



# Members of the Investor Advisory Group

Via Email

February 16, 2023

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006-2803

***PCAOB Rulemaking Docket Matter No. 028: Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards, PCAOB Release No. 2022-009.***

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (PCAOB or Board):

The Members of the Investor Advisory Group (MIAG)<sup>1</sup> appreciate the opportunity to comment upon the PCAOB’s “Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards” (Proposal).<sup>2</sup> We agree with PCAOB Chair Erica Y. Williams that “[i]t is critical to ensure . . . [the PCAOB’s] confirmation standard is fit for purpose in today’s capital markets to ensure investors receive the protection they deserve.”<sup>3</sup>

We understand the Proposal would replace in its entirety AS 2310, “The Auditor’s Use of Confirmation” (AS 2310). However, many of the concepts in AS 2310, such as the use of positive confirmations, a presumption that positive confirmations should be used for accounts receivable, an auditor controlling the transmittal and receipt of confirmations, and the use of auditor judgment are carried forward into the Proposal.<sup>4</sup>

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<sup>1</sup> This letter represents the views of Investor Advisory Group (IAG) and does not necessarily represent the views of all of its individual members, or the organizations by which they are employed. IAG views are developed by the members of the group independent of the views of the Public Company Accounting Oversight Board (PCAOB or Board) and its staff. For more information about the IAG, including a listing of the current members, their bios, and the IAG charter, see <https://pcaobus.org/about/advisory-groups/investor-advisory-group>.

<sup>2</sup> PCAOB, Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards, PCAOB Release No. 2022-009 (Dec. 20, 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket\\_028/2022-009-confirmation.pdf?sfvrsn=d3d14ede\\_2](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket_028/2022-009-confirmation.pdf?sfvrsn=d3d14ede_2).

<sup>3</sup> PCAOB Chair Williams’ Statement on Proposed New Standard for the Auditor’s Use of Confirmation (Dec. 20, 2022), <https://pcaobus.org/news-events/speeches/speech-detail/pcaob-chair-williams-statement-on-proposed-new-standard-for-the-auditor-s-use-of-confirmation>.

<sup>4</sup> See PCAOB Release No. 2022-009 at 8-9 (describing “key provisions of existing AS 2310”).

As described by Soyoung Ho of *Thomson Reuters*: “AS 2310 is an old [American Institute of Certified Public Accountants] AICPA standard that became effective in 1992 when electronic communications were far less advanced than are today.”<sup>5</sup> The MIAG believes that by replacing AS 2310, the Proposal, subject to the adoption of our proposed revisions, would be generally consistent with the following recommendation contained in our comment letter in response to “Request for Public Comment – PCAOB Draft Plan 2022-2026”:<sup>6</sup>

We know that auditors have been working with long-standing “interim” standards since the PCAOB’s inception and their modernization is long overdue . . . .  
. . . .  
. . . We recommend that the Board prioritize modernization of interim auditing standards . . . .<sup>7</sup>

More specifically, the MIAG generally supports the Proposal, subject to the adoption of our proposed revisions, because we believe it could strengthen and modernize the Board’s requirements for the auditor’s use of confirmation.<sup>8</sup> At the outset, we note that we generally agree with basic tenets of the Proposal including:

- Basic principles should apply to all confirmations, whether paper-based or electronic communication.<sup>9</sup>
- Positive confirmation of cash and accounts and loans receivable is necessary to provide the auditor with persuasive, sufficient and competent evidence to provide a basis for the high level of assurance that the auditor’s opinion provides to investors, as required by the

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<sup>5</sup> Soyoung Ho, PCAOB Issues Second Proposal to Modernize Rules on Audit Confirmation Process, Thomson Reuters (Dec. 20, 2022), <https://tax.thomsonreuters.com/news/pcaob-issues-proposal-to-modernize-audit-confirmation-process/#:~:text=PCAOB%20Issues%20Second%20Proposal%20to%20Modernize%20Rules%20on%20Audit%20Confirmation%20ProcessSoyoung%20Ho%20Senior&text=More%20than%20a%20dozen%20years,issue%20another%20proposal%20for%20comment>.

