reasons:

- The first sentence of the third paragraph in the summary states, "This proposed statement retains the notion . . ." According to Webster's dictionary, "notion" is a broadly defined word. We assume the Board would not object to use of the words "general concept", which is more definitive than "a notion". (However, as described below, one could conclude that confirmation is neither a notion nor a general concept, but is an absolute requirement.)
- The second sentence of paragraph 32 states, "Confirmation of accounts receivable is a generally accepted auditing procedure". This unequivocally requires confirmation. However, in the following parts of paragraphs 32 and 33, the words state (a presumption) that accounts receivable confirmations will be requested. Obviously, there is a significant difference between requesting and receiving a confirmation, or simply requesting one. Assuming the Board knows what it wants the standard to be, paragraphs 32 and 33 should be corrected to indicate whether confirmation is required or whether a request for confirmation is required.
- The first sentence in the third bullet in paragraph 32 is entirely consistent with the conceptual guidance in SAS 47. However, the next sentence in that paragraph sends a contrary signal. If the Board wants to send a contrary signal to a conceptual type standard (SAS 47), it should define (in this procedural standard) what constitutes those kinds of "many situations". If the Board cannot elaborate on how many is "many" or what constitutes such "situations", it should remove the second sentence from the third bullet in paragraph 32 from the standard.

Paragraph 33 of the proposed standard deals with documentation. We believe the Board should be extremely sensitive to the matter of documentation. Statement 41 is a conceptual statement dealing with working papers (documentation). Pure logic suggests that documentation should and will vary, depending on factors such as the experience level of persons performing the audit (i.e., a partner or an entry level staff), the extent of supervision and review (presumably, covered by the firm's quality control policies and procedures) and the auditor's evaluation of audit risk. We are categorically opposed to the Auditing Standards Board writing standards that require documentation solely for the purpose of providing a basis for conclusions by peer reviewers or other third parties. Accordingly, we want paragraph 33 deleted from the proposed standard.

(14)

WILLIS A. SMITH  
815 Norgate Drive  
Ridgewood, N.J. 07450

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Tel: (201) 444-6754

December 27, 1990

Mr. Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division, File 2371  
American Institute of Certified Public Accountants  
1211 Avenue of the Americas  
New York, N. Y. 10036-8775

Dear Mr. Sauter:

Re: Exposure Draft - Proposed Statement on Auditing Standards  
The Confirmation Process

Thank you for the opportunity to comment on the above Exposure Draft.

It is my opinion that this proposed statement in trying to cover all forms of confirmation in an audit engagement loses the effectiveness that is present in AU Section 331.03 to 331.08. The proposed statement jumps back and forth from confirmation of receivables and inventories in public warehouses to confirmations with financial institution officials. Although there may be a common term - confirmation - the form that it takes is very different.

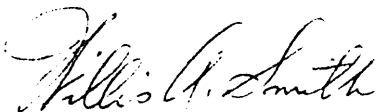
Statements on Auditing Standards should be written in such manner that they will give guidance to the smallest auditing practice as well as the largest. I recommend that the Statement should be reorganized with a preface about audit risk, materiality, etc. and the need for the confirmation process. Then there should be individual sections on confirmation of transactions with financial institutions, confirmations of transactions with customers, confirmation of transactions with custodians of inventories and confirmation of transactions with suppliers.

In the proposed statement, I could not find any mention of the important statement contained in the present statement (Par. 331.06) that "in many situations a combination of the two forms (positive and negative) may be appropriate, with the positive form used for large balances and the negative form used for small balances." I also could not find any mention in the proposed statement of the need for a follow-up of second and third requests in connection with a positive confirmation and of the type of procedures that would be required when a reply is not received from a positive confirmation (Par. 331.08).

The proposed statement in paragraph 32 gives an "out" to the auditor to not to confirm. This should not be. The auditor should always "try" to confirm. There always should be evidence in the working papers of the confirmation attempt and the alternative procedures used to verify the amounts. To not "try" could subject the auditor to criticism and possible liability.

I hope that Auditing Standards Board will see merit in my comments.

