

February 20, 2023

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803
comments@pcaobus.org
Re: PCAOB Rulemaking Docket Matter No. 028

Dear Board Members:

I am pleased to comment on the PCAOB's proposed auditing standard for *The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards and amendments to other PCAOB auditing standards*. (Docket Matter No. 028), dated December 20, 2022. These comments and recommendations are my opinion alone.

GENERAL COMMENTS

I strongly support the Board's goal and efforts towards modernizing its standards. I have a particular personal interest in AS 2310, which as noted in the news release¹, has not changed substantially since 2003, largely based on the AICPA's legacy SAS 67 and AU Sec. 330. As noted, the proposal addresses principles-based requirements considering both paper-based and electronic communications; in particular, the proposal introduces to AS 2310 the role of a confirmation intermediary and issues related to electronic confirmation processes.

The rise and virtual domination in some confirmation areas of confirmation intermediaries – where, in some cases, leading banks will only accept confirmations through a specific intermediary electronically and not from mail using forms or letters² or electronically from other providers - must be recognized in current standards. For example, Bank of America was one of the first financial institutions to stop responding to paper confirmation requests, in 2008.³ However, those intermediaries vary in features and functionality, and an intermediary may provide both electronic and hybrid mail/electronic services.

In recognition of the changing confirmation environment, the AICPA had issued AU Section 9330 *The Confirmation Process: Auditing Interpretations of Section* with the first section focusing on the *Use of Electronic Confirmations* back in April 2007. The IAASB likewise approved a revised and redrafted ISA 505 *External Confirmations* in September 2008. The codified AU-C 505 (SAS 122) became effective for periods ending on or after December 15, 2012.

The PCAOB had certainly not ignored these changes; as noted in Release No. 2022-009, the PCAOB issued a concept release in 2009 and a proposed auditing standard in 2010. I had evaluated those

¹ <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-proposes-new-standard-for-the-auditors-use-of-confirmation>

² Bank of America and others noted at <https://www.us.confirmation.com/2022av-new-banks>

³ <https://www.journalofaccountancy.com/news/2008/nov/dealingwithelectronicconfirmations.html>

responses at the time; I read indications that many of the proposal respondents were not ready for inclusion of principles related to third-parties and electronic confirmations at the time.

As one of the original founders of XBRL, and the creator of XBRL's Global Ledger Technology Framework (XBRL GL) (for standardizing detailed business documents and conditions), I had hoped that electronic *standards* for the confirmation messages would be developed by the audit community, where the details would be based on XBRL GL, and the forms based on a hybrid of XBRL GL and a series of confirmation request XBRL taxonomies. My intent was that the audit information supply chain would converge around a single, unifying set of electronic confirmation messages, supporting an industry of electronic confirmation providers and systems, rather than focus on a single, commercial, centralized service provider, bringing lock-in to that vendor.

I was pleased to see the document comparing the new proposed AS 2310 with ISA 505 and AU-C Section 505.⁴ As part of my work with my former employer's National Audit Office, I had been engaged in developing a similar comparison with the legacy AS 2310, ISA 505, and AU-C Section 505. As that work was the property of my former employer, I do not have access to those original detailed analyses.

The focus of my analysis was largely related to IT technical concerns and risks, in particular:

- Electronic authorization and verification

Ink signatures are legal but difficult to verify; state-by-state rules around digital signatures had variation; how would a chain of trust be maintained in a new electronic (assisted⁵) environment?

- Concerns about electronic versus paper

Did the electronic environment help with the integrity of the process, minimize the risks of concerns such as man-in-the-middle attacks, etc.? Were there enhanced concerns about issues related to client confidentiality and privacy?

Paper (and paper paradigm) confirmations can be customized for specific needs. Many electronic providers use fixed templates, which may or may not correspond to Firm requirements based on experience and specialized needs.

