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25 June 2025

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Proposed Statement on Auditing Standards, *External Confirmations*

Dear Ms. Hazel,

Ernst & Young LLP (EY US) appreciates the opportunity to provide comments to the Auditing Standards Board (ASB) on its proposed Statement on Auditing Standards (SAS), *External Confirmations*.

We support the ASB's efforts to drive consistency in practice, clarify definitions and enhance quality for audits of financial statements of non-issuers by evaluating whether similar changes as those introduced by the Public Company Accounting Oversight Board (PCAOB) Auditing Standard (AS) 2310, *The Auditor's Use of Confirmation*, would be appropriate for AICPA *Professional Standards*.

We believe the proposed SAS generally would align with PCAOB standards, which would reduce the risk of different conclusions being reached when audits are performed under PCAOB and AICPA standards. However, we recommend that "direct access" be recognized as an alternative means of obtaining relevant and reliable information, rather than included in the external confirmation definition, similar to the PCAOB's approach.

We further support the proposed presumptive requirement to use external confirmation procedures for cash and cash equivalents held by third parties but recommend removing the proposed exceptions, as we believe these should be determined by the confirming party to avoid misapplication.

Attachment A contains our responses to the ASB's requests for comments and additional recommendations for your consideration. Attachment B includes other editorial comments. We would be pleased to discuss our comments with members of the ASB or its staff.

Sincerely yours,

Attachment A – Responses to request for comments

1. Do respondents believe that the proposed effective date is appropriate and provides adequate time for implementation? If not, respondents are asked to state their reasons and an alternate effective date.

We believe the proposed effective date for audits of financial statements for periods ending no earlier than 15 December 2027 provides sufficient time for auditors to implement the proposed amendments.

2. Do respondents agree with adding a presumptively mandatory requirement to confirm cash as shown in proposed paragraph .21 of AU-C section 330? If not, respondents are asked to state their reasons.

We support the addition of a presumptively mandatory requirement to use external confirmation procedures for cash and cash equivalents held by third parties, as we believe this would enhance audit quality and consistency in practice.

However, we believe the proposed paragraph .21 should explicitly acknowledge direct access is an alternative means of obtaining audit evidence at least as persuasive as external confirmation. While the ASB appears to categorize direct access as a form of external confirmation, we believe this distinction requires further clarification (see response to question 9).

We have provided suggested language updates to proposed paragraph .21 in our response to question 3 below.

3. Do respondents believe that the exceptions provided in proposed paragraph .21 of AU-C section 330 are appropriate and understandable?

We do not believe that the exceptions outlined in proposed paragraph .21 would be appropriate or understandable. We believe these exceptions may lead auditors to misinterpret them as broadly applicable and could result in an inappropriate override of the presumption to confirm. Further, we believe that the auditor is not the appropriate party to conclude whether the confirming party can respond.

Given that confirming party policies and practices are continually evolving, the confirming party should be the individual making decisions whether to confirm based on their current policies or practices. We believe that auditors should consistently use external confirmation procedures, regardless of whether a response from the confirming party is anticipated. Additionally, we emphasize the need to explicitly acknowledge that direct access provides audit evidence that is at least as persuasive as external confirmation, as mentioned in our response to question 2.

We recommend the following revisions to proposed paragraph .21:

.21 The auditor should use external confirmation procedures or ***otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source*** for cash and cash equivalents held by third parties (cash) in response to the assessed risks of material misstatement, ~~except when:~~

- ~~a. external confirmation procedures, including direct access to information held by a confirming party, are prohibited by law or regulation, or~~
- ~~b. the auditor has determined that the confirming party will not respond to confirmation requests as a matter of policy or practice.~~

4. Do respondents believe that there are other circumstances in which the auditor may be unable to or should not be required to confirm cash?

We do not believe there are additional circumstances in which the auditor should be unable or not required to confirm cash and cash equivalents held by third parties, or otherwise be unable or not required to obtain equivalent audit evidence through direct access of a knowledgeable external source.

That said, we believe that not all cash accounts are required to be confirmed. We support a risk-based approach as introduced by the proposed amendments to paragraph .19 that allows the auditor to determine, based on assessed risks of material misstatement, whether confirmation is necessary for individual cash accounts.

5. Do respondents agree with adding the requirement to document the basis for any determination not to use external confirmation procedures for cash in accordance with proposed paragraph .21? If not, respondents are asked to state their reasons.

We support the requirement to document the basis for any determination not to request external cash confirmations. However, refer to our response to question 3 above, where we indicate we do not believe it should be possible to overcome the presumption to confirm cash and cash equivalents.

6. Do respondents agree with the revisions to document the basis for any determination not to use external confirmation procedures for accounts receivable in accordance with paragraph .20?