Very truly yours,



Willis A. Smith



# ASSOCIATION of GOVERNMENT ACCOUNTANTS

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February 1, 1991

Douglas P. Sauter, Technical Manager  
Auditing Standards Division, File 2371  
AICPA  
1211 Avenue of the Americas  
New York, New York 10036-8775


Dear Mr. Sauter:

Attached is a response to the Exposure Draft "Proposed Statement on Auditing Standards: The Confirmation Process" dated November 13, 1990. This response is submitted on behalf of the Association of Government Accountants (AGA). The AGA represents over 13,000 individuals who have an interest in government accounting, either as a user, preparer or attestor. Our members come from the federal, state and local levels of government and academia.

This response was prepared by the Financial Management Standards Committee which has the primary responsibility for responding to issues that affect government accounting and reporting. Attached is a listing of the members of the Committee.

If you have any questions concerning our response, please address them to me at 208/236-4292.

Respectfully,

  
Lela (Kitty) D. Pumphrey, Chair  
Financial Management Standards Committee

Comments on  
Proposed Statement on Auditing Standards  
The Confirmation Process

Prepared by  
Association of Government Accountants

The Committee believes that the document is basically acceptable. The Committee does, however, have a few comments which are related more to clarification than to criticism.

1. Paragraphs 16-21 discuss negative and positive confirmations. We believe that it is important to indicate that both types are permissible and that, under the appropriate circumstances, both types might be used in the same engagement, so long as the guidance in paragraphs 18 and 19 is followed.
2. The proposed statement frequently mentions accounts receivable in the discussion of confirmation, but neglects mention of notes receivable which are also subject to the confirmation process. We believe that the confirmation procedures relevant to notes receivable should also be discussed in this proposed statement.
3. Paragraph 27 addresses nontraditional media means of obtaining confirmations. One example cited is the use of facsimile machines. Facsimile copies often deteriorate after a short period of time. If facsimile copies are permitted as audit evidence (We believe that, under certain circumstances, they should be permitted) then it should be permissible to store such evidence in other forms, such as xerographic copies of facsimile copies, to preserve the evidence. Perhaps the exposure draft should address this type of problem in more general terms so as to be applicable to all types of audit evidence which can deteriorate over short periods of time.
4. Paragraph 23 addresses the design of confirmation requests. A good example of an entity which can generally provide confirmation of single transactions rather than entire account balances is a government entity. This should be used as an example. This concept should be cross-referenced to paragraph 30. The guidance presented in paragraph 30 is only adequate to cover those instances where the auditor does not receive replies to the confirmation requests.

ASSOCIATION OF GOVERNMENT ACCOUNTANTS  
Financial Management Standards Committee  
Membership List  
1990-1991

Lela D. Pumphrey, Chair  
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College of Business  
Idaho State University  
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Larry Stout  
U.S. Department of Treasury  
Financial Management Service  
Federal Finance Account Group  
941 N. Capitol Street, N.E.  
Washington, D.C. 20227  
202/208-2446

February 5, 1991

Auditing Standards Board  
American Institute of Certified  
Public Accountants  
1211 Avenue of the Americas  
New York, New York 10036-8775

## The Confirmation Process

Ernst & Young supports the above-captioned proposed statement on auditing standards. We believe the proposed statement provides useful guidance about the relationship of confirmation procedures to the assessment of audit risk, the design of confirmation requests, the performance of alternative procedures, and the evaluation of confirmation results. However, we believe the proposed statement could be improved as described below.

### **Sufficiency of Evidence Provided by Confirmation Procedures**

Paragraph 8 uses the example of inventory held at public warehouses to illustrate that evidence provided by confirmations may not be sufficient. This situation is specifically addressed in SAS 1 (AU Section 331.14), and therefore the example does not provide additional guidance. We suggest that a different example be provided, such as the following: to achieve an appropriately low level of audit risk relating to the existence of accounts receivable, an auditor normally performs sales cutoff tests in addition to confirming accounts receivable.