- Issues about the different process model

When sending the AICPA's *Standard Form to Confirm Account Balance Information with Financial Institutions*, the form is structured as **from the customer to the financial institution giving instruction and permission to respond directly to the auditor**. The form would have a copy of the customer's

⁴ https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket_028/comparison-as-2310-with-isa-505-and-au-c-section-505.pdf

⁵ The use of an external confirmation provider is not the same as a purely electronic trail. Where the external provider does not have an existing relationship, the provider may prepare a paper form and mail it on the practitioner's behalf. The provider may have regional centers that will facilitate the delivery and receipt of paper mail in other countries, which improves the process, but is not a closed-loop, secure, electronic system. While existing relationships with financial institutions are common, relationships for receivables, inventory, and other assets are less common.

authorized signature, which could be compared with signature cards at the financial institution. When using the predominant external confirmation service, the requests are instead **from the auditor and bear an indication of approval by the customer through the intermediary to the respondent**. This places more reliance on the intermediary.

Some have questioned whether an authorization received through multiple layers (the auditor's request, backed by the client's authorization, delivered by the external confirmation provider) may pose more risks than an authorization received "directly" from the customer.

- Issues related to an appropriate address to send the confirmation

My Firm had processes in place for traditional mailed confirms to assess whether addresses given by the client were appropriate. In the electronic environment, routing messages to an in-network confirming organizations is established through a pre-developed electronic channel with specific confirming parties. However, other confirming parties and respondents still posed a problem.

- An appropriate respondent

Where the external confirmation service had a relationship with the confirming party, the agreement included who were appropriate respondents. The auditor does not have visibility to this process, and no management of relationships between the authorized respondent and customers is monitored. Was this enough to ensure that respondent was knowledgeable and objective/free from bias (to minimize the risk of collusion)?

Our service provider had pre-existing relationships with many institutions, where they took responsibility for the addresses and appropriate respondents. But for out-of-network electronic correspondents and for paper correspondents, the audit was still responsible for these issues.

- Were call backs still necessary?

To address the reliability of responses, my firm would engage in "call-backs", to correspond with the named respondent and re-confirm the confirmed details. Was this task now made obsolete, or was there still some value to have a direct connection from the auditor to the respondent in a closed loop electronic environment?

- SOC reports

How much responsibility could the service provider assume?

NEW TECHNOLOGIES

I note that as technology has continued to advance, the processes related to confirmations may be at the beginnings of a next stage of change. Whether these new trends fall under confirmations or elsewhere, they are important to note:

First, **Open Banking⁶ (UK) and the Payment Services Directive 2⁷ (PSD2)** is a trend where customers can authorize their financial institutions to share their detailed activities with authorized providers. At least 30 other jurisdictions have followed the UK's lead. Using APIs and services to get client data on demand is a useful supplement to audit processes, with issues of its own.

Second, the growth of **blockchain and related technologies** may have significant impact on the confirmation process. There have been multiple pilot projects to replace or augment confirmations between audit firms and financial firms, the most visible in Taiwan⁸ and China. Additionally, as the FASB is developing its ASUs related to *Accounting for and Disclosure of Crypto Assets*⁹, determining how the classifications from the FASB line up with the classifications laid out in the proposed AS 2310 will be interesting.

This is not to minimize the potential of **artificial intelligence** in any part of the confirmation process, with particular focus on AI as the respondent.

PCAOB QUESTIONS AND PERSONAL RESPONSES

Questions from PCAOB Release No. 2022-009	Response
1. Are there problems relating to the auditor's use of confirmation that are not described above? If so, what are the problems and what changes should be considered to address them?	Proposed AS 2310.24 introduces the idea of an intermediary to facilitate direct electronic transmission of confirmation requests and responses. It does not introduce the idea of an intermediary where the intermediary transmits electronically with the auditor but – where necessary - using traditional means with the confirming party. For example, one major confirmation provider with whom I have worked can provide a fall-back service where it will send a paper confirmation to a confirming party that refuses to use the electronic service. This is particularly efficient where that provider has international, regional offices where the form can be mailed locally, reducing lead time, but incorporating the manual process within its otherwise electronic tracking. If the response is sent directly to the auditor, Proposed AS 2310.29 is not relevant, but if the response is sent to the provider (for the local efficiencies), .29 will kick in. Is that a problem?
3. Should the new proposed standard more explicitly address the use of technology, including situations where the use of technology might improve the quality of evidence obtained through the	The AICPA and the IAASB have both taken the position that the principles should be at a level above the technology, but sufficient application guidance should be provided related to technology. At the present time, a primary concern in this area relates to a decentralized organization or service being part of the confirmation process, particularly as a reporting entity. The concepts of management, SOC reports, and other centralized