<sup>6</sup> Request for Comment, Draft 2022-2026 PCAOB Strategic Plan, PCAOB Release No. 2022-003 (Aug. 16, 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a\\_4%2022-003-RFC-DraftStrategicPlan.pdf](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a_4%202022-003-RFC-DraftStrategicPlan.pdf); PCAOB, Strategic Plan, 2022-2026, Draft for Comment (Aug. 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db\\_4%20Draft-2022-2026-Strategic-Plan.pdf](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db_4%20Draft-2022-2026-Strategic-Plan.pdf).

<sup>7</sup> Letter from Members of the IAG to Office of the Secretary, PCAOB 2 (Sept. 15, 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/strategic-plan-comments-2022/10\\_iag.pdf?sfvrsn=f24d0e63\\_4](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/strategic-plan-comments-2022/10_iag.pdf?sfvrsn=f24d0e63_4).

<sup>8</sup> Cf. PCAOB Chair Williams’ Statement on Proposed New Standard for the Auditor’s Use of Confirmation (“And that is why I support strengthening and modernizing our requirements for the auditor’s use of confirmation [and] I look forward to receiving input from all our stakeholders.”).

<sup>9</sup> See PCAOB Release No. 2022-009 at 4 (“The new proposed standard and amendments, which would apply to all audits conducted under PCAOB standards, are intended to enhance the Board’s standard on the use of confirmation by describing principles-based requirements that apply to all methods of confirmation, including paper-based and electronic means of communications”).

PCAOB's standards.<sup>10</sup> However, as discussed in more detail below, we believe the use of positive confirmations should be expanded given the nature of business transactions today including, but not limited to, supply-chain financing, and digital coin/crypto transactions. We believe failing to address such transactions could render the Proposal obsolete before a final standard is adopted.

- Information and evidence obtained directly from an independent third-party provides higher quality evidence than that provided internally by management and employees of the company.<sup>11</sup>
- Negative confirmations provide low quality, if any, audit evidence and will always need to be supplemented by other audit procedures that will result in the same level of persuasive evidence a positive confirmation would provide.<sup>12</sup>
- The auditor must maintain control over the confirmation, including over the transmission and receipt of the confirmation directly to and from the third party.<sup>13</sup>
- When a positive confirmation results in an exception, such as when it is not returned, or the recipient returns it with differences from information the auditor received from the company, the auditor *must* perform audit procedures to resolve any inconsistencies in evidence, including examining other third party evidence such as purchase orders.<sup>14</sup> We believe the other audit procedures should be designed to result in persuasive, sufficient and competent evidence.<sup>15</sup>

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<sup>10</sup> See AS 1015: Due Professional Care in the Performance of Work, PCAOB ¶ .10 (last visited Feb. 13, 2023), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS1015> (“The exercise of due professional care allows the auditor to obtain *reasonable assurance* about whether the financial statements are free of material misstatement, whether caused by error or fraud, or whether any material weaknesses exist as of the date of management's assessment . . . [and] [a]lthough not absolute assurance, reasonable assurance is a high level of assurance.”); AS 1105: Audit Evidence, PCAOB ¶ .03 (last visited Feb. 3, 2023), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS1105> (“The objective of the auditor is to plan and perform the audit to obtain appropriate audit evidence that is sufficient to support the opinion expressed in the auditor's report.”).

<sup>11</sup> See PCAOB Release No. 2022-009 at 24 (“Obtaining and examining appropriate third-party evidence increases the quality of the audit evidence obtained.”); see generally ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS, AND IMPOSING SANCTIONS In the Matter of Price Waterhouse, Bangalore, Lovelock & Lewes, Price Waterhouse & Co., Bangalore, Price Waterhouse, Calcutta, and Price Waterhouse & Co., Calcutta, Respondents, PCAOB Release No. 105-2011-002 at ¶ 26 (Apr. 1, 2011), [https://pcaobus.org/Enforcement/Decisions/Documents/PW\\_India.pdf](https://pcaobus.org/Enforcement/Decisions/Documents/PW_India.pdf) (“Confirmation ‘is undertaken to obtain evidence from third parties about financial statement assertions made by management’ consistent with the presumption that “[w]hen evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity.’”).