### **Use of Negative Confirmations**

Paragraph 20 describes three conditions for use of negative confirmations. We agree with these conditions, but believe that the third condition should be worded positively; that is, "the auditor has reason to believe that the recipients of the requests are likely to give them adequate consideration." We also believe guidance should be provided regarding how an auditor might obtain the basis for such a belief. For example, the following sentence could be added following condition (c):

To become satisfied that recipients are likely to give the negative requests adequate consideration, the auditor might consider the results of positive confirmation procedures performed in prior years on the engagement or on similar engagements, or sending some positive confirmation requests as well as the negative confirmation requests.

We also believe the Statement should provide practical guidance about the extent of procedures when using negative confirmations, similar to the last sentence in AU section 331.05. Such practical guidance might be worded along the following lines:

If the negative rather than the positive method of confirmation is used, the number of requests sent or the extent of other auditing procedures applied to the related financial statement assertion should normally be greater for the auditor to obtain the same degree of satisfaction with respect to that assertion.

In addition, we believe that referring to specialized industries where negative confirmations may be used might lead readers of the Statement to incorrectly conclude that the use of negative confirmations in the identified industries is appropriate in all circumstances or that the use of negative confirmations in other industries is not appropriate. Therefore, we suggest that the second sentence in paragraph 20 be deleted as well as the words "for certain types of entities" in the first sentence.

#### **Respondent Considerations**

Paragraph 25 describes various factors relating to a respondent, such as the respondent's competence, knowledge, and freedom from bias with respect to the audited entity, that affect the effectiveness of the confirmation process. The fourth sentence in this paragraph states, "Normally, the auditor is not obligated to search for information relative to these factors." The word "normally" implies that, in certain circumstances, the auditor is obligated to search for such information. We believe the word "normally" should be deleted, or the Statement should explain when an auditor should search for this information.

\* \* \* \* \*

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

Sincerely,

*Ernst & Young*



**Society of Louisiana  
Certified Public Accountants**

February 5, 1991

Mr. Douglas P. Sauter, Technical Manager  
AICPA Auditing Standards Division, File 2371  
AICPA, 1211 Avenue of the Americas  
New York, New York 10036-8775

Dear Mr. Sauter:

The Accounting and Auditing Standards Committee of the Society of Louisiana Certified Public Accountants submitted on January 29, 1991, its response to the exposure draft entitled "Proposed Statement on Auditing Standards - The Confirmation Process" dated November 13, 1990.

Please find attached the response from one of the members of the Committee that was not received in time to be included in the January 29, 1991, response. Please include this response with the response from the Society of Louisiana Certified Public Accountants.

If you have any questions or additional information is needed, please do not hesitate to call.

Yours very truly,

HUGH J. POSNER, CHAIRMAN  
ACCOUNTING & AUDITING  
STANDARDS COMMITTEE

HJP/ebc  
Enclosure

RECEIVED  
JAN 27 1991  
DERBES

J. M. FRIED, JR.  
7444 JADE STREET  
NEW ORLEANS, LOUISIANA 70124

Telephone (504) 282-0821

January 29, 1991

TO: Hugh Fosner, Chairman, SLCPA Accounting & Auditing Standards  
Committee  
copy: Al Suffrin, Staff Liaison

RE: ASB Exposure Draft - The Confirmation Process  
Committee meeting, January 21, 1991

The following comments are my understanding of suggestions made at the meeting on the referenced exposure draft, including comments of others as well as my comments.

PARAGRAPH 20:

Suggestion 1: Delete the second sentence which reads, "Auditors of financial statements of entities in certain specialized industries (such as financial institutions, utilities, and retail organizations) may meet these conditions."

Reason for Suggestion 1: Entities in the industries listed are no more likely to meet the criteria (a) and (c) of the first paragraph than are any other entities. In fact, in many cases, all but the large retail organizations probably have a control risk in this area which cannot be evaluated as low and a large percentage of customers of large as well as small retailers are among those who are unlikely to give confirmation requests adequate consideration. Relative to financial institutions, certainly the customers of small loan companies are among those not likely to give confirmation requests adequate consideration and, to some extent, not likely to understand them completely. Credit card customers of banks would, to a large extent, probably have the same tendencies relative to the consideration of confirmation requests as customers of retailers or small loan companies.

