

File No. PCAOB 2023-02
Consists of 1275 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 19b-4

Proposed Rules

By

Public Company Accounting Oversight Board

In accordance with Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of the Proposed Rules

(a) Pursuant to the provisions of Section 107(b) of the Sarbanes-Oxley Act of 2002 (the “Act”), the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) amendments to auditing standards for the auditor’s use of confirmation and amendments to related PCAOB auditing standards (collectively, the “proposed rules”), including the retitling and replacement of an existing standard with a new standard. The proposed rules are attached as Exhibit A to this filing. In addition, the Board is also requesting the SEC’s approval, pursuant to Section 103(a)(3)(C) of the Act, of the application of the proposed rules to audits of emerging growth companies (“EGCs”), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934. Section 104 of the Jumpstart Our Business Startups Act provides that any additional rules adopted by the Board subsequent to April 5, 2012 do not apply to the audits of EGCs unless the SEC “determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.” *See* Exhibit 3.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Board

(a) The Board approved the proposed rules, and authorized them for filing with the SEC, at its open meeting on September 28, 2023. No other action by the Board is necessary for the filing of the proposed rules.

(b) Questions regarding this filing may be directed to Barbara Vanich, Chief Auditor (202/207-9363, vanichb@pcaobus.org); Dima Andriyenko, Deputy Chief Auditor (202/207-9130, andriyenkod@pcaobus.org); David Hardison, Associate Counsel (202/591-4168, hardisond@pcaobus.org); or Connor Raso, Acting Deputy General Counsel (202/591-4478, rasoc@pcaobus.org).

3. Board’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules Change

(a) Purpose

The Board is replacing AS 2310, *The Confirmation Process*, in its entirety with a new standard, AS 2310, *The Auditor’s Use of Confirmation* (“new standard”) to strengthen and modernize the requirements for the confirmation process. As described in the new standard, the confirmation process involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party (e.g., a financial institution), evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions. If properly designed and executed by an auditor, the confirmation process may provide important evidence that the auditor obtains as part of an audit of a company’s financial statements.

AS 2310 is an important standard for audit quality and investor protection, as the audit confirmation process touches nearly every audit. The standard was initially written over 30 years ago and has had minimal amendments since its adoption by the PCAOB in 2003.

The Board is adopting the new standard after substantial outreach, including several rounds of public comment. The PCAOB previously considered updating AS 2310

by issuing a concept release in 2009 and a proposal in 2010 for a new auditing standard that would supersede AS 2310. While the PCAOB did not amend or replace AS 2310 at that time, subsequent developments – including the increasing use of electronic communications and third-party intermediaries in the confirmation process – led the Board to conclude that enhancements to AS 2310 and modifications to the approach proposed in 2010 could improve the quality of audit evidence obtained by auditors. In addition, the Board has observed continued inspection findings related to auditors' use of confirmation, as well as enforcement actions involving failures to adhere to requirements in the existing auditing standard regarding confirmation, such as the requirement for the auditor to maintain control over the confirmation process.

Accordingly, having considered these developments and input from commenters, the Board revisited the previously proposed changes and issued a new proposed standard to replace AS 2310, along with conforming amendments to other PCAOB auditing standards, in December 2022. Commenters generally supported the Board's objective of improving the confirmation process, and suggested areas to further improve the new standard, modify proposed requirements that would not likely improve audit quality, and clarify the application of the new standard. In adopting the new standard and related amendments, the Board has taken into account all of these comments, as well as observations from PCAOB oversight activities.

The new standard and related amendments are intended to enhance the PCAOB's requirements 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. In addition, the new standard is more expressly integrated with the

PCAOB's risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor's responsibilities for obtaining relevant and reliable audit evidence through the confirmation process. Among other things, the new standard:

- Includes a new requirement regarding confirming cash and cash equivalents held by third parties, or otherwise obtaining relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source;
- Carries forward the existing requirement regarding confirming accounts receivable, while addressing situations where it would not be feasible for the auditor to perform confirmation procedures or obtain relevant and reliable audit evidence for accounts receivable by directly accessing information maintained by a knowledgeable external source;
- States that the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence (and includes examples of situations where the auditor may use negative confirmation requests to supplement other substantive audit procedures);
- Emphasizes the auditor's responsibility to maintain control over the confirmation process and provides that the auditor is responsible for selecting the items to be confirmed, sending confirmation requests, and receiving confirmation responses; and
- Identifies situations in which alternative procedures should be performed by the auditor (and includes examples of such alternative procedures that may provide relevant and reliable audit evidence for a selected item).

See Exhibit 3 for additional discussion of the purpose of the project.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

4. Board's Statement on Burden on Competition

Not applicable. The Board's consideration of the economic impact of the proposed rules is discussed in Exhibit 1.

5. Board's Statement on Comments on the Proposed Rules Change Received from Members, Participants or Others

The Board released the proposed rules for public comment in PCAOB Release No. 2022-009 (Dec. 20, 2022) ("2022 Proposal"). *See* Exhibit 2(a)(A). The Board previously issued a concept release for public comment in PCAOB Release No. 2009-002 (Apr. 14, 2009) ("2009 Concept Release") and a proposed auditing standard related to confirmation and related amendments to PCAOB standards in PCAOB Release No. 2010-003 (July 13, 2010) ("2010 Proposal"). *See* Exhibits 2(a)(B) and 2(a)(C). The Board received 98 written comments relating to the 2022 Proposal, the 2009 Concept Release, and the 2010 Proposal. *See* Exhibits 2(a)(D), 2(a)(E), and 2(a)(F). The Board's Standard Advisory Group also discussed the 2009 Concept Release and 2010 Proposal at meetings on April 2, 2009, October 14, 2009, and October 14, 2010. *See* Exhibit 2(a)(G).

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rules Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

Exhibit A - Text of the Proposed Rules

Exhibit 1 - Form of Notice of Proposed Rules for Publication in the Federal Register

Exhibit 2(a)(A) PCAOB Release No. 2022-009 (2022 Proposal)

Exhibit (2)(a)(B) PCAOB Release No. 2009-002 (2009 Concept Release)

Exhibit 2(a)(C) PCAOB Release No. 2010-003 (2010 Proposal)

Exhibit 2(a)(D) Alphabetical List of Comments and Written Comments on 2022 Proposal

Exhibit 2(a)(E) Alphabetical List of Comments and Written Comments on 2009 Concept Release

Exhibit 2(a)(F) Alphabetical List of Comments and Written Comments on 2010 Proposal

Exhibit 2(a)(G) Transcripts from SAG meetings on April 2, 2009, October 14, 2009, and October 14, 2010

Exhibit 3 - PCAOB Release No. 2023-008 (Adopting Release)

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

A handwritten signature in blue ink, appearing to be 'PWB', with a long horizontal line extending to the right.

By: _____
Phoebe W. Brown
Secretary

October 4, 2023

EXHIBIT A – TEXT OF THE PROPOSED RULES

The Board adopted amendments to AS 2310, *The Confirmation Process*, to amend that standard in its entirety and retitle it as *The Auditor’s Use of Confirmation*. The Board also adopted technical and conforming amendments to other standards.

The text of these proposed rule changes is set forth below.

AMENDMENTS TO AS 2130, THE CONFIRMATION PROCESS

AS 2310 is retitled and amended in its entirety to read as follows:

AS 1310: *The Auditor’s Use of Confirmation*

Introduction

.01 This standard establishes requirements regarding obtaining audit evidence from a knowledgeable external source through the auditor’s use of confirmation. The standard also includes additional requirements regarding obtaining audit evidence for cash, accounts receivable and terms of certain transactions.

Objective

.02 The objective of the auditor in designing and executing the **confirmation process** is to obtain relevant and reliable audit evidence from a knowledgeable external source about one or more relevant financial statement assertions of a significant account or disclosure.¹

Relationship of the Confirmation Process to the Auditor’s Identification and Assessment of and Response to the Risks of Material Misstatement

.03 AS 2110, *Identifying and Assessing Risks of Material Misstatement*, establishes requirements regarding the process of identifying and assessing risks of material misstatement of the financial statements and provides that the auditor’s assessment of risks of material

¹ Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

misstatement, including fraud risks, should continue throughout the audit. When the auditor obtains audit evidence during the course of the audit (including through the confirmation process) that contradicts the audit evidence on which the auditor originally based the risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in respect to the revised risk assessments.²

.04 AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, requires the auditor to design and implement appropriate responses that address risks of material misstatement. This may include using confirmation to address the assessed risks of material misstatement for certain relevant assertions of significant accounts and disclosures.

Note: If different components in a significant account or disclosure are subject to significantly differing risks of material misstatement, the auditor's responses should include procedures that are responsive to the differing risks of material misstatement.

.05 AS 2301 provides that as the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by substantive procedures depends upon the mix of the nature, timing, and extent of those procedures.

Note: AS 2110.68 provides that the auditor should presume that there is a fraud risk involving improper revenue recognition. According to paragraph .54 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, examples of audit procedures that might be performed in response to this risk include confirming with customers certain relevant contract terms and the absence of side agreements.

² See AS 2110.74; see also paragraphs .02 and .29 of AS 1105, *Audit Evidence*.

.06 Audit evidence obtained from a knowledgeable external source is generally more reliable than evidence obtained only from internal company sources.³ The following are examples of financial statement assertions for which the confirmation process, when properly designed and executed, can provide relevant and reliable audit evidence:

- Existence (e.g., cash, accounts receivable, investments)
- Occurrence (e.g., revenue transactions)
- Completeness (e.g., accounts payable, debt)
- Rights and obligations (e.g., cash, assets pledged as collateral)

.07 This standard describes the auditor's responsibilities related to the confirmation process, as follows:

- Paragraphs .08-.13 discuss designing the **confirmation request**.
- Paragraphs .14-.17 discuss maintaining control over the confirmation process.
- Paragraphs .18-.23 discuss **confirmation responses, confirmation exceptions and nonresponses**.
- Paragraphs .24-.30 discuss additional considerations for cash, accounts receivable, and terms of certain transactions.
- Paragraph .31 discusses evaluating the results of confirmation and other audit procedures.

³ See AS 1105.08.

Other PCAOB standards also address auditor responsibilities relevant to the auditor's use of confirmation.⁴ This standard does not address matters described in AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

Designing Confirmation Requests

Identifying Information to Confirm

.08 The auditor should identify the information related to the relevant assertions that the auditor plans to verify with **confirming parties** or (when using a blank form) obtain from confirming parties.