<sup>12</sup> See PCAOB Release No. 2022-009 at ¶ .21 (“the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence”).

<sup>13</sup> See *id.* at 9 (“the auditor to maintain control over confirmation requests and responses by establishing direct communication between the intended recipient and the auditor”).

<sup>14</sup> See *id.* at 39 (“The new proposed standard would provide that the auditor should evaluate the confirmation exceptions and determine their implications for certain aspects of the audit . . .”).

<sup>15</sup> See AS 1100: Audit Evidence, PCAOB ¶ .29 (last visited Feb. 13, 2023), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS1100> (“If audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of

- Independent auditors rather than internal auditors should perform this important audit step of confirmation.<sup>16</sup> We believe the internal auditor should also be precluded from evaluating the results of the confirmations, as it is the responsibility of the auditor to evaluate the results of the audit procedures performed, not the internal auditor.

While the MIAG generally agrees with many of the basic tenets of the Proposal, we also believe that some of the provisions of the Proposal require substantial revisions including the following:

- Due to the importance of confirmation of cash and cash equivalents and accounts and loans receivable, and the ability to confirm the existence of these balances directly with a third-party, if an auditor decides not to use positive confirmations as prescribed by the Proposal, we agree the auditor should communicate this to the audit committee responsible for overseeing the audit.<sup>17</sup> However, in light of the various enforcement actions discussed in the Proposal,<sup>18</sup> we believe a final standard should require that this decision also be communicated to investors, increasing the transparency of the quality of an audit for investors and providing an incentive to use confirmations.<sup>19</sup>
- The Proposal gives too much latitude to the auditor to overcome a presumption that positive confirmations will be used “. . . if the auditor determines that those other procedures would provide audit evidence that is at least as persuasive as the evidence the auditor might expect to obtain through confirmation.”<sup>20</sup> We believe this provision of the Proposal should be revised so that a final standard provides that the auditor can overcome the presumption if, and only if, they (1) document the evidence and basis for their conclusion, and (2) have communicated the conclusion to the (a) audit committee and (b) investors.<sup>21</sup> **We also note that overcoming the presumption could result in what would be considered a critical audit matter.**

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information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.”).

<sup>16</sup> See PCAOB Release No. 2022-009 at 42 (“the auditor would not be permitted to use internal auditors for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses”).

<sup>17</sup> See *id.* at 61 (“The requirement to communicate to the audit committee instances where the auditor has determined that the presumption to confirm accounts receivable has been overcome (including the basis for the auditor’s determination) may reinforce the auditor’s obligation to exercise due professional care in making that determination.”).

<sup>18</sup> See *id.* at 11-12 (describing observations from enforcement actions).

<sup>19</sup> See *id.* at 16 (responsive to question # 2: “Would investors find it useful in making investment decisions to have more information about the auditor’s use of confirmation in the audit of an issuer’s financial statements?”).

<sup>20</sup> *Id.* at 15.

<sup>21</sup> See *id.* at 16 (responsive to question # 2: “Would investors find it useful in making investment decisions to have more information about the auditor’s use of confirmation in the audit of an issuer’s financial statements?”).

- As indicated, we agree that positive confirmations should be used by auditors for obtaining persuasive evidence with respect to cash and cash equivalents and accounts and loans receivable. We, however, believe that the scope of a final standard should be further expanded to provide for the use of positive confirmations for the following additional transactions:
  - Those with unusual terms and conditions and/or the terms of agreement may have a material effect on the fair presentation of financial reports, including the disclosures.
  - Those with related parties, including the assessment of the nature, the substance of such transactions and the completeness of the disclosures.
  - Those where the auditor has a concern about whether or not side agreements may exist.
  - Those where financing is obtained, including bank debt or supplier provided financing.<sup>22</sup>
  - Those involving certain sales practices such as the terms of bill and hold arrangements, supplier discounts or concessions.
  - Those involving certain oral arrangements or guarantees.
  - Those involving sales, lending, or liability for custodianship of digital assets, especially in light of losses investors have recently suffered.<sup>23</sup>
- The Proposal refers to the use of “professional judgment” by the auditor.<sup>24</sup> In court cases auditors often refer to their use of professional judgment as to why their judgments with regards to such items as risk assessments and materiality should not be challenged. But as PCAOB inspections and Securities and Exchange Commission and Board enforcement actions have noted, there are “reasonable” and there are unsupportable professional judgments that have been made by auditors. Yet the Proposal for the most part simply refers to the generic term. Accordingly, we believe that it is important that a final standard explicitly refer to AS 2501, “Auditing Accounting Estimates, Including Fair Value Measurements,”<sup>25</sup> and remind auditors that in exercising their professional judgments, such judgments must be well reasoned, careful, documented and comply with the requirements and standards set forth therein.