Suggestion 2: Add wording to the paragraph to the effect that, where the first and/or the third criteria in the first sentence of the paragraph are not met, the auditor may still receive some assurance by using negative confirmations but should consider performing other substantive procedures to a greater extent than in the cases where both of the criteria are met. If this wording is added, then it would be helpful to use the deleted wording above (Suggestion 1) as an example of conditions that may meet the conditions described in Suggestion 2.

Reason for Suggestion 2: It is a common and meaningful procedure to send a large number of negative confirmations in the audits of entities when a large number of small balances is involved, despite the fact that control risk is not low and/or the auditor has some doubt relative to the consideration the confirmation requests will receive. Paragraph 20 of the exposure draft appears to eliminate entirely the use of negative confirmation under such circumstances.

#### NEW PARAGRAPH 21

Suggestion 3: Add a paragraph between the present Paragraph 20 and Paragraph 21 setting forth the use of stratification to send some positive and some negative confirmations in situations where there are a large number of small balances. Stratification is discussed in other SASs and reference to them can be made. (Of course, adding a paragraph at this point would require renumbering subsequent paragraphs.)

Reason for Suggestion 3: Because stratification is a common and desirable procedure in many instances where confirmations are used, it should be discussed in the pronouncement on "The Confirmation Process."



# Illinois CPA Society

Martin H. Rosenberg  
Executive Director

Ernest R. Wish  
President

28

February 1, 1991

Mr. Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036-8775

Exposure Draft - Proposed Statement on Auditing Standards  
"The Confirmation Process"  
File Reference #2371

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Dear Mr. Sauter:

The Auditing Procedures and Accounting and Review Services Committee of the Illinois CPA Society is pleased to submit its response to the request for comments on the above Exposure Draft.

In certain sections of the proposed statement, references are made to procedures which are required under generally accepted auditing standards (e.g., the example presented in paragraph 8 regarding confirmation of inventories held at public warehouses). We believe that, where appropriate, reference should be made to the appropriate section within the AICPA Professional Standards which mandates the use of that procedure.

In discussing the conditions under which negative confirmation requests may be used, a reference is made to a "low" assessed level of control risk. SAS #55 does not introduce the term "low" in describing the assessed level of control risk. The statement does refer to "maximum" and "below maximum", and Appendix B of the statement refers to the assessed level of control risk varying along a range from "maximum to minimum". We believe that the proposed statement should use terms consistent with those used in SAS #55 or, alternatively, the term "low" should be defined within the proposed statement.

Paragraph 25 of the proposed statement discusses factors associated with the respondent to a confirmation which impacts the effectiveness of the confirmation process. This paragraph states that "Normally, the auditor is not obligated to search for information relative to these factors." Our committee believes that the use of the word "normally" implies that under certain circumstances the auditor is obligated to search for such information. Prior auditing standards do not require any such

procedure. If it is the AICPA's intention to add this requirement to the current standards, then additional guidance should be included within the proposed statement. It is our opinion that such a requirement should not be spelled out. Given the difficulty of such a procedure, the word "normally" should be eliminated so as to express the positive statement that such a search is not required.

In many situations where the auditor requests positive confirmations, sampling may result in the mailing of requests to confirm relatively immaterial balances. The requirement in paragraph 28 that "...the auditor should generally follow up with a second and sometimes a third request..." may result in the inefficient application of audit procedures. We believe that this paragraph should be modified by the use of terminology such as "in light of the availability and effectiveness of alternative procedures, and the assessed level of audit risk..." This would permit the auditor to deal with immaterial amounts according to his or her judgement as to their implications to the assertion being tested.

The above represents the views of the Illinois CPA Society rather than that of any of the individual members of the Committee or any of the firms or organizations with which they are associated.

Please do not hesitate to contact me at 708/291-9600 should you need any additional information.

Very truly yours,

A handwritten signature in cursive script that reads "Steven F. Sawatski". Below the signature, the initials "SFS" are written in a smaller, simpler font.