Note: Some forms of **positive confirmation requests** ask the confirming party to indicate whether the confirming party agrees with the information stated on the request.

Other forms of positive confirmation requests, referred to as blank forms, do not state the amount (or other information) to be confirmed, but request the confirming party to fill in the balance or furnish other information. Using a blank form confirmation request may provide more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., a customer account balance).

However, blank forms might result in lower response rates because additional effort may be required of the confirming party; consequently, the auditor may have to perform alternative procedures for more selected items.

Identifying Confirming Parties for Confirmation Requests

⁴ See, e.g., AS 2301 (regarding the nature, timing, and extent of audit procedures); AS 2315, *Audit Sampling* (regarding planning, performing, and evaluating audit samples); and AS 2510, *Auditing Inventories* (regarding confirmation of inventories in the hands of public warehouses or other outside custodians).

.09 The auditor should direct confirmation requests to confirming parties (individuals or organizations) who are knowledgeable about the information to be confirmed and determine that the confirmation requests are properly addressed.

Note: AS 2401.53 provides that when the auditor has assessed a fraud risk, sending confirmation requests to a specific party within an organization is an example of an audit response to the risk.

.10 If the auditor is aware of information about a potential confirming party's (i) motivation, ability, or willingness to respond, or (ii) objectivity and freedom from bias with respect to the audited entity,⁵ the auditor should consider this information, including its source, in selecting the confirming parties.

Note: Such information may indicate that the potential confirming party has incentives or pressures to provide responses that are inaccurate or otherwise misleading.

.11 If the auditor is unable to identify a confirming party for a selected item who would provide relevant and reliable audit evidence in response to a confirmation request (including considering any information discussed in paragraph .10), the auditor should perform alternative procedures for the selected item in accordance with Appendix C.

Note: The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained.⁶

Using Negative Confirmation Requests

⁵ AS 2410, *Related Parties*, requires the auditor to perform procedures to obtain an understanding of the company's relationships and transactions with related parties.

⁶ See AS 1105.08.

.12 Generally, the auditor obtains significantly less audit evidence when using **negative confirmation requests** than when using positive confirmation requests because the auditor typically does not receive from the confirming party a confirmation response to a negative confirmation request unless the confirming party disagrees with the information provided in the request. Therefore, the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence for addressing the risk of material misstatement to a financial statement assertion.

.13 The following are examples of situations in which the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence:

- a. The auditor has (i) assessed the risk of material misstatement for the relevant assertions as low, and (ii) obtained sufficient appropriate audit evidence regarding the design and operating effectiveness of controls.⁷
- b. The population of items within the account balance or class of transactions for which the auditor considers sending negative confirmation requests is composed of many small, homogeneous items.
- c. The auditor expects a low exception rate in response to negative confirmation requests and has a reasonable basis for this expectation.

Maintaining Control over the Confirmation Process

.14 The auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted or altered.

⁷ See also AS 2301.16-.18 for a discussion of tests of controls.

.15 The auditor should (i) select the items to be confirmed, (ii) send confirmation requests, and (iii) receive confirmation responses.⁸

.16 The auditor should send the confirmation request directly to the confirming party and obtain the confirmation response directly from the confirming party.

.17 The auditor or the confirming party can engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. When using an intermediary for this purpose, the auditor should evaluate the implications on the reliability of confirmation requests and responses as discussed in Appendix B.

Evaluating Confirmation Responses and Confirmation Exceptions, and Addressing Nonresponses and Incomplete Responses

Evaluating Reliability of Confirmation Responses

.18 The auditor should evaluate the reliability of confirmation responses, taking into account any information about events, conditions, or other information that the auditor becomes aware of that (i) contradicts the information used when selecting the confirming party pursuant to paragraphs .09 and .10 or (ii) indicates that the confirmation request or confirmation response may have been intercepted and altered.⁹

Note: The following are examples of information that indicates that a confirmation request or confirmation response may have been intercepted or altered:

⁸ The auditor may use internal auditors to provide direct assistance in other aspects of the confirmation process in accordance with AS 2605, *Consideration of the Internal Audit Function*, which establishes requirements for using internal auditors to provide direct assistance to the auditor including supervising, reviewing, evaluating and testing the work performed by internal auditors.

⁹ A note to AS 1105.08 also describes the auditor's responsibilities to evaluate third-party evidence provided to the auditor subject to restrictions, limitations, or disclaimers.

- a. The confirmation response comes from a physical or electronic address other than the address on the confirmation request.
- b. The confirmation response does not include a signature of the confirming party or otherwise identify the confirming party.
- c. The confirmation response does not include a copy of the original confirmation request, e-mail chain, or any other information indicating that the confirming party is responding to the auditor's confirmation request.

.19 If the auditor is unable to determine that the confirmation response is reliable, the auditor should perform alternative procedures for the selected item in accordance with Appendix C.

Evaluating Confirmation Exceptions

.20 The auditor should evaluate confirmation exceptions and determine whether the confirmation exceptions individually or in the aggregate indicate (i) a misstatement that should be evaluated in accordance with AS 2810, *Evaluating Audit Results*, (ii) a deficiency in the company's internal control over financial reporting,¹⁰ or both.

Note: The auditor's determination under this paragraph generally involves examining external information, which may include information that the company received from knowledgeable external sources.

Addressing Nonresponses and Incomplete Responses

¹⁰ In an integrated audit of financial statements and internal control over financial reporting, the auditor should perform the evaluation in accordance with AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. In an audit of financial statements, the auditor should follow the direction of AS 2201.62-.70, as stated in paragraph .03 of AS 1305, *Communications About Control Deficiencies in an Audit of Financial Statements*.

.21 If the auditor does not receive a confirmation response to a positive confirmation request, the auditor should follow up with the confirming party. The auditor should evaluate any confirmation response subsequently received in accordance with paragraphs .18-.19 and any confirmation exception in accordance with paragraph .20.

.22 If a confirmation response is returned by the confirming party to anyone other than the auditor, the auditor should contact the confirming party and request that the response be re-sent directly to the auditor. If the auditor does not subsequently receive a confirmation response from the intended confirming party, the auditor should treat the situation as a nonresponse.

.23 In the case of a nonresponse or an incomplete response, the auditor should perform alternative procedures for the selected item in accordance with Appendix C.

Additional Considerations for Cash, Accounts Receivable, and Terms of Certain

Transactions

Obtaining Audit Evidence Directly from a Knowledgeable External Source

.24 For cash and cash equivalents held by third parties (“cash”), and for accounts receivable that arise from the transfer of goods or services to a customer or a financial institution’s loans (“accounts receivable”), the auditor should perform confirmation procedures in accordance with paragraphs .08 through .23, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.

Note: The direction in paragraphs .08-.10 for identifying the information related to the relevant assertions that the auditor plans to verify with confirming parties and selecting confirming parties also applies when identifying the information maintained by knowledgeable external sources and selecting knowledgeable external sources.

.25 For accounts receivable, if the auditor determines it is not feasible to obtain audit evidence pursuant to paragraph .24 based on the auditor's experience, such as prior years' audit experience with the company or experience with similar engagements where the auditor did not receive confirmation responses, and the auditor's expectation of similar results if procedures were performed pursuant to paragraph .24, the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details.¹¹ The auditor should document any such determination in accordance with AS 1215, *Audit Documentation*.

Note: Obtaining external information indirectly may include, for example, obtaining from the company information such as subsequent cash receipts, shipping documents from third-party carriers, purchase orders, or signed contracts and amendments thereto, that the company received, in electronic form or in paper form, from one or more knowledgeable external sources.

Selecting Individual Items of Cash and Accounts Receivable

.26 In selecting the individual items of cash for which audit evidence should be obtained, the auditor should take into account the auditor's understanding of the company's cash management and treasury function, and the substance of the company's arrangements and transactions with third parties.

.27 In selecting the individual accounts receivable for which audit evidence should be obtained, the auditor should take into account the auditor's understanding of the substance of the

¹¹ Under PCAOB standards, in general evidence obtained directly by the auditor is more reliable than evidence obtained indirectly. *See* AS 1105.08. In addition, AS 1105 establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence and AS 2810 establishes requirements regarding the auditor's evaluation of audit results and determination of whether sufficient appropriate audit evidence has been obtained.

company's arrangements and transactions with third parties and the nature of items that make up account balances.

Communicating with the Audit Committee

.28 Under paragraph .09 of AS 1301, *Communications with Audit Committees*, the auditor should discuss with the audit committee the significant risks of material misstatement identified through the auditor's risk assessment procedures. In addition, for significant risks associated with either cash or accounts receivable, the auditor should communicate when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source in accordance with paragraph .24.¹²

Other Considerations

.29 In addition to obtaining audit evidence from a knowledgeable external source regarding cash in accordance with paragraph .24, the auditor should consider sending confirmation requests to that source about other financial relationships with the company, based on the assessed risk of material misstatement. Examples of other financial relationships are lines of credit, other indebtedness, compensating balance arrangements, or contingent liabilities, including guarantees.

.30 For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk. Examples of such terms may include terms related to: (i) oral side agreements, or undisclosed written or oral side agreements, where the auditor has reason to

¹² The term "audit committee," as used in this standard, has the same meaning as defined in Appendix A of AS 1301. The communication to the audit committee should be made and documented in accordance with AS 1301.25 and .26.

believe that such agreements may exist, (ii) bill and hold sales,¹³ and (iii) supplier discounts or concessions.

Evaluating the Results

.31 AS 2810 establishes requirements regarding the auditor's evaluation of audit results and determination of whether the auditor has obtained sufficient appropriate audit evidence.¹⁴ In performing this evaluation, the auditor should take into account all relevant audit evidence provided by confirmation procedures,¹⁵ alternative procedures, and other procedures to determine whether sufficient appropriate audit evidence has been obtained about the relevant financial statement assertions.¹⁶

APPENDIX A – Definitions

.A1 For purposes of this standard, the terms listed below are defined as follows:

.A2 Confirmation exception – Information in a confirmation response that differs from information the auditor obtained from the company.

.A3 Confirmation process – The process that involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions.

¹³ Bill and hold sales are sales of merchandise that are billed to customers before delivery and are held by the entity for the customers.

¹⁴ See AS 2810.01.