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<sup>22</sup> Cf. Vinicios Andrade et al., Vanished \$4 Billion Brings Down Century-Old Retailer in a Week, Bloomberg (Jan. 20, 2023), available at <https://gulfnews.com/business/markets/vanished-4-billion-brings-down-century-old-retailer-in-a-week-1.1674223102115> (“The company's disclosures imply it misreported numbers tied to financing of debts with suppliers while also wrongly deducting interest paid to lenders from its liabilities.”).

<sup>23</sup> See, e.g., Francie McKenna, The PCAOB, and the SEC, can do so much more to rein in auditors giving false assurance about crypto, The Dig (Jan. 28, 2023) (on file with MIAG) (Discussing FTX Trading and commenting that “PCAOB Chair Erica Williams has been reluctant to address audits in the crypto industry [and] [s]he does not even mention it in the proposed new confirmation standard!”).

<sup>24</sup> See, e.g., PCAOB Release No. 2022-009 at 66 (“the language is sufficiently clear to allow for the continued exercise of professional judgment . . .”).

<sup>25</sup> See AS 2501: Auditing Accounting Estimates, Including Fair Value Measurements, PCAOB ¶¶ .16-.18 (last visited Feb. 3, 2020), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS2501> (“Evaluating the Reasonableness of Significant Assumptions”).

- Existing auditing standards require auditors test the five categories of financial statement assertions: (1) Existence or occurrence; (2) Completeness; (3) Valuation or allocation; (4) Rights and obligations; and (5) Presentation and disclosure.<sup>26</sup> The auditor is required to test each of these assertions pursuant to the PCAOB auditing standards. We understand that the confirmation work is often performed by less experienced audit staff. Accordingly, to assist auditors in their understanding of a final standard on confirmations, we believe a final standard should more fully explain that a confirmation generally serves to test the assertion of existence, but does not serve to test other assertions such as valuation, including collectability. It should also be noted that the design of the confirmation request is necessarily important as it also can determine what assertion the confirmation will address.

Finally, the MIAG offers the following additional specific comments on the Proposal for the Board's consideration:

- Page 26, first full paragraph.<sup>27</sup> This paragraph states that the “. . . standard would require the auditor to take into account the auditor's understanding of the substance of the company's arrangements and transactions with third parties and the nature of the items that make up the company's account balances in selecting the individual accounts receivable to confirm.”<sup>28</sup> However, no such language is included in the proposed auditing standard. We believe the Board should include this language in any final standard.
- Paragraph .05.<sup>29</sup> We believe that if an auditor has reason to believe there may be side agreements to revenue transactions, that creates a significant fraud risk, especially if intentional misstatements exist. We believe language should be added to this paragraph stating the auditor should also take into account, the internal controls over cash, including segregation of duties. Too often a lack of proper segregation of duties has resulted in a misappropriation of cash, which the auditor did not adequately plan and address in determining the audit procedures applied.
- Paragraph .15.<sup>30</sup> This paragraph discusses a “complex” or an “unusual” transaction that involves “significant risks of ‘material’ misstatement.”<sup>31</sup> Yet the PCAOB states that an auditor need only “consider” confirming such a material transaction, despite the fact that the Board has also stated that confirmations provide more persuasive audit evidence than other types of evidence.<sup>32</sup> As a result, we believe the word “consider” should be struck.
- Paragraph .19.<sup>33</sup> We strongly concur with the language the PCAOB has used in this paragraph. Related party transactions have often been present in frauds and it is important the auditor assess the objectivity of the respondent in such transactions.

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<sup>26</sup> See AS 1105: Audit Evidence, PCAOB ¶ .11 (“Financial Statement Assertions”).