STEVEN F. SAWATSKI, Chairman  
Auditing Procedures and Accounting  
and Review Services Committee

SFS:jh



## Division for CPA Firms

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February 4, 1991

Douglas P. Sauter, CPA  
AICPA Auditing Standards Division  
File 2371  
American Institute of CPAs  
1211 Avenue of the Americas  
New York, NY 10036-8775

Dear Mr. Sauter:

Re: Proposed Statement on Auditing Standards, The Confirmation Process

One of the objectives that Council established for the Private Companies Practice Section (PCPS) is to "provide a better means for member firms to make known their views on professional matters, including the establishment of technical standards." We are submitting these comments in accordance with that objective.

### Good, Practical Guidance

We commend the Auditing Standards Board for developing this practical guidance which should be very useful to local practitioners, especially the portions dealing with confirmation of single transactions and the establishment of a rebuttable presumption regarding a requirement for confirmation of accounts receivable. We believe, however, that some clarification would be helpful in the following areas.

### Negative Confirmations

Our discussions with Board and staff members indicated that the intent of paragraph 20 is to discourage reliance solely upon negative confirmations except under very restrictive conditions. The (a) condition requires an assessment of control risk at a "low" level, a term currently not defined in SAS 55. We believe that the proposed SAS could be clarified through the use of terminology which more closely follows the guidance in SAS 55. Also, it would be beneficial to state that the use of negative confirmations as a supplement to positive confirmations may be an inexpensive means of providing additional audit evidence.

### Information About the Respondent

Paragraph 25 describes the characteristics of respondents which may impact the effectiveness of the confirmation process, including the respondent's objectivity and freedom from bias with respect to the audited entity. While it states that the auditor is not normally obligated to search for such information, the proposed SAS offers no guidance for auditors who become aware that such characteristics exist. It would be helpful if the SAS were to include guidance for such situations and when an auditor becomes aware of collusion between the client and the respondent. A reference to SAS 53 might also be appropriate.

A similar but far more common scenario for small firms relates to the confirmation of related party transactions. We believe the SAS could be significantly improved by including guidance on increasing the effectiveness of confirmations from related parties.

### Confirmation of Accounts Receivable

As previously stated, we appreciate the establishment of a rebuttable presumption that the confirmation of accounts receivable is a required audit procedure. However, paragraph 32 does not make it clear that any one of the three conditions listed would be sufficient to negate the requirement to confirm. We suggest adding the underscored passage to the sentence introducing the three conditions:

"...the auditor will request the confirmation of accounts receivable during an audit unless any of the following conditions exist --"

Also, paragraph 32 is unclear as to when an auditor should apply alternative procedures if any of the conditions described in the three bullets exist. The conditions in the first and third bullets (i.e. accounts receivable are immaterial, and the combination of low risk and other procedures is sufficient) apparently do not require additional audit procedures, while they may be needed when the condition in the second bullet (the use of confirmations would be ineffective) is met. We believe this section should make clear when alternative procedures should be considered and perhaps refer the reader to paragraphs 29-30.

### Effective Date

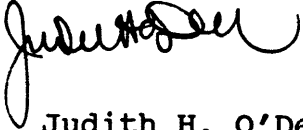
It appears customary for auditing standards to be made effective for audits of financial statements for periods beginning on or after a specified date. Local practitioners, for a variety of reasons, are often requested to audit short period financial statements. Consequently, we are sometimes forced to implement new auditing standards before we have an opportunity to become properly prepared to do so. We would appreciate the Board's consideration of making this and

all future pronouncements effective for audits of financial statements for periods ending on or after a specified date.

\* \* \*

We appreciate this opportunity to present these comments on behalf of the PCPS. Members of our Committee would be glad to discuss any aspect of them with you or any Board representatives.