¹⁵ Evaluating evidence provided by confirmation procedures includes, for example, the evaluation of confirmation exceptions in accordance with paragraph .20.

¹⁶ AS 2810.35 addresses situations where the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion.

.A4 Confirmation request – A request from the auditor to a confirming party regarding information about one or more particular accounts, balances, transactions, or other items as a means of obtaining audit evidence about one or more financial statement assertions.

.A5 Confirmation response – Information obtained as a direct written communication (in paper or electronic form) to the auditor from a confirming party in response to a confirmation request.

.A6 Confirming party – A third party, whether an individual or an organization, to which the auditor sends a confirmation request.

.A7 Negative confirmation request – A confirmation request in which the auditor requests a confirmation response only if the confirming party disagrees with the information provided in the confirmation request.

.A8 Nonresponse – A situation in which (i) after sending a confirmation request, the request is returned undelivered; (ii) the auditor does not receive a confirmation response to a positive confirmation request directly from the intended confirming party; (iii) the auditor receives correspondence from the intended confirming party indicating that the confirming party is unable or unwilling to respond to the confirmation request; or (iv) the auditor receives an oral response only.

.A9 Positive confirmation request – A confirmation request in which the auditor requests a confirmation response.

APPENDIX B – Evaluating the Implications of Using an Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses

.B1 Paragraph .17 requires that the auditor evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the

auditor and the confirming party on the reliability of confirmation requests and responses. In performing the evaluation, the auditor should:

- a. Obtain an understanding of the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses.
- b. Determine whether the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively.

Note: If the auditor performs procedures to determine whether the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively at an interim date, the auditor should evaluate whether the results of the procedures can be used during the period the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses or whether additional procedures need to be performed to update the results. In performing the evaluation, the auditor should consider the length of time between the date of the procedures and the period the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses, and the nature and extent of any changes in the process and controls used by the intermediary during that time.

- c. Assess the relationship of the intermediary with the company – specifically, whether circumstances exist that give the company the ability to override the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses (e.g., through financial, ownership, or other business relationships, contractual rights, or otherwise).

.B2 If the auditor determines that (i) the intermediary has not implemented controls that are designed and operating effectively to address the risk of interception and alteration of the confirmation requests and responses and the auditor cannot address such risk by performing other audit procedures beyond inquiry, or (ii) circumstances exist that give the company the ability to override the intermediary's controls, the auditor should not use the intermediary to send confirmation requests or receive confirmation responses. In this case, the auditor should send confirmation requests for the selected items without the use of an intermediary or, if unable to do so, perform alternative procedures in accordance with Appendix C.

Appendix C – Performing Alternative Procedures for Selected Items

.C1 When the auditor is unable to obtain relevant and reliable audit evidence about the selected item through confirmation, performing other audit procedures may be necessary. In addition, the auditor should evaluate the implications for the auditor's assessment of the relevant risks of material misstatement, including fraud risks.¹⁷

.C2 Paragraphs .11 (inability to identify a confirming party), .19 (unreliable response), .23 (nonresponse or incomplete response), and .B2 (inability to use an intermediary) discuss certain situations in which the auditor should perform alternative procedures. The following are examples of alternative procedures that individually or in combination may provide relevant and reliable audit evidence for the selected item:¹⁸

¹⁷ If the auditor is unable to obtain sufficient appropriate audit evidence about a relevant assertion, the auditor considers the impact on the audit opinion in accordance with AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*.

¹⁸ Performing alternative procedures that involve obtaining information from knowledgeable external sources will generally provide more relevant and reliable audit evidence than performing alternative procedures that involve obtaining information from only internal company sources.

- a. For cash items, verifying information about the company's cash account maintained in a financial institution's information system by viewing this information directly on a secure website of the financial institution.
- b. For accounts receivable items, examining one or more of the following:
 - (i) subsequent cash receipts, including comparing the receipts with the amounts of the respective invoices being paid, (ii) shipping documents, or (iii) other supporting documentation (e.g., purchase orders or signed contracts and amendments thereto).
- c. For terms of a transaction or agreement, inspecting the signed contract and amendments thereto, comparing contractual terms to industry norms, and discussing and verifying significant information with other parties involved in the transaction or agreement (e.g., banks, guarantors, agents, or attorneys).
- d. For accounts payable items, examining one or more of the following:
 - (i) subsequent cash disbursements, (ii) correspondence from vendors and suppliers, or (iii) other supporting documentation.

Note: Performing alternative procedures for items for which the auditor was not able to complete the audit procedures may not be necessary if these items,¹⁹ in the aggregate, and when added to the sum of all other uncorrected misstatements in relation to the account, would not change the outcome of the auditor's evaluation performed in accordance with AS 2810.17.

¹⁹ The auditor would treat the items as 100 percent misstatements and, when sampling is used, project the misstatements to the populations from which the sample was selected in accordance with AS 2315.26.

AMENDMENTS TO RELATED PCAOB AUDITING STANDARDS

In connection with the amendments to PCAOB auditing standards adopted by the Board, the Board has adopted conforming amendments to its auditing standards.

Amendment to AS 1105, *Audit Evidence*

- I. AS 1105 is amended by revising paragraph .18 and footnote 10 to paragraph .18, such that revised AS 1105.18 reads as follows:

.18 A confirmation response is information obtained as a direct written communication (in paper or electronic form) to the auditor from a confirming party in response to a confirmation request in accordance with PCAOB standards.¹⁰

¹⁰ See AS 2310, *The Auditor's Use of Confirmation*. The terms "confirmation response," "confirmation request," and "confirming party," as used in this standard, have the same meaning as defined in Appendix A of AS 2310.

Amendment to AS 1301, *Communications with Audit Committees*

- II. AS 1301 is amended by adding a bullet at the end of Appendix B to read as follows:
- AS 2310, *The Auditor's Use of Confirmation*, paragraph .28.

Amendments to AS 2401, *Consideration of Fraud in a Financial Statement Audit*

- III. AS 2401 is amended by revising footnote 21 to paragraph .54 to read as follows:

²¹ AS 2310, *The Auditor's Use of Confirmation*, establishes requirements regarding the use of confirmation in audits of financial statements.

- IV. AS 2401 is amended by revising the note to paragraphs .66A to read as follows:

Note: AS 2301.11A requires the auditor to take into account the types of potential misstatements that could result from significant unusual transactions in designing and performing further audit procedures. Additionally, AS 2310.30 states that for significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk. Examples of such terms may include terms related to: (i) oral side agreements, or undisclosed written or oral side agreements, where the auditor has reason to believe that such agreements may exist, (ii) bill and hold sales, and (iii) supplier discounts or concessions.

Amendment to AS 2510, *Auditing Inventories*

- V. AS 2510 is amended by adding footnote 1 to paragraph .14, such that revised AS 2510.14 reads as follows:

.14 If inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian.¹ If such inventories represent a significant proportion of current or total assets, to obtain reasonable assurance with respect to their existence, the auditor should apply one or more of the following procedures as he considers necessary in the circumstances.

- a. Test the owner's procedures for investigating the warehouseman and evaluating the warehouseman's performance.
- b. Obtain an independent accountant's report on the warehouseman's control procedures relevant to custody of goods and, if applicable, pledging of receipts, or

apply alternative procedures at the warehouse to gain reasonable assurance that information received from the warehouseman is reliable.

- c. Observe physical counts of the goods, if practicable and reasonable.
- d. If warehouse receipts have been pledged as collateral, confirm with lenders pertinent details of the pledged receipts (on a test basis, if appropriate).

¹ See AS 2310, *The Auditor's Use of Confirmation*, which establishes requirements regarding obtaining audit evidence from a knowledgeable external source through the auditor's use of confirmation.

Amendments to AS 2605, Consideration of the Internal Audit Function

VI. AS 2605 is amended by revising paragraph .22 to read as follows:

.22 On the other hand, for certain assertions related to less material financial statement amounts where the risk of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is low, the auditor may decide, after considering the circumstances and the results of work (either tests of controls or substantive tests) performed by internal auditors on those particular assertions, that audit risk has been reduced to an acceptable level and that testing of the assertions directly by the auditor may not be necessary. Assertions about the existence of prepaid assets and fixed-asset additions are examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to AS 2201.18-.19 regarding assessing the interrelationship of the nature of the controls and the competence and objectivity of those who performed the work.

VII. AS 2605 is amended by revising paragraph .27 and adding footnote 7A to paragraph .27, such that revised AS 2605.27 reads as follows:

.27 In performing the audit, the auditor may request direct assistance from the internal auditors, except when PCAOB standards require procedures to be performed by the auditor.^{7A} This direct assistance relates to work the auditor specifically requests the internal auditors to perform to complete some aspect of the auditor's work. For example, internal auditors may assist the auditor in obtaining an understanding of internal control or in performing tests of controls or substantive tests, consistent with the guidance about the auditor's responsibility in paragraphs .18 through .22. When direct assistance is provided, the auditor should assess the internal auditors' competence and objectivity (*see* paragraphs .09 through .11) and supervise,⁸ review, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances. The auditor should inform the internal auditors of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible accounting and auditing issues. The auditor should also inform the internal auditors that all significant accounting and auditing issues identified during the audit should be brought to the auditor's attention.

^{7A} *See, e.g.,* paragraph .15 of AS 2310, *The Auditor's Use of Confirmation*, which states that the auditor should (i) select items to be confirmed, (ii) send confirmation requests, and (iii) receive confirmation responses.

⁸ *See* AS 1201, *Supervision of the Audit Engagement*, for the type of supervisory procedures to apply.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-XXXXX; File No. PCAOB-2023-02)

[Date]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on the Auditor's Use of Confirmation, and Other Amendments to Related PCAOB Standards

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on [Date of Form 19b-4 Submission], the Public Company Accounting Oversight Board (the "Board" or "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or "SEC") the proposed rules described in Items I and II below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On September 28, 2023, the Board adopted amendments to auditing standards for the auditor's use of confirmation, and amendments to related PCAOB standards (collectively, the "proposed rules"), including the retitling and replacement of an existing standard with a new standard. The text of the proposed rules appears in Exhibit A to the SEC Filing Form 19b-4 and is available on the Board's website at <https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-028-proposed-auditing-standard-related-to-confirmation> and at the Commission's Public Reference Room.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The

Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. In addition, the Board is requesting that the Commission approve the proposed rules, pursuant to Section 103(a)(3)(C) of the Act, for application to audits of emerging growth companies (“EGCs”), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934 (“Exchange Act”). The Board's request is set forth in section D.