<sup>27</sup> See PCAOB Release No. 2022-009 at 26.

<sup>28</sup> *Id.*

<sup>29</sup> See *id.* at A1-1.

<sup>30</sup> See *id.* at A1-4.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> See *id.* at A1-5.

- Paragraph .21.<sup>34</sup> We believe the word “Generally” should be struck.<sup>35</sup> As the Proposal has indicated, a negative confirmation is not sufficient audit evidence by itself and certainly is unequivocally not as persuasive as a positive confirmation.
- Paragraph .26.<sup>36</sup> We believe this paragraph should state that if an auditor is unable to determine the reliability of a confirmation of a material transaction or disclosure, and the auditor is unable to perform alternative procedures that provide sufficient, competent and persuasive evidence with respect to the material items, that determination would likely also result in a scope limitation.
- Paragraphs .25 to .31.<sup>37</sup> It has been noted that too often, the auditor identifies an exception to a confirmation, including a non-response, in which the auditor assesses the matter as an “isolated exception.” In turn, the auditor then fails to appropriately consider the nature of the exception and fails to adequately consider whether it may have a material effect on the financial statements and/or investors. The Proposal should provide greater clarity to the auditor’s evaluation of the amount and nature of individual confirmation exceptions, and the potential alternative audit procedures that would then be necessary.
- Paragraph .31.<sup>38</sup> The Proposal discusses the need for evidence the auditor considers and evaluates to be both sufficient and competent as well as persuasive.<sup>39</sup> Accordingly, footnote 10 of this paragraph should be modified by inserting the words “that is persuasive” after the words “. . . sufficient appropriate audit evidence . . . .”<sup>40</sup>
- Paragraph .31(b).<sup>41</sup> The phrase “. . . or (iii) . . . ” should be replaced with “. . . and (iii) . . . .”<sup>42</sup> We believe that merely reviewing shipping documents or other supporting documents, which may be altered, is unlikely to provide “persuasive” evidence that meets the quality of evidence required by PCAOB standards.
- Paragraph .B1c.<sup>43</sup> We believe the word “documented” should be inserted after the word “has.”<sup>44</sup>
- Paragraph .B2b.<sup>45</sup> We believe the phrase “and document” should be inserted after the word “Determine.”

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<sup>34</sup> *See id.*

<sup>35</sup> *Id.*

<sup>36</sup> *See id.* at A1-6.

<sup>37</sup> *See id.* at A1-6-7

<sup>38</sup> *See id.* at A1-7.

<sup>39</sup> *See AS 1015.*

<sup>40</sup> *See PCAOB Release No. 2022-009 at A1-7 n.10.*

<sup>41</sup> *See id.* at A1-8.

<sup>42</sup> *Id.*

<sup>43</sup> *See id.* at A1-10.

<sup>44</sup> *Id.*

<sup>45</sup> *See id.*

- Page A2-1, paragraph .18.<sup>46</sup> We believe the word “~~third~~” should not be struck.<sup>47</sup> We note that throughout the Proposal there are references to a “third party”.<sup>48</sup> We recommend the term “third” be retained as it may provide clarity with respect to a confirming party.

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Thank you for carefully considering the comments of the MIAG and other investors—the primary customers of audited financial reports.<sup>49</sup> If you, any members of the Board, or your staff have questions or seek further elaboration of our views, please contact Amy McGarrity at [amcgarrity@copera.org](mailto:amcgarrity@copera.org).

Sincerely,

*Members of the Investor Advisory Group*

Members of the Investor Advisory Group

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<sup>46</sup> See *id.* at A2-1.

<sup>47</sup> *Id.*

<sup>48</sup> See, e.g., *id.* at 8 (“Procedures for designing the confirmation request, including the requirement that the auditor direct the confirmation request to a third party who the auditor believes is knowledgeable about the information to be confirmed.”).

<sup>49</sup> See, e.g., Council of Institutional Investors, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), [https://www.cii.org/policies\\_other\\_issues#indep\\_acct\\_audit\\_standards](https://www.cii.org/policies_other_issues#indep_acct_audit_standards) (“investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors’ information needs”).