Sincerely,



Judith H. O'Dell, CPA  
Chair  
PCPS Technical Issues Committee

JHD:dt  
File 2221

cc: Dan Guy  
PCPS Executive and Technical Issues Committees



Public Oversight Board

540 Madison Avenue  
New York, NY 10022

(212) 486-2448  
Fax: (212) 758-5603

SEC Practice Section  
American Institute of  
Certified Public Accountants

February 5, 1991

Auditing Standards Division  
American Institute of CPAs  
1211 Avenue of the Americas  
New York, NY 10036

Re: Proposed Statement on Auditing Standards--The Confirmation Process--File 2371

Gentlemen:

The staff of the Public Oversight Board supports the issuance of a statement of auditing standards providing additional guidance to practitioners on the use of confirmations. We have two recommendations directed to clarifying the guidance included in the exposure draft.

The exposure draft specifically addresses the confirmation of accounts receivables in Paragraphs 32 and 33. However, guidance in all other paragraphs of the exposure draft could be intended as equally applicable to both the confirmation of accounts receivables as well as confirmation of other accounts and transactions. This is particularly true of Paragraphs 10-30. However, arguably the broad guidance about the assessment of inherent risk and control risk in Paragraphs 7-9 could be intended as relating only to confirmations other than accounts receivable; since guidance about the auditor's combined assessment of inherent risk and control risk, as well as his consideration of other factors, when reaching a decision whether to confirm accounts receivables is specific in Paragraph 32. In any event, if the guidance in Paragraphs 7-9 was intended to apply to accounts receivable confirmations, it is redundant and furthermore, none of the examples in those paragraphs involves accounts receivables. Therefore, we suggest Paragraph 32 and 33 be relocated in the document immediately after Paragraph 6 with the same heading "Confirmation of Accounts Receivable." Immediately after those two relocated paragraphs we suggest a heading "Confirmation of Other Account Balances and Transactions," to be followed by Paragraphs 7-9. Paragraphs 10-30 would then be clearly applicable to the entire confirmation process.

Paragraph 20 includes the sentence "In such cases, when the auditor sends a large number of negative confirmation requests, the auditor normally expects to receive some responses indicating misstatements if such misstatements are widespread." We question the placement of that sentence. Does the phrase "in such cases" refer to the auditor giving consideration to performing other substantive procedures as discussed in the preceding sentence or

conditions (a), (b) and (c) as discussed in an earlier sentence? The sentence in question does not appear to relate to any of the foregoing discussion. Furthermore, the example sentence that follows had no relationship to the sentence in question.

Sincerely,

*Jerry D. Sullivan mb*

Jerry D. Sullivan  
Executive Director

JDS/mb

OFFICERS

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VICE PRESIDENT  
VICE PRESIDENT  
SECRETARY  
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EXECUTIVE DIRECTOR



NEW YORK STATE SOCIETY  
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**nysscpa**

February 12, 1991

Mr. Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division, File 2371  
1211 Avenue of the Americas  
New York, New York 10036-8775

RE: PROPOSED STATEMENT ON AUDITING STANDARDS -  
THE CONFIRMATION PROCESS

Dear Mr. Sauter:

We are enclosing the comments of the New York State Society of Certified Public Accountants in response to the above AICPA exposure draft. These comments were prepared by the Society's Auditing Standards & Procedures Committee.

Thank you for your consideration.

Very truly yours,

*Walter M. Primoff*

Walter M. Primoff, CPA  
Director of Professional  
Programs

WMP/er  
enc.

cc: Accounting & Auditing Chairmen



We appreciate this opportunity to provide our observations and recommendations on the exposure draft entitled Proposed Statement on Auditing Standards - The Confirmation Process.

Paragraph 7.

The next to last sentence that begins with the word "Furthermore," addresses unusual and complex transactions. This appears to be redundant. The first two sentences of the paragraph addressed inherent and control risk. It would seem that unusual and complex transactions are transactions that have high inherent risk. Since the statement already says that when there is increased inherent risk, the auditor should consider using confirmations, it would seem that saying the auditor should consider using confirmations for complex and unusual transactions is saying the same thing again.

Paragraph 10.

The paragraph addresses the assertions in SAS No. 31. It has been the opinion of many auditors that the assertions of cut off and accuracy are missing from that SAS. Mentioning these assertions creates yet another standard that will need to be corrected when SAS No. 31 is revised. The statement should just make general allusion to those assertions and not mention them by name.

Paragraph 14.