⁶ <https://www.gov.uk/government/publications/update-governance-of-open-banking/update-on-open-banking>

⁷ <https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/5402>

⁸ <https://www.regulationasia.com/big-four-to-pilot-blockchain-based-auditing-in-taiwan/>

⁹ <https://www.fasb.org/Page/ProjectPage?metadata=fasb-Accounting-for-and-Disclosure-of-Crypto-Assets>

<p>confirmation process? If so, how?</p>	<p>expectations are challenged when a decentralized service or organization (DAO) is involved. DAOs may be recognized as legal organizations in multiple states (Wyoming, Tennessee, Vermont).</p> <p>Given the changes underway related to Crypto Assets, blockchain, AI and other potential enablers, it is difficult to build into the standards potential considerations for these changes.</p>
<p>8. Is the new proposed standard sufficiently flexible to accommodate situations where an auditor chooses to confirm information about newer types of assets (e.g., existence, and rights and obligations of digital assets based on blockchain or similar technologies)? If not, what changes or additions should we consider to address confirmation of newer types of assets?</p>	<p>With the FASB's ASU draft underway (https://www.fasb.org/Page/ProjectPage?metadata=fasb-Accounting-for-and-Disclosure-of-Crypto-Assets), classification issues related to Crypto Assets will be clearer soon. At first consideration, the principles should not change, but guidance may be necessary.</p>
<p>24. Is the requirement in the new proposed standard to send a confirmation request directly to the confirming party, and determine that the request is properly addressed, sufficiently clear and appropriate? Should the new proposed standard contain specific procedures for the auditor to test information about the confirming party such as the address?</p>	<p>The principle that the auditor is responsible for maintaining control of the process is clear. AU-505.A7 includes guidance related to validating the accuracy of postal addresses, e-mail addresses, and other variables in the points of contact.</p> <p>During the long period of my work in this area, I was aware of audit firms developing their own Internet-based confirmation systems (hoping respondents would be willing to reply into those environments) and also institutions responsible to respond to a large number of confirmation requests establishing their own systems. These permit direct electronic connections between auditors and confirming parties, but leave other questions open.</p>
<p>26. Are the requirements in the new proposed standard to evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses (including as set forth in paragraph .B2 of the new proposed standard) sufficiently clear and appropriate? Are there other requirements or considerations that the auditor should perform or take into</p>	<p>As noted throughout, it is vitally important to understand the capabilities and features of the intermediary. Proposed AS 2310.B2 offers important considerations, in particular:</p> <ol style="list-style-type: none"> 1. Whether controls address risks of interception and alteration of requests and responses and whether they are operating effectively, and 2. Whether the intermediary and the customer have relationships that may give the customer undue influence over the intermediary. <p>As noted in my comments and throughout, there are many variations to consider here.</p>

<p>account when using an intermediary in the confirmation process?</p>	<ul style="list-style-type: none"> • An audit firm or a company may develop their own secure electronic environments that an information partner may choose to work with. • In environments with more than one potential intermediary, the confirming party may work with one, but not others. • Intermediaries may be a complete, closed-loop secure environment, or may only be a partial solution, and on a case-by-case basis. • Intermediaries may be decentralized (no central management, no SOC reports), such as in a consortium blockchain. • Intermediaries may have an existing relationship with the confirming party, or the auditor may still be fully responsible for contact points (addresses, email) and appropriate responding parties. <p>The principles of maintaining control are the same, but the guidance may differ wildly.</p>
<p>37. Are the definitions included in the new proposed standard sufficiently clear and appropriate? If not, what changes should be made to the definitions?</p>	<p>The definitions include .A6 Confirming party, but does not differentiate between an organization and a specific person at that organization who is knowledgeable, free from bias, and suited to specifically respond to the confirmation request. 2022-009 does use the term <i>respondent</i> once (p 9). Is it at all helpful to differentiate between the organization, the intended recipient (addresses) and the respondent (the person who actually fills out/authorizes/"signs" the response)?</p>

I appreciate this opportunity to express my opinion on this matter. I would be pleased to discuss these comments and share my prior experience in greater detail if it would be helpful.

Sincerely,



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