A. Board’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

(a) Purpose

Summary

The Board is replacing AS 2310, *The Confirmation Process*, in its entirety with a new standard, AS 2310, *The Auditor’s Use of Confirmation* (“new standard”) to strengthen and modernize the requirements for the confirmation process. As described in the new standard, the confirmation process involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party (e.g., a financial institution), evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions. If properly designed and executed by an auditor, the confirmation process may provide important evidence that the auditor obtains as part of an audit of a company’s financial statements.

Why the Board is Adopting These Changes Now

AS 2310 is an important standard for audit quality and investor protection, as the audit confirmation process touches nearly every audit. The standard was initially written over 30 years ago and has had minimal amendments since its adoption by the PCAOB in 2003.

The Board adopted the new standard after substantial outreach, including several rounds of public comment. The PCAOB previously considered updating AS 2310 by issuing a concept release in 2009 and a proposal in 2010 for a new auditing standard that would supersede AS

2310. While the PCAOB did not amend or replace AS 2310 at that time, subsequent developments – including the increasing use of electronic communications and third-party intermediaries in the confirmation process – led the Board to conclude that enhancements to AS 2310 and modifications to the approach proposed in 2010 could improve the quality of audit evidence obtained by auditors. In addition, the Board has observed continued inspection findings related to auditors’ use of confirmation, as well as enforcement actions involving failures to adhere to requirements in the existing auditing standard regarding confirmation, such as the requirement for the auditor to maintain control over the confirmation process.

Accordingly, having considered these developments and input from commenters, the Board revisited the previously proposed changes and issued a new proposed standard to replace AS 2310, along with conforming amendments to other PCAOB auditing standards, in December 2022. Commenters generally supported the Board’s objective of improving the confirmation process, and suggested areas to further improve the new standard, modify proposed requirements that would not likely improve audit quality, and clarify the application of the new standard. In adopting the new standard and related amendments, the Board has taken into account all of these comments, as well as observations from PCAOB oversight activities.

Key Provisions of the New Standard

The new standard and related amendments are intended to enhance the PCAOB’s requirements 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. In addition, the new standard is more expressly integrated with the PCAOB’s risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor’s

responsibilities for obtaining relevant and reliable audit evidence through the confirmation process. Among other things, the new standard:

- Includes a new requirement regarding confirming cash and cash equivalents held by third parties (“cash”), or otherwise obtaining relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source;
- Carries forward the existing requirement regarding confirming accounts receivable, while addressing situations where it would not be feasible for the auditor to perform confirmation procedures or obtain relevant and reliable audit evidence for accounts receivable by directly accessing information maintained by a knowledgeable external source;
- States that the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence (and includes examples of situations where the auditor may use negative confirmation requests to supplement other substantive audit procedures);
- Emphasizes the auditor’s responsibility to maintain control over the confirmation process and provides that the auditor is responsible for selecting the items to be confirmed, sending confirmation requests, and receiving confirmation responses; and
- Identifies situations in which alternative procedures should be performed by the auditor (and includes examples of such alternative procedures that may provide relevant and reliable audit evidence for a selected item).

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

B. Board’s Statement on Burden on Competition

Not applicable. The Board's consideration of the economic impacts of the proposed rules is discussed in section D below.

C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed rules for public comment in PCAOB Release No. 2022-009 (Dec. 20, 2022) ("2022 Proposal"). The Board previously issued a concept release for public comment in PCAOB Release No. 2009-002 (Apr. 14, 2009) ("2009 Concept Release") and a proposed auditing standard related to confirmation and related amendments to PCAOB standards in PCAOB Release No. 2010-003 (July 13, 2010) ("2010 Proposal"). The Board received 98 written comment letters relating to the 2022 Proposal, the 2009 Concept Release, and the 2010 Proposal. The Board has carefully considered all comments received. The Board's response to the comments it received and the changes made to the rules in response to the comments received are discussed below.

Background

Information obtained by the auditor directly from knowledgeable external sources, including through confirmation, can be an important source of evidence obtained as part of an audit of a company's financial statements.¹ Confirmation has long been used by auditors. For example, one early auditing treatise noted the importance of confirmation for cash deposits, accounts receivable, and demand notes.² In addition, confirmation of accounts receivable has been a required audit procedure in the United States since 1939, when the American Institute of

¹ See, e.g., paragraph 08 of AS 1105, *Audit Evidence* (providing that, in general, "[e]vidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources").

² Robert H. Montgomery, *Auditing Theory and Practice* 91 (confirmation of cash deposits), 263 (confirmation of accounts receivable), and 353 (confirmation of demand notes) (1912).

Accountants³ adopted Statement on Auditing Procedure No. 1 (“SAP No. 1”) as a direct response to the *McKesson & Robbins* fraud case, which involved fraudulently reported inventories and accounts receivable that the independent auditors failed to detect after performing other procedures that did not involve confirmation.⁴

SAP No. 1 required confirmation of accounts receivable by direct communication with customers in all independent audits of financial statements, subject to the auditor’s ability to overcome the presumption to confirm accounts receivable for certain reasons. Following the adoption of SAP No. 1, the accounting profession also adopted a requirement in 1942, which remained in effect until the early 1970s, that auditors should disclose in the auditor’s report when confirmation of accounts receivable was not performed. The AICPA’s subsequent revisions to its auditing standards included the promulgation of AU sec. 330, *The Confirmation Process*, which was adopted in 1991 and took effect in 1992. The PCAOB adopted AU sec. 330 (now AS 2310) as an interim standard in 2003.⁵

The amendments to the standards for the auditor’s use of confirmation are intended to improve audit quality through principles-based requirements that apply to all methods of confirmation and are more expressly integrated with the Board’s risk assessment standards. These enhancements should also lead to improvements in practice, commensurate with the

³ The American Institute of Accountants was the predecessor to the American Institute of CPAs (“AICPA”).

⁴ See *In the Matter of McKesson & Robbins, Inc.*, SEC Rel. No. 34-2707 (Dec. 5, 1940).

⁵ Shortly after the Board’s inception, the Board adopted the existing standards of the AICPA, as in existence on Apr. 16, 2003, as the Board’s interim auditing standards. See *Establishment of Interim Professional Auditing Standards*, PCAOB Rel. No. 2003-006 (Apr. 18, 2003). AU sec. 330 was one of these auditing standards. As of Dec. 31, 2016, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated number system, at which time AU sec. 330 was designated AS 2310. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Rel. No. 2015-002 (Mar. 31, 2015).

associated risk, among audit firms of all sizes. The expected increase in audit quality should also enhance the credibility of information provided in a company's financial statements.

Rulemaking History

The final amendments to the auditing standards reflect public comments on a concept release and two proposals. In April 2009, the PCAOB issued a concept release seeking public comment on the potential direction of a standard-setting project that could result in amendments to the PCAOB's existing standard on the confirmation process or a new auditing standard that would supersede the existing standard.⁶ The 2009 Concept Release discussed existing requirements and posed questions about potential amendments to those requirements.

In July 2010, the PCAOB proposed an auditing standard that, if adopted, would have superseded the existing confirmation standard.⁷ The 2010 Proposal was informed by comments on the 2009 Concept Release and was intended to strengthen the existing standard by, among other things, expanding certain requirements and introducing new requirements. In general, commenters on the 2010 Proposal supported updating the existing standard to address relevant developments in audit practice, including greater use of emailed confirmation requests and responses and the involvement of third-party intermediaries. At the same time, some commenters asserted that the proposed requirements in the 2010 Proposal were unduly prescriptive (i.e., included too many presumptively mandatory requirements) and would result in a significant increase in the volume of confirmation requests without a corresponding increase in the quality of audit evidence obtained by the auditor. The PCAOB did not adopt the 2010 Proposal.

⁶ *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*, PCAOB Rel. No. 2009-002 (Apr. 14, 2009).

⁷ *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*, PCAOB Rel. No. 2010-003 (July 13, 2010).

In December 2022, the Board issued a proposed auditing standard to improve the quality of audits when confirmation is used by the auditor and to reflect changes in the means of communication and in business practice since the standard was originally issued.⁸ The 2022 Proposal was informed by comments on the 2009 Concept Release and 2010 Proposal and specified the auditor’s responsibilities regarding the confirmation process. The Board received 46 comment letters on the 2022 Proposal from commenters across a range of affiliations. Those comments are discussed throughout this release. Commenters on the 2022 Proposal generally expressed support for the project’s objective and suggested ways to revise or clarify the proposed standard. The Board considered the comments on the 2022 Proposal, as well as on the 2009 Concept Release and the 2010 Proposal, in developing the final amendments.⁹ The Board also considered observations from PCAOB oversight activities.

Existing Standard

This section discusses key provisions of the existing PCAOB auditing standard on the confirmation process.

In 2003, the PCAOB adopted the standard now known as AS 2310 (at that time, AU sec. 330), when it adopted the AICPA’s standards then in existence. Existing AS 2310 indicates that confirmation is the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement

⁸ *Proposed Auditing Standard –The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2022-009 (Dec. 20, 2022). In this exhibit, the term “proposed standard” refers to the proposed auditing standard relating to the auditor’s use of confirmation as described in the 2022 Proposal.

⁹ The comment letters received on the 2009 Concept Release, 2010 Proposal, and 2022 Proposal are available in the docket for this rulemaking on the PCAOB’s website (<https://pcaobus.org/Rulemaking/Pages/Docket028Comments.aspx>).

assertions.¹⁰ For example, an auditor might request a company's customers to confirm balances owed at a certain date, or request confirmation of a company's accounts or loans payable to a bank at a certain date.