We agree with the proposed requirement to document the basis for any decision not to use external confirmation procedures for accounts receivable. This requirement would support transparency in applying professional judgment.

7. Do respondents believe that the proposed amendment to paragraphs .01, .19, and .A53 are appropriate? If not, respondents are asked to state their reasons.

We agree with the proposed amendments to paragraphs .01, .19, and .A53, which would be appropriate and help improve clarity and consistency.

8. Respondents are asked whether

- a. the proposed definitions in paragraph .06 and new paragraph .07 and the related conforming amendments for consistency of terminology in AU-C section 330, AU-C section 500, and AU-C section 505 are appropriate;
- b. the proposed amendments to other AU-C sections as shown in appendix A are appropriate; and
- c. there are other sections of AICPA *Professional Standards* that might need to reflect the terminology of this proposed SAS.

We agree with all the proposed definitions stated in paragraphs .06 and .07, except for the definitions of external confirmation procedures and external confirmation response.

While direct access is an appropriate method of obtaining audit evidence that is at least as persuasive as external confirmation, we believe it should not be classified as a form of external confirmation because it does not involve a confirmation request or response. Refer to our response to question 9 for further detail.

We suggest the following revisions to paragraph .06:

- ▶ *External confirmation procedures. Procedures that involve selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party ~~(or otherwise directly accessing the information held by a confirming party)~~, and evaluating the information received and addressing nonresponses to obtain audit evidence about one or more relevant assertions.*
- ▶ *External confirmation response. Audit evidence obtained as a direct written communication to the auditor from a confirming party, either in paper form or by electronic ~~or other medium (for example, through the auditor's direct access to information provided by the confirming party)~~ in response to a confirmation request. (Ref: par. .A1-.A2)*

We also agree with the proposed conforming revisions and additions to the other AU-C sections as reflected in Appendix A in the proposal.

We do not believe any other sections of AICPA *Professional Standards* would require updates to reflect the terminology introduced by the proposed SAS.

9. Do respondents believe that retaining the concept that direct access to information held by a confirming party is a form of confirmation and including that language in the proposed definition of *external confirmation procedures* is appropriate? If not, respondents are asked to state their reasons.

Consistent with our prior responses, we believe that direct access can provide relevant and reliable audit evidence that is at least as persuasive as external confirmation. However, we do not believe it is appropriate to classify direct access as a form of external confirmation when the process does not involve a request and response.

Accordingly, we recommend relocating the definition of direct access, currently presented in application material paragraphs .A1 and .A2, to the main body of the SAS to provide clear and authoritative guidance.

We recommend the following revisions:

- ▶ ~~.06.A1~~ The auditor's *Direct* access ~~is a method the auditor uses to obtain third party evidence by directly obtaining from to information held by the confirming party meets the definition of an external confirmation response when, for example, the auditor is provided by the third confirming party with the~~ electronic access codes or information necessary to directly access a secure website where data that addresses the subject matter ~~of the confirmation~~ is held. ~~The auditor's access to information held by the confirming party may also be facilitated by an intermediary.~~
- ▶ ~~.06.A2~~ When access to the ~~confirming third~~ party's data is provided by management to the auditor, information obtained by the auditor through such access does not meet the definition of ~~an external confirmation response~~ *direct access*. However, such procedure may be considered an alternative audit procedure subject to relevance and reliability considerations in accordance with section 500.

10. Do respondents believe that the proposed requirement in paragraph .11, proposed revisions to renumbered paragraph .A22 (formerly paragraph .A14), and the introduction of new paragraphs .A15-.A18 are appropriate? If not, respondents are asked to state their reasons.

We believe that the proposed additions of paragraph .11 and the related application material in .A15-.A18 would provide guidance and clarity as the use of intermediaries becomes more widespread. Additionally, we believe that the proposed revisions to renumbered paragraph .A22 would be appropriate.

11. Do respondents believe that the proposed revisions in paragraphs .A1-.A2 are appropriate? If not, respondents are asked to state their reasons.

We believe it would be more appropriate to include the proposed application guidance in paragraphs .A1 and .A2 in the main body of the standard, as noted in our response to question 9. We believe this change would enhance clarity regarding the distinction between external confirmations and direct access. In addition, we believe certain edits are necessary to align with our view that direct access should not be classified as a form of external confirmation.

12. Do respondents believe that the proposed revisions to renumbered paragraph .A8 (formerly paragraph .A3) and addition of paragraph .A9 are appropriate? If not, respondents are asked to state their reasons.

We believe that the proposed revisions to renumbered paragraph .A8 and the addition of paragraph .A9 would be appropriate.

13. Do respondents believe that the proposed addition of paragraph .A8 and proposed revisions in renumbered paragraphs .A19-.A20 are appropriate? If not, respondents are asked to state their reasons.