SAS No. 53, paragraph 21 attempts to define professional skepticism. It does not address a questioning attitude directly, instead it states that if the results of a test vary from expectations, the auditor should re-assess risk. This paragraph should indicate that confirmations should be designed in such a way that respondents will be easily able to express and explain exceptions. This would give the auditor opportunity to exercise professional skepticism by eliciting exceptions.

Paragraph 20.

The last sentence ends with the phrase, "past experience indicates that the recipients consider the request." This appears to be at odds with point (c) which states, "the recipients of the requests are unlikely to give them adequate consideration." The last sentence needs to be changed to be consistent or made more clear.

Paragraph 28.

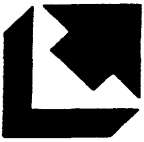
Sending second requests has been procedure used by most auditors. This paragraph should contain an explanation as to why; for example, it is cheaper to send another confirmation to increase the probability of a response than to perform alternative procedures. This guidance would be helpful in the decision to send second or more requests.

Paragraph 33.

This paragraph ends with the phrase "this presumption." Because of the amount of verbiage between this word and the the word "presumed," it refers to in paragraph 32, it would be better to say "this presumption that the evidence obtained from third parties will provide higher-quality audit evidence than that which is typically available from within the entity.

Paragraph 34.

"Permissible" should be changed to "encouraged" to give a more positive reinforcement of the guidance provided in this standard.



## Division for CPA Firms

American Institute of Certified Public Accountants

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February 21, 1991

Donald L. Neebes, CPA  
Chairman  
Auditing Standards Board  
American Institute of CPAs  
1211 Avenue of the Americas  
New York, NY 10036-8775

Subject: Exposure Draft Proposed Statement on Auditing Standards  
The Confirmation Process (November 13, 1990)

Dear Mr. Neebes:

The SEC Practice Section of the AICPA Division for CPA Firms established the Quality Control Inquiry Committee ("QCIC") to assist in the section's efforts to improve the quality of practice before the Securities and Exchange Commission. One objective of the QCIC's investigative procedures is to determine if a reconsideration of relevant professional standards is warranted. In that connection, the QCIC has reviewed the above mentioned Exposure Draft (the "Draft"), proposed by the Auditing Standards Board ("ASB"). The QCIC believes the Draft represents a significant improvement over present standards. Moreover, the QCIC has some further observations on this subject that the ASB may wish to consider. The following comments are based on the QCIC's consideration of litigation matters that have been on its agenda and supplement the discussions we have previously had on this subject.

Relationship of Confirmation Procedures to the Auditor's Assessment of Audit Risk Paragraph eight of the Draft states that the evidence provided by confirmations may sometimes have to be supplemented with additional audit procedures. The QCIC concurs in this and encourages that the guidance emphasize this fact to a greater extent, particularly when confirmations are used in connection with the audit consideration of significant or unusual transactions. Such additional emphasis may further reduce the risk of over-reliance on confirmations as audit evidence.

The Confirmation Process Paragraph fourteen states that the auditor should exercise an appropriate level of professional skepticism throughout the confirmation process and directs the auditor's attention to SAS No. 53, The Auditor's Responsibility to Detect and Report Errors and Irregularities. The QCIC believes this guidance may be too general - professional skepticism is a concept that pervades the entire audit process. The Draft would be improved by inclusion of examples of transactions that merit special attention, (e.g., related party transactions, those occurring near year-end, bill and hold sales, sales recorded in anticipation of future orders, to name a few).

In some cases, the auditor may wish to include a positive affirmation in the client representation letter that no undisclosed side agreements exist with respect to transactions and arrangements.

Alternative Procedures The Draft contains a discussion on the application of alternative procedures. The QCIC feels that guidance on alternative procedures will be of limited benefit to auditors unless it is supplemented with descriptions of specific alternative procedures and their application. For example, the reference to examination of subsequent cash receipts would be more meaningful if it outlined procedures used to verify the cash received and stressed the importance of matching such receipts with the actual year-end balances.

The Draft does not discuss the relative strengths and weaknesses of various alternative procedures. The QCIC believes auditors would benefit from guidance on the varying degrees of assurance different alternative procedures provide. For example, the review of subsequent cash receipts will generally provide stronger audit evidence than the review of shipping records or the review of third party shipping documents will provide stronger evidence than those generated internally. Such a discussion would encourage the use of audit procedures that appropriately address existing risk levels.

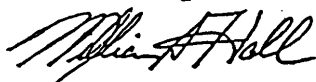
Confirmation of Accounts Receivable Paragraph thirty-two states that the confirmation of accounts receivable is a generally accepted auditing procedure and that there is a presumption the auditor will confirm accounts receivable. Paragraph thirty-three adds that an auditor who has not confirmed accounts receivable should document how he or she overcame this presumption. The QCIC believes it would be

Donald L. Neebes, CPA  
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helpful to specify that alternative procedures alone, in lieu of confirmation procedures, provide only limited assurance of existence at the balance sheet date. For example, a review of subsequent cash receipts may strongly support the valuation assertion, but provides limited assurance of existence unless other procedures are applied to ensure that a proper cut-off was made at period end.

Please do not hesitate to contact me or the SECPS staff if you would like to discuss these comments further.

Sincerely,



William D. Hall, CPA  
Chairman  
Quality Control Inquiry Committee

WDH:al

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March 6, 1991

Mr. Douglas P. Sauter  
Technical Manager  
AICPA Auditing Standards Division  
1211 Avenue of Americas  
New York, New York 10036-8775

Re: File 2371 AICPA  
Proposed Statement on Auditing Standards  
The Confirmation Process

Dear Mr. Sauter:

KPMG Peat Marwick agrees with the guidance contained in the Auditing Standards Board's proposed statement on auditing standards, *The Confirmation Process*. However, we have the following comments regarding negative confirmations and the criteria for overcoming the presumption that the auditor will request the confirmation of accounts receivable.

### NEGATIVE CONFIRMATIONS

Paragraph 20 states that negative confirmation requests may be used for certain types of entities when (a) the assessed level of control risk is low, (b) a large number of small balances is involved, and (c) the auditor has no reason to believe that the recipients of the requests are unlikely to give them adequate consideration. The example given in paragraph 20 states that it may be appropriate for the auditor to send negative confirmation requests to customers for demand deposit accounts in a financial institution when control risk is assessed to be low and the auditor's past experience indicates that the recipients consider the requests. We believe less emphasis should be placed on low control risk when liability accounts are to be confirmed. This could be accomplished by changing the first sentence in paragraph 20 to the following two sentences and by changing the last sentence in paragraph 20 as follows:

#### First Sentence

Negative confirmation requests may be used for certain types of entities when justified by the circumstances. For example, negative confirmation requests may be appropriate when (a) the assessed level of control risk is low, (b) a large number of small balances is involved, and (c) the auditor has no reason to believe that the recipients of the requests are unlikely to give them adequate consideration.



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Last Sentence

For example, in the examination of demand deposit accounts in a financial institution, it may be appropriate for an auditor to include negative confirmation requests with the customers' regular statements when there are a large number of small balances and the auditor's past experience gives him no reason to believe that the recipients do not consider the requests.

**ACCOUNTS RECEIVABLE CONFIRMATIONS**

Paragraph 32 states there is a presumption that the auditor will request confirmation of accounts receivable during an audit unless...the auditor's combined assessment of inherent risk and control risk is low, and that assessment, 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. We believe that there should be few occasions for overcoming the presumption of accounts receivable confirmations. We suggest that the last sentence of paragraph 32 be changed to the following three sentences:

There is a presumption that the auditor will request confirmation of accounts receivable during an audit. The auditor who issues an opinion when he has not confirmed accounts receivable has the burden of justifying the opinion expressed. For example, accounts receivable confirmations may not be considered necessary (a) when the accounts receivable are immaterial to the financial statements or (b) when the use of confirmations would be ineffective as an audit procedure.

We would be pleased to discuss any questions which you may have regarding our comments.

Very truly yours,

*KPMG Peat Marwick*

KPMG Peat Marwick