Key provisions of existing AS 2310 include the following:

- A presumption that the auditor will request confirmation of accounts receivable. The standard states that confirmation of accounts receivable is a generally accepted auditing procedure and provides the situations in which the auditor may overcome the presumption.
- 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.
- Procedures relating to the use of both positive and negative confirmation requests. A positive confirmation request directs the recipient to send a response back to the auditor stating the recipient's agreement or disagreement with information stated in the request, or furnishing requested information. A negative confirmation request directs the recipient to respond back to the auditor only when the recipient disagrees with information in the auditor's request. The standard states that "[n]egative confirmation requests may be used to reduce audit risk to an acceptable level when (a) the combined assessed level of inherent and control risk is low, (b) a large number of small balances is involved, and (c) the auditor has no reason to believe that the

¹⁰ Under PCAOB standards, financial statement assertions can be classified into the following categories: existence or occurrence, completeness, valuation or allocation, rights and obligations, and presentation and disclosure. *See, e.g.,* AS 1105.11.

recipients of the requests are unlikely to give them consideration.”¹¹ If negative confirmation requests are used, the auditor should consider performing other substantive procedures to supplement their use.¹²

- A requirement for the auditor to maintain control over confirmation requests and responses by establishing direct communication between the intended recipient and the auditor.
- Procedures to consider when the auditor does not receive a written confirmation response via return mail, including how the auditor should evaluate the reliability of oral and facsimile responses to written confirmation requests. The standard provides that, when confirmation responses are in other than a written format mailed to the auditor, additional evidence may be necessary to establish the validity of the respondent.
- A requirement that the auditor should perform alternative procedures when the auditor has not received a response to a positive confirmation request.
- Requirements for the auditor’s evaluation of the results of confirmation procedures and any alternative procedures performed by the auditor. These provisions include the requirement that, if the combined evidence provided by confirmation, alternative procedures, and other procedures is not sufficient, the auditor should request additional confirmations or extend other tests, such as tests of details or analytical procedures.

Current Practice

¹¹ See AS 2310.20.

¹² *Id.*

This section discusses the Board's understanding of current practice based on, among other things, observations from oversight activities of the Board and SEC enforcement actions.

Overview of Current Practice

The audit confirmation process touches nearly every financial statement audit conducted under PCAOB auditing standards. This is due in part to the presumption in existing AS 2310 that the auditor will confirm accounts receivable, which include claims against customers that have arisen from the sale of goods or services in the normal course of business and a financial institution's loans, unless certain exemptions apply. In addition, audit methodologies of many larger audit firms affiliated with global networks recommend or require confirming cash accounts. In the past, the use of confirmation was a common practice for auditing a financial institution's customer deposits. In recent years, however, there has been an increased wariness about phishing attempts by unauthorized parties aimed at obtaining sensitive personal or financial information of customers. As a result, some customers might not understand or trust an -unsolicited confirmation request from an auditor and, indeed, many financial institutions and other companies now advise customers not to reply to unsolicited correspondence concerning their accounts or other customer relationships.¹³

Existing AS 2310 was written at a time when paper-based confirmation requests and responses were the prevailing means of communication. Since then, emailed confirmation requests and responses, and the use of technology-enabled confirmation tools, including the use of intermediaries to facilitate the confirmation process, have become commonplace. For example, numerous financial institutions in the United States, and an increasing number of

¹³ Situations that involve using audit procedures other than confirmation and situations where companies adopt the policy of responding to electronic confirmation requests from auditors only through an intermediary are discussed later in this exhibit.

international banks, mandate the use of an intermediary as part of the confirmation process and will not otherwise respond to an auditor's confirmation request.

As noted above, existing AS 2310 provides that the auditor should maintain control over the confirmation process. In practice, complying with this requirement involves the auditor directly sending the confirmation request to the confirming party via mail or email, without involving company personnel. The auditor's confirmation request generally specifies that any correspondence should be sent directly to the auditor's location (or email address) to minimize the risk of interference by company personnel. When an intermediary facilitates direct electronic communications between the auditor and the confirming party, the auditor is still required to maintain control over the confirmation process. Procedures performed by audit firms to address this requirement vary depending on facts and circumstances. Some auditors have used a report on controls at a service organization ("SOC report") to evaluate the design and operating effectiveness of the intermediary's controls relevant to sending and receiving confirmations.

Under the existing standard, auditors can use positive confirmation requests and, provided certain conditions are met, negative confirmation requests. A positive confirmation request either asks the recipient to respond directly to the auditor about whether the recipient agrees with information that is stated in the request or asks the recipient to provide the requested information by filling in a blank form. In comparison, a negative confirmation request directs the recipient to respond only when the recipient disagrees with the information included in the request. In practice, negative confirmation requests have typically been used to obtain audit evidence related to the completeness of deposit liabilities and other accounts of a similar nature and, less frequently, to obtain evidence related to the existence of accounts receivable. In some cases, auditors use a combination of positive and negative confirmation requests.

Observations from Inspections and Enforcement Actions

This section discusses observations from PCAOB oversight activities and SEC enforcement actions, including (1) PCAOB inspections of registered public accounting firms (“firms”) and (2) enforcement actions relating to deficient confirmation procedures performed by the auditor. These observations have informed the Board’s view that providing greater clarity as the Board strengthens the requirements could result in improved compliance by auditors.

Inspections. Over the past several years, PCAOB inspections indicated that some auditors did not fulfill their responsibilities under the existing standard when performing confirmation procedures. The shortcomings have been noted at large and small domestic firms, and at large firms with domestic and international practices. For example, some auditors did not: (1) consider performing procedures to verify the source of confirmation responses received electronically; (2) perform sufficient alternative procedures; (3) restrict the use of negative confirmation requests to situations where the risk of material misstatement was assessed as low; or (4) maintain appropriate control over the confirmation process, including instances where company personnel were involved in either sending or receiving confirmations.

The PCAOB has also continued to monitor developments relating to the use of confirmation through its other oversight and research activities. For example, in 2021, the PCAOB staff issued a Spotlight discussing, among other things, the use of technology in the confirmation process.¹⁴ In addition, in 2022, the PCAOB staff issued a Spotlight that specifically discussed observations and reminders on the use of a service provider in the confirmation process.¹⁵

¹⁴ See *Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>.

¹⁵ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation*

Enforcement actions. Over the years, there have been a number of enforcement actions by the PCAOB and the SEC alleging that auditors failed to comply with PCAOB standards related to the confirmation process. Enforcement actions have been brought against large and small firms, and against U.S. and non-U.S. firms.

For example, PCAOB enforcement cases have involved allegations that auditors failed to: (1) perform appropriate confirmation procedures to address a fraud risk;¹⁶ (2) adequately respond to contradictory audit evidence obtained from confirmation procedures;¹⁷ (3) perform appropriate confirmation procedures and alternative procedures for accounts receivable;¹⁸ or (4) maintain proper control over the confirmation process.¹⁹

In several confirmation-related enforcement cases, the SEC alleged that the deficient confirmation procedures by the auditors involved companies that had engaged in widespread fraud, where properly performed confirmation procedures might have led to the detection of the fraudulent activity.²⁰ Further, in a number of proceedings, the SEC alleged that confirmation

Process (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

¹⁶ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Whitley Penn LLP*, PCAOB Rel. No. 105-2020-002 (Mar. 24, 2020); *In the Matter of PMB Helin Donovan, LLP*, PCAOB Rel. No. 105-2019-031 (Dec. 17, 2019); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015).

¹⁷ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

¹⁸ See, e.g., *In the Matter of Whitley Penn LLP*, PCAOB Rel. No. 105-2020-002 (Mar. 24, 2020); *In the Matter of PMB Helin Donovan, LLP*, PCAOB Rel. No. 105-2019-031 (Dec. 17, 2019); *In the Matter of Wander Rodrigues Teles*, PCAOB Rel. No. 105-2017-007 (Mar. 20, 2017); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

¹⁹ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

²⁰ See, e.g., *In the Matter of CohnReznick LLP*, SEC Rel. No. 34-95066 (June 8, 2022); *In the Matter of Ravindranathan Raghunathan, CPA*, SEC Rel. No. 34-93133 (Sept. 27, 2021); *In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020); *In the Matter of Schulman Lobel Zand Katzen Williams & Blackman, LLP A/K/A Schulman Lobel LLP*, SEC Rel. No. 34-88653 (Apr. 15, 2020); *In the Matter of William Joseph Kouser Jr., CPA*, SEC Rel. No. 34-80370 (Apr. 4, 2017).

procedures were not properly designed²¹ or, more frequently, that the auditors failed to adequately evaluate responses to confirmation requests and perform alternative or additional procedures in light of exceptions, nonresponses, or responses that should have raised issues as to their reliability or the existence of undisclosed related parties.²² Several of these proceedings were brought in recent years, suggesting that problems persist in this area.

Reasons to Improve Auditing Standards

The amendments to PCAOB standards being adopted are intended to enhance audit quality by clarifying and strengthening the requirements for the auditor's use of confirmation. The final amendments are also more expressly integrated with the PCAOB's risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor's responsibilities for obtaining relevant and reliable audit evidence through the confirmation process. The Board believes that these improvements will enhance both audit quality and the credibility of the information provided in a company's financial statements.

Areas of Improvement

The Board has identified two important areas where improvements are warranted to existing standards, discussed below: (1) updating the standards to reflect developments in

²¹ See, e.g., *In the Matter of RSM US LLP*, SEC Rel. No. 34-95948 (Sept. 30, 2022); *In the Matter of Ravindranathan Raghunathan, CPA*, SEC Rel. No. 34-93133 (Sept. 27, 2021); *In the Matter of Winter, Kloman, Moter & Repp, S.C.*, SEC Rel. No. 34-83168 (May 4, 2018); *In the Matter of Edward Richardson, Jr., CPA*, SEC Rel. No. 34-80918 (June 14, 2017).

²² See, e.g., *In the Matter of Jason Jianxun Tang, CPA*, SEC Rel. No. 34-96347 (Nov. 17, 2022); *In the Matter of Steven Kirn, CPA*, SEC Rel. No. 34-95949 (Sept. 30, 2022); *In the Matter of Friedman LLP*, SEC Rel. No. 34-95887 (Sept. 23, 2022); *In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020); *In the Matter of Schulman Lobel Zand Katzen Williams & Blackman, LLP A/K/A Schulman Lobel LLP*, SEC Rel. No. 34-88653 (Apr. 15, 2020); *In the Matter of Anton & Chia, LLP*, SEC Rel. No. 34-87033 (Sept. 20, 2019); *In the Matter of Edward Richardson, Jr., CPA*, SEC Rel. No. 34-80918 (June 14, 2017); *In the Matter of William Joseph Kouser Jr., CPA*, SEC Rel. No. 34-80370 (Apr. 4, 2017).

practice and (2) clarifying the auditor's responsibilities to evaluate the reliability of evidence obtained through confirmation responses.

Updating the Standards to Reflect Developments in Practice

The new standard supports the auditor's use of electronic forms of communication between the auditor and the confirming party. Since the AICPA standard on the confirmation process adopted by the PCAOB took effect in 1992, there has been a significant change in the auditing environment and the means by which an auditor communicates with confirming parties. Emails and other forms of electronic communications between auditors and confirming parties have become ubiquitous, and third-party intermediaries now often facilitate the electronic transmission of confirmation requests and responses between auditors and confirming parties.

In addition, the Board believes its auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence. Traditionally, auditors have used confirmation in circumstances where reliable evidence about financial statement assertions could be obtained directly from a third party that transacts with the company (e.g., to confirm the existence of cash or accounts receivable). Generally, audit evidence obtained directly from knowledgeable external sources, including through confirmation, has been viewed as more reliable than evidence obtained through other audit procedures available to the auditor,²³ especially where the auditor identified a risk of fraud, chose not to test controls, or determined that controls could not be relied on.²⁴

²³ The confirmation process involves obtaining audit evidence from a confirming party. Under PCAOB standards, in general, evidence obtained from a knowledgeable source that is independent from the company is more reliable than evidence obtained only from internal company sources. *See, e.g.*, AS 1105.08.

²⁴ *See, e.g.*, Staff Audit Practice Alert No. 8, *Audit Risks in Certain Emerging Markets* (Oct. 3, 2011) ("SAPA No. 8") at 11 (stating that, when an auditor has identified fraud risks relating to a company's bank accounts or amounts due from customers, "it is important for the auditor to confirm amounts included in the company's financial statements directly with a knowledgeable individual from the bank or customer who is objective and free

The PCAOB staff's research indicates that some audit firms may have developed or may yet develop audit techniques that enable the auditor to obtain relevant and reliable audit evidence for the same assertions by performing substantive audit procedures that do not include confirmation, as discussed in more detail below. To reflect these developments, the new standard allows the performance of other procedures in lieu of confirmation for cash and accounts receivable in situations where the auditor can obtain relevant and reliable audit evidence by directly accessing information maintained by knowledgeable external sources. Further, the new standard acknowledges that, in certain situations, it may not be feasible for the auditor to obtain audit evidence for accounts receivable directly from a knowledgeable external source and provides that in those situations the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details.

*Clarifying the Auditor's Responsibilities to Evaluate the Reliability of
Confirmation Responses*

While information obtained through the confirmation process can be an important source of audit evidence, the confirmation process must be properly executed for the evidence obtained to be relevant and reliable. The enforcement actions discussed above and other recent high-profile financial reporting frauds have also called attention to the importance of well-executed confirmation procedures, including the confirmation of cash.²⁵ In addition, PCAOB oversight

from bias with respect to the audited entity rather than rely solely on information provided by the company's management"). The requirements of the new standard are consistent with the guidance in SAPA No. 8, which auditors should continue to consider when using confirmations to address fraud risks in emerging markets.

²⁵ See, e.g., *In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020) (failure by auditors to properly evaluate confirmation responses to requests for information on cash balances of a Mexican homebuilder subsequently found to have engaged in a "multi-billion dollar financial fraud"). See also Olaf Storbeck, Tabby Kinder, and Stefania Palma, *EY failed to check Wirecard bank statements for 3 years*, Financial Times (June 26, 2020) (potential failure by auditors to confirm cash balances purportedly held by Wirecard AG, a German company whose securities were not registered with the SEC, directly with a Singapore-based bank).

activities have identified instances in which auditors did not obtain sufficient appropriate audit evidence when using confirmation. Accordingly, the new standard includes a new requirement to confirm certain cash balances and clarifies the auditor's responsibilities to evaluate the reliability of evidence obtained through confirmation responses (and, when necessary, to obtain audit evidence through alternative procedures).

Comments on the Reasons for Standard Setting

Many commenters on the 2022 Proposal broadly expressed support for revisions to the Board's standard on the auditor's use of confirmation to reflect developments in practice since the AICPA standard on the confirmation process adopted by the PCAOB took effect in 1992. A number of commenters also agreed that the standard on the auditor's use of confirmation should be more closely aligned with the Board's risk assessment standards. In addition, some commenters stated that updates to the PCAOB's standard on the auditor's use of confirmation would be generally consistent with their prior recommendations to the Board that the Board modernize its interim auditing standards. Other commenters suggested that the Board should also engage in additional outreach with investors or that it consider other mechanisms to engage with stakeholders prior to the adoption of standards, such as roundtables and pre-implementation "field testing" of proposed standards.

In addition, several commenters expressed support for the proposition that the PCAOB's auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence. These commenters generally stated that standards should be written to evolve with future technologies, including new methods of confirmation that may arise from technological changes in auditing in the future. A few commenters stated that the 2022 Proposal provided flexibility to respond to the current use of technology in the audit process, or left

enough room for judgment-based application for further advances in technology. In comparison, some commenters stated that the proposed standard was not sufficiently forward-looking. Several commenters cautioned against more explicitly addressing the use of technology (i.e., by adding prescriptive requirements), noting that doing so might not allow the standard to age effectively with time and innovation.

Several commenters broadly expressed support for the Board's goal, as described in the 2022 Proposal, of improving the quality of audit evidence obtained by auditors when using confirmation. One of these commenters stated that it was critical that confirmation requests are properly designed and that confirmation responses are appropriately evaluated, especially when there are confirmation exceptions or concerns about their reliability. In addition, other commenters generally expressed support for the proposed requirements and stated they would lead to improvements in audit quality. A number of commenters, primarily firms and firm-related groups, asserted that certain requirements in the 2022 Proposal were unduly prescriptive and that the final standard should be more principles-based and risk-based to allow for more auditor judgment. In comparison, an investor-related group suggested that the Board remind auditors that, in exercising professional judgment, their judgments must be reasonable, careful, documented, and otherwise in compliance with applicable professional requirements.

In adopting the new standard, the Board has considered these comments on the 2022 Proposal, as well as the comments received on the 2010 Proposal and the 2009 Concept Release. Based on the information available to the Board – including the current regulatory baseline, observations from our oversight activities, academic literature, and comments – the Board believes that investors will benefit from strengthened and clarified auditing standards in this area. To the extent that commenters provided comments or expressed concerns about specific aspects

of the proposed revisions to the Board's existing standard on the auditor's use of confirmation, the Board's consideration of these comments is discussed further below and elsewhere in this exhibit. While the Board does not expect that the new standard will eliminate inspection deficiencies observed in practice, it is intended to clarify the auditor's responsibilities and align the requirements for the use of confirmation more closely with the PCAOB's risk assessment standards.

The new standard also reflects several changes that were made after the Board's consideration of comments received about the potential impact of the proposed new standard on auditors, issuers, and intermediaries. In addition, some commenters called for a broader alignment of PCAOB standards with standards issued by other standard setters, namely the International Auditing and Assurance Standards Board ("IAASB") and the AICPA's Auditing Standards Board ("ASB"). A few commenters stated that PCAOB standards should be harmonized with IAASB standards, in the interest of global comparability, and, in the view of one commenter, with ASB standards. A few commenters stated that the Board should provide robust and detailed explanations of differences between PCAOB standards and the standards of other standard setters. One commenter indicated that the dual standard-setting structure in the United States (i.e., the existence of both PCAOB and ASB standards) creates issues that could erode audit quality.

The Board carefully considered the approaches of other standard setters when developing the 2022 Proposal, and the new standard reflects the approach that the Board believes best protects investors and furthers the public interest. As a result, certain differences will continue to exist between the Board's new standard and those of other standard setters, including a number

of provisions that the Board believes are appropriate and consistent with its statutory mandate to protect the interests of investors and further the public interest.

Discussion of Final Rules

Overview of New Standard

The new standard replaces existing AS 2310 in its entirety. The provisions of the new standard the Board has adopted are intended to strengthen existing requirements for the auditor's use of confirmation. Key aspects of the new standard:

- *Include principles-based requirements that are designed to apply to all methods of confirmation.* The new standard is designed to enhance requirements that apply to longstanding methods, such as the use of paper-based confirmation requests and responses sent via regular mail; methods that involve electronic means of communications, such as the use of email or an intermediary to facilitate direct electronic transmission of confirmation requests and responses; and methods that are yet to emerge, thus encouraging audit innovation.
- *Expressly integrate the requirements for the auditor's use of confirmation with the requirements of the Board's risk assessment standards, including AS 1105.* The new standard specifies certain risk-based considerations and emphasizes the auditor's responsibilities for obtaining relevant and reliable audit evidence when performing confirmation procedures.
- *Emphasize the use of confirmation procedures in certain situations.* The new standard adds a new requirement that the auditor should perform confirmation procedures for cash held by third parties, carries forward an existing requirement that the auditor should perform confirmation procedures for accounts receivable, and adds a new

provision that the auditor may otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source for cash and accounts receivable. In addition, the new standard carries forward an existing requirement to consider confirming the terms of certain other transactions.

- *Address situations in which it would not be feasible for the auditor to obtain information directly from a knowledgeable external source.* The new standard provides that if it would not be feasible for the auditor to obtain audit evidence directly from a knowledgeable external source for accounts receivable, the auditor should perform other substantive audit procedures, including tests of details, that involve obtaining audit evidence from external sources indirectly.
- *Communicate to the audit committee certain audit responses to significant risks.* Under the new standard, for significant risks associated with cash or accounts receivable, the auditor is required to communicate with the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.
- *Reflect the relatively insignificant amount of audit evidence obtained when using negative confirmation requests.* Under the new standard, the use of negative confirmation requests may provide sufficient appropriate audit evidence only when combined with other substantive audit procedures. The new standard includes examples of situations in which the use of negative confirmation requests in combination with other substantive audit procedures may provide sufficient appropriate audit evidence.

- *Emphasize the auditor’s responsibility to maintain control over the confirmation process.* The new standard states that the auditor should select the items to be confirmed, send confirmation requests, and receive confirmation responses.
- *Provide more specific direction for circumstances where the auditor is unable to obtain relevant and reliable audit evidence through confirmation.* The new standard identifies situations where other procedures should be performed by the auditor as an alternative to confirmation. The new standard also includes examples of alternative procedures that individually or in combination may provide relevant and reliable audit evidence.

Introduction and Objective

(See paragraphs .01 and .02 of the new standard)

The 2022 Proposal included requirements for the auditor’s use of confirmation. As discussed in the proposal, the confirmation process involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions. Confirmation is one of the specific audit procedures described in PCAOB standards that an auditor could perform when addressing a risk of material misstatement.²⁶ As is the case with other audit procedures, information obtained through confirmation may support and corroborate management’s assertions or it may contradict such assertions.²⁷

²⁶ See, e.g., AS 1105.14 and .18.

²⁷ See AS 1105.02.

Under the 2022 Proposal, the auditor's objective in designing and executing the confirmation process was to obtain relevant and reliable audit evidence about one or more relevant financial statement assertions of a significant account or disclosure.²⁸ Existing AS 2310 does not include an objective.

As discussed below, the Board has modified the introduction and objective in the proposed standard in several respects.

A number of commenters stated that the objective of the proposed standard was clear. One commenter stated that the objective should be to provide requirements and guidance in situations where the auditor, as a result of its risk-assessment procedures, determines that confirmation procedures provide an appropriate response to one or more assertions related to an identified risk of material misstatement. Another commenter asserted that the objective in the proposed standard did not result in greater clarity than the proposed objective in the 2010 Proposal and created a wider gap between the PCAOB's standards and the equivalent standard of the IAASB.

Having considered these comments, the Board has revised the introduction to provide that the new standard establishes requirements regarding obtaining audit evidence from a knowledgeable external source through the auditor's use of confirmation. The introduction further states that the new standard includes additional requirements regarding obtaining audit evidence for cash, accounts receivable, and terms of certain transactions. The Board believes that this language more clearly aligns with the approach to the auditor's use of confirmation in the

²⁸ An account or disclosure is a significant account or disclosure if there is a reasonable possibility that the account or disclosure could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements, considering the risks of both overstatement and understatement. See footnote 33 of AS 2110, *Identifying and Assessing Risks of Material Misstatement*; paragraph .A10 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

new standard and the inclusion of specific requirements in the new standard with respect to cash, accounts receivable, and terms of certain transactions.

In addition, the Board has added the phrase “from a knowledgeable external source” to the objective, such that the new standard provides that the objective of the auditor in designing and executing the confirmation process is to obtain relevant and reliable audit evidence from a knowledgeable external source about one or more relevant financial statement assertions of a significant account or disclosure. This language underscores that, when properly designed and executed, the confirmation process involves obtaining audit evidence regarding specific items from a knowledgeable external source. A knowledgeable external source, as referred to in the new standard, generally is a third party who the auditor believes has knowledge of the information that may be used as audit evidence. To the extent that this objective differs from the objective in standards adopted by other standard-setting bodies on the auditor’s use of confirmation, the Board believes it appropriately reflects the Board’s approach in the new standard and is consistent with its statutory mandate to protect the interests of investors and further the public interest. The next section of this exhibit further discusses the relationship of the confirmation process to the auditor’s identification and assessment of, and response to, the risks of material misstatement.

Relationship of the Confirmation Process to the Auditor’s Identification and Assessment of and Response to the Risks of Material Misstatement

(See paragraphs .03 - .07 of the new standard)

When an auditor uses confirmation, the auditor should be mindful of, and comply with, the existing obligation to exercise due professional care in all matters relating to the audit.²⁹ Due

²⁹ See AS 1015, *Due Professional Care in the Performance of Work*. The Board currently has a

professional care requires the auditor to exercise professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of audit evidence. Professional skepticism should be exercised throughout the audit process,³⁰ including when identifying information to confirm, identifying confirming parties, evaluating confirmation responses, and addressing nonresponses. The requirements related to exercising professional skepticism, in combination with requirements in other PCAOB standards, are designed to reduce the risk of confirmation bias, a phenomenon wherein decision makers have been shown to actively seek out and assign more weight to evidence that confirms their hypothesis, and ignore or assign less weight to evidence that could disconfirm their hypothesis.³¹

The 2022 Proposal described how the proposed standard would work in conjunction with the PCAOB standards on risk assessment. AS 2110 establishes requirements regarding the process of identifying and addressing the risks of material misstatement of the financial statements, and AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding designing and implementing appropriate responses to the risks of material misstatement. Fundamental to the PCAOB's risk assessment standards is the concept that as risk increases, so does the amount of evidence that the auditor should obtain.³² Further, evidence obtained from a knowledgeable external source generally is more reliable than evidence obtained only from internal company sources.³³

separate standard-setting project to reorganize and consolidate a group of interim standards adopted by the Board in Apr. 2003, including AS 1015. *See Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2023-001 (Mar. 28, 2023).

³⁰ See AS 1015.07-.08.

³¹ For a discussion of confirmation bias, *see, e.g.*, Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 *Review of General Psychology*, 175 (1998).

³² See AS 1105.05.

³³ See AS 1105.08.

Where the auditor uses confirmation as part of the auditor's response, the 2022 Proposal addressed the auditor's responsibilities for designing and executing the confirmation process to obtain relevant and reliable audit evidence. When properly designed and executed, the confirmation process can be an effective and efficient way of obtaining relevant and reliable external audit evidence, including in situations where the auditor identifies an elevated risk of material misstatement due to error or fraud.

The 2022 Proposal also recognized that performing confirmation procedures can effectively and efficiently provide evidential matter about certain financial statement assertions, including existence, occurrence, completeness, and rights and obligations. For example, confirmation may provide audit evidence related to the existence of cash, accounts receivable, and financial instruments, or the completeness of debt. However, the confirmation process generally provides less relevant evidence about the valuation assertion (e.g., the confirming party may not intend to repay in full the amount owed, or the custodian may not know the value of shares held in custody). Confirmation could also be used to obtain audit evidence about the terms of contractual arrangements (e.g., by verifying supplier discounts or concessions, corroborating sales practices, or substantiating oral arrangements and guarantees). Information in confirmation responses may indicate the existence of related parties, or relationships or transactions with related parties, previously undisclosed to the auditor.

The Board also observed in the 2022 Proposal that, in some situations, an auditor may determine that evidence obtained through confirmation may constitute sufficient appropriate audit evidence for a particular assertion, while in other situations performing other audit procedures in addition to confirmation may be necessary to obtain sufficient appropriate audit evidence. For example, for significant unusual sales transactions and the resulting accounts

receivable balances, an auditor might confirm significant terms of the transactions and the receivable balances with the transaction counterparties and perform additional substantive procedures, such as examination of shipping documents and subsequent cash receipts.

Determining the nature, timing, and extent of confirmation procedures, and any other additional audit procedures, is part of designing and implementing the auditor's response to the assessed risk of material misstatement.

The Board adopted the provisions in the 2022 Proposal that address the relationship of the confirmation process to the auditor's identification and assessment of and response to the risks of material misstatement, with certain modifications discussed below.

Overall, commenters expressed support for aligning the proposed standard on confirmation with the PCAOB's existing risk assessment standards. Several commenters stated that they had not identified changes needed to the proposed standard to align further with the PCAOB's risk assessment standards. Other commenters, as discussed below, called for various changes to the proposed provisions:

- Several commenters suggested that there could be further alignment of the 2022 Proposal with the risk assessment standards to enable the level of risk to drive the nature of the audit response. A number of commenters asserted that the 2022 Proposal included certain prescriptive requirements for the confirmation process, regardless of the assessed level of risk, and that those provisions could detract from the auditor's ability to apply professional judgment to determine the appropriate audit response. Consistent with the objective of the new standard, the requirements under the new standard apply to a significant account or disclosure.³⁴ The new standard thus does not establish a

³⁴

AS 2110.59e directs the auditor to identify significant accounts and disclosures and their relevant

presumption to confirm cash or accounts receivable if the auditor has not determined cash or accounts receivable to be a significant account. The auditor may choose to perform confirmation procedures, however, in situations other than those specifically addressed in paragraphs .24 through .30 of the new standard. The new standard does not otherwise prescribe the timing or extent of confirmation procedures, which are discussed as part of the auditor's response to the risks of material misstatement in AS 2301.

- Several commenters stated that paragraphs .06 and .07 of the proposed standard overly emphasized confirmation as being the most persuasive substantive audit procedure, with any other procedure thereby viewed as being less persuasive. One commenter asserted that that the 2022 Proposal appeared to be premised on an assumption that third-party confirmations represent “first best” audit evidence, regardless of the facts and circumstances. In addition, one commenter questioned whether the Board intended for confirmation to be used whenever possible to obtain evidence. Having considered these comments, the Board has made several changes in the new standard to clarify certain provisions. In the new standard, the Board has revised paragraph .06, which discusses obtaining audit evidence from knowledgeable external sources, to emphasize the source of the audit evidence, rather than the type of audit procedure performed. The Board understands that advances in technology, as well as changes in attitudes towards confirmation (e.g., the potential hesitation of confirming parties to reply to a confirmation request from auditors because of the concern of falling victim to a phishing attack), have led auditors to perform other types of audit procedures that can provide relevant and reliable external evidence.

- Some commenters stated that the proposed standard could give rise to unrealistic expectations about confirmation procedures effectively addressing the risk of material misstatement due to fraud in all circumstances. While the Board does not believe that the new standard creates an unrealistic expectation about audit evidence obtained through confirmation, the appropriate focus of the auditor should be the obligation to obtain relevant and reliable audit evidence. Accordingly, the Board did not adopt paragraph .07 of the proposed standard, which had provided that “in situations involving fraud risks and significant unusual transactions, audit evidence obtained through the confirmation process generally is more persuasive than audit evidence obtained solely through other procedures.”
- Several commenters recommended that the standard address the current and anticipated use of technology to enable auditors to obtain sufficient appropriate audit evidence through performing audit procedures other than confirmation. Some commenters provided examples of using technology-based procedures in lieu of confirmations, including accessing company balances directly at the relevant financial institution and testing internal data against external data sources using audit data analytics. The Board considered these comments in developing the new standard. In particular, as discussed below, the new standard includes a presumption for the auditor to confirm cash and accounts receivable, or otherwise obtain relevant and reliable audit evidence for these accounts by directly accessing information maintained by a knowledgeable external source.
- One commenter suggested that the note to paragraph .05 of the proposed standard should also direct the auditor to take into account internal controls over cash, including

segregation of duties, when there are side agreements to revenue transactions. The Board did not make this change in the new standard. The Board notes that internal control considerations are addressed by existing PCAOB standards, which require obtaining an understanding of the company's controls when assessing the risk of material misstatement and identifying and testing certain controls when the auditor plans to rely on controls to respond to the assessed risk.³⁵ The auditor would consider controls over cash when performing these procedures.

- With respect to the examples of assertions in paragraph .06 of the proposed standard, one commenter asserted that 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. The Board did not incorporate such language in the new standard because it believes that limiting the use of confirmation to the existence assertion would be overly prescriptive and might disallow use of confirmation in other situations where the auditor has determined that confirmation could be used to obtain relevant and reliable information to test other assertions.

As discussed below, the Board continues to believe that confirmation procedures generally would provide relevant and reliable audit evidence for cash and accounts receivable. Accordingly, under the new standard the auditor should perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source when the auditor determines that these accounts are significant accounts. In addition, the new standard specifies that when the auditor has identified a significant risk of material misstatement associated with either a complex transaction

³⁵ See, e.g., AS 2110 and AS 2301.

or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk.

Other Use of Confirmation Procedures. The 2022 Proposal requested commenters' views on whether there were additional accounts or financial statement assertions for which the auditor should be required to perform confirmation procedures. In addition, the 2022 Proposal requested views on whether the proposal was sufficiently flexible to accommodate situations where an auditor chooses to confirm information about newer types of assets (e.g., digital assets based on blockchain or similar technologies).

Two investor-related groups identified specific types of additional transactions that should be subject to confirmation, including transactions (1) with unusual terms and conditions, (2) with related parties, (3) where the auditor has concern about whether side letters may exist, (4) where financing is obtained, including bank debt or supplier-provided financing, (5) involving certain sales practices, such as bill-and-hold arrangements or supplier discounts or concessions, (6) involving certain oral arrangements or guarantees, or (7) involving sales, lending, or liability for custodianship of digital assets. Another commenter suggested that confirmation of accounts payable should be considered, but not required, when auditors assess controls over the recording of liabilities to be ineffective. This commenter also suggested that the Board state that the use of confirmation is not limited to the circumstances discussed in the proposed standard.

In comparison, many firms and firm-related groups stated that the proposed standard should not prescribe additional other presumptive requirements to use confirmation. These commenters noted that doing so would be unduly prescriptive. Several commenters stated that

the proposed standard provided for an appropriate amount of auditor judgment in determining when to perform confirmation procedures in situations other than those specifically addressed in the standard. In addition, several commenters indicated that the 2022 Proposal offered sufficient flexibility to accommodate situations where an auditor confirms information about newer types of assets.

Several commenters asserted that the effectiveness of confirmation procedures is negatively affected by the fact that third parties are not obligated, under legislation or regulation, to reply to an auditor's confirmation request.

The new standard does not specify additional accounts or transactions for which confirmation procedures are presumptively required beyond those in the 2022 Proposal. The PCAOB's risk assessment standards are foundational and are used by the auditor to determine the appropriate response to identified risks of material misstatement. The Board believes that confirmation can be an important tool for addressing certain risks for cash and accounts receivable, and for obtaining audit evidence about other financial relationships, and certain terms of complex transactions or significant unusual transactions, as discussed below. However, identifying additional accounts or scenarios that require the auditor to use confirmation, without regard to the specific facts and circumstances of the audit including the assessed risk of material misstatement and whether other audit procedures would provide sufficient appropriate audit evidence, would be overly prescriptive.

The auditor's responsibilities relevant to the use of confirmation are also addressed in several other PCAOB standards. AS 2315, *Audit Sampling*, which discusses planning, performing, and evaluating audit samples, is used if the auditor uses sampling in the confirmation process. AS 2510, *Auditing Inventories*, addresses confirmation of inventories in

the hands of public warehouses or other outside custodians. Additionally, the new standard does not address auditor responsibilities regarding inquiries concerning litigation, claims, and assessments, which are addressed in AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

Designing Confirmation Requests

(See paragraphs .08 - .13 of the new standard)

A properly designed and executed confirmation process may provide relevant and reliable audit evidence. Auditor responsibilities regarding designing a confirmation request are described in paragraphs .08 - .13, as follows:

- Paragraph .08 discusses identifying information to confirm;
- Paragraphs .09 through .11 discuss identifying the confirming parties for confirmation requests; and
- Paragraphs .12 through .13 discuss using negative confirmation requests.

The new standard does not prescribe a particular format for a confirmation request. For example, requests could be paper-based or electronic, specifying the information to be confirmed or providing a blank response form, or sent with or without the involvement of an intermediary that facilitates electronic transmission. As a practical matter, the auditor determines the format of a confirmation request to increase the likelihood that the request is received and clearly understood by the confirming party, taking into consideration, among other things, the facts and circumstances of the company and the confirming party.

Identifying Information to Confirm

The 2022 Proposal provided that the auditor should, as part of designing confirmation requests, identify information related to the relevant assertions that the auditor plans to verify

with confirming parties or (when using a blank form) obtain from confirming parties. Such information could include transaction amounts, transaction dates, significant terms of transactions, and balances due to or from the confirming party as of a specific date. In addition, the 2022 Proposal discussed that using a blank confirmation request generally provides more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., a customer account balance). In the latter scenario, it is possible that a confirming party could agree to the information without verifying it against the confirming party's records.

The Board adopted the proposed requirement relating to identifying information to confirm with certain modifications discussed below.

Several commenters indicated that the provisions of the 2022 Proposal related to identifying information to confirm were clear and appropriate. A few commenters requested retaining a statement analogous to a statement in existing AS 2310 to emphasize in the standard that responding to blank form confirmation requests generally requires additional effort, which might lower the response rates and lead auditors to perform alternative procedures. One commenter expressed concern that fraudsters could use fake confirmation requests and, in particular, fake blank form confirmation requests, to defraud bank customers (e.g., by soliciting their bank details).

Existing AS 2310 includes details regarding the form of confirmation requests, which includes general information regarding blank form positive confirmation requests. This information has been included in the new standard in a note to paragraph .08. Further, after considering the comments received, the new standard includes language not included in the proposed standard that is similar to language in existing AS 2310. This language explains that

responding to blank form confirmation requests generally requires additional effort, which might lower the response rates and lead auditors to perform alternative procedures for more selected items. Despite the possibility of lower response rates, responses to blank form confirmation requests may provide more reliable audit evidence than responses to confirmation requests using pre-filled forms.

Paragraph .17 of the proposed standard also included a reminder of an existing requirement in AS 1105.10, pursuant to which the auditor should test the accuracy and completeness of information produced by the company that the auditor uses as audit evidence. The reminder emphasized that, in the confirmation process, the requirement in AS 1105.10 applies to the information produced by the company (e.g., populations from which items are selected for confirmation, such as detailed account listings, vendor listings, and contractual agreements) that the auditor uses in selecting the items to confirm.

Several firms and firm-related groups indicated that the existing requirement in AS 1105.10 for the auditor to evaluate information produced by a company as audit evidence was sufficient and that paragraph .17 of the proposed standard was duplicative. A few commenters stated that confirmation requests are often designed to test the accuracy of a given account balance or disclosure and, accordingly, that the requirement should only focus on testing completeness. Finally, a few commenters suggested that the standard, consistent with AS 1105.10, should allow for the auditor to test controls over the accuracy and completeness of information produced by the company that the auditor uses in selecting items to confirm.

After considering these comments, in order to avoid duplication with other PCAOB standards, the new standard does not include paragraph .17 of the proposed standard.

Identifying Confirming Parties for Confirmation Requests

The 2022 Proposal provided that, to obtain reliable audit evidence from the confirmation process, the auditor should direct the confirmation requests to third parties (individuals or organizations) who are knowledgeable about the information to be confirmed. That provision was similar to existing AS 2310.26, which directs the auditor to send confirmation requests to third parties who the auditor believes are knowledgeable about the information to be confirmed, such as a counterparty who is knowledgeable about a transaction or arrangement.

When designing confirmation requests, an auditor may become aware of information about a potential confirming party's motivation, ability, or willingness to respond, or about the potential confirming party's objectivity and freedom from bias with respect to the audited entity. Because this type of information can affect the reliability of audit evidence provided by the confirming party to the auditor, the 2022 Proposal, similar to existing AS 2310.27, provided that the auditor should consider any such information that comes to the auditor's attention when selecting the confirming parties. The note to paragraph .19 of the proposed standard further emphasized that such information may indicate that the potential confirming party has incentives or pressures to provide responses that are inaccurate or otherwise misleading.³⁶

The 2022 Proposal also provided that the auditor should consider the source of any such information. For example, if management indicates to the auditor that a potential confirming party is unlikely to respond to a confirmation request, management may have other reasons to

³⁶ See also paragraph .10 of AS 2401, *Consideration of Fraud in a Financial Statement Audit* (stating that fraud may be concealed through collusion among management, employees, or third parties, and that an auditor may receive a false confirmation from a third party that is in collusion with management); SAPA No. 8 at 12 (stating that, when using confirmation to address fraud risks in emerging markets, "the auditor should evaluate who the intended recipient of the confirmation request is and whether the company's management has an influence over this individual to provide false or misleading information to the auditor" and that "[f]or example, if the company is the only or a significant customer or supplier of the confirming entity, the staff of that entity may be more susceptible to pressure from the company's management to falsify documentation provided to the auditor").

avoid a confirmation request being sent (e.g., concealing management's fraudulent understatement of the amount the company owes to that party).

In addition, the 2022 Proposal provided more specific direction than existing AS 2310 for situations in which the auditor is unable to identify a confirming party who, in response to a confirmation request, would provide relevant and reliable audit evidence about a selected item. In such a scenario, the 2022 Proposal prescribed that the auditor should perform alternative procedures.

The 2022 Proposal also provided that the auditor should determine that confirmation requests are properly addressed, thus increasing the likelihood that they are received by the confirming party. The 2022 Proposal did not prescribe the nature or extent of procedures to be performed by the auditor when making this determination, thereby allowing the auditor to tailor the procedures to the facts and circumstances of the audit. For example, in practice, some auditors compare some or all confirming party addresses, which are typically provided by the company, to physical addresses or email domains included on the confirming party's website.

Alternatively, when using an intermediary to facilitate direct electronic transmission of confirmation requests and responses, Appendix B of the proposed standard required the auditor to obtain an understanding of the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses and determine whether the relevant controls used by the intermediary are designed and operating effectively. The Board noted in the 2022 Proposal that, where an auditor determines that controls that address the risk of interception and alteration also include controls related to validating the addresses of confirming parties, the auditor may be able to determine that audit procedures performed in accordance with