We believe that the proposed addition of paragraph .A8 and the proposed revisions in renumbered paragraphs .A19-.A20, which address the reliability of responses to confirmation requests, would be appropriate. We believe the illustrative examples would be especially helpful in guiding practitioners.

14. Do respondents believe that the proposed revisions to AU-C section 500 are appropriate and complete? If not, respondents are asked to state their reasons.

We generally find the proposed revisions to AU-C section 500 to be appropriate and complete, with one exception related to paragraph .A55.

In line with our previous comments, we recommend excluding direct access from the definition of an external confirmation and propose the following revisions:

.A55 An external confirmation response is defined as audit evidence obtained as a direct written communication to the auditor from confirming party, either in paper form or by electronic or other medium ~~(for example, through the auditor's direct access to information provided by the confirming party)~~ in response to a confirmation request. See section 505, *External Confirmations*, for further guidance.

15. Is the use of negative confirmations as the sole substantive audit procedure still appropriate under the conditions specified by AU-C section 505, or should AU-C section 505 require that negative confirmation requests be used only in combination with the performance of other substantive audit procedures?

It is our understanding that negative confirmation requests are rarely used in practice considering the relatively insignificant amount of audit evidence obtained from them. We believe that auditors should not rely solely on negative confirmations to address the risk of material misstatement for a financial statement account assertion.

16. **We recommend that AU-C section 505 require the use of negative confirmations only in combination with other substantive procedures.** Do respondents agree with the decision to retain the exception such that the auditor is not required to confirm accounts receivable when the overall account balance for accounts receivable is immaterial? If not, respondents are asked to state their reasons.

We agree with retaining the principles-based approach that allows auditors to exercise professional judgment when determining whether to confirm accounts receivable. However, we believe that referencing the immateriality of the overall account balance would be unnecessary, given the standard's emphasis on responding to assessed risks of material misstatement.

We suggest the following revisions to proposed paragraph .20:

.20 The auditor should use external confirmation procedures for accounts receivable in response to the assessed risks of material misstatement, except when one or more of the following is applicable: (Ref: par. .A57)

- ▶ ~~The overall account balance is immaterial (both qualitatively and quantitatively).~~
- ▶ External confirmation procedures for accounts receivable would be ineffective. (Ref: par. .A58)
- ▶ The auditor's assessed risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk. In many situations, the use of external confirmation procedures for accounts receivable and the performance of other substantive procedures are necessary to reduce the assessed risk of material misstatement to an acceptably low level.

Attachment B – Recommendations for other edits and improvements

Other editorial comments	
Paragraph	Observation
AU-C Section 500 .A15	<p>We recommend the following revision to enhance consistency with PCAOB AS 2310.30:</p> <p>.A15 External confirmation procedures may provide relevant information to be used as audit evidence when addressing assertions associated with certain account balances and their elements. However, confirmation requests need not be restricted to classes of transactions, account balances, or disclosures. For example, the auditor may request confirmation of the terms of agreements, contracts, or transactions between an entity and other parties, particularly for complex transactions agreements or significant unusual transactions that are associated with a significant risk. The confirmation request may be designed to ask if any modifications have been made to agreements or contracts and, if so, the relevant details. External confirmation procedures are also used to obtain audit evidence about the absence of certain conditions (for example, the absence of a side agreement that may influence revenue recognition).</p>
AU-C Section 550 .03	<p>We recommend the following revisions consistent with our responses:</p> <p>.03 Other AU-C sections recognize the importance of external confirmations as audit evidence; for example</p> <ul style="list-style-type: none"> ▶ section 330 discusses the auditor's responsibility (a) to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level and (b) to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level. The auditor is required to consider whether external confirmation procedures are to be performed as substantive procedures to respond to the assessed risks of material misstatement and is required to use external confirmation procedures for <ul style="list-style-type: none"> ▶ accounts receivable unless <ul style="list-style-type: none"> ▶ the overall account balance is immaterial (both qualitatively and quantitatively), ▶ external confirmation procedures would be ineffective, or ▶ the auditor's assessed risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk.

Other editorial comments

Paragraph

Observation

	<ul style="list-style-type: none"> ▶ cash and cash equivalents held by third parties except when ▶ external confirmation procedures, including direct access to information held by a confirming party, are prohibited by law or regulation, or ▶ the auditor has determined that the confirming party will not respond to confirmation requests as a matter of policy or practice. <p>▶ section 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk. To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. Section 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks.</p> <p>▶ section 240, <i>Consideration of Fraud in a Financial Statement Audit</i>, indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.</p> <p>▶ section 500 indicates that confirmation requests need not be restricted to classes of transactions, account balances, or disclosures. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, the relevant details. External confirmation procedures are also used to obtain audit evidence about the absence of certain conditions (for example, the absence of a side agreement that may influence revenue recognition).</p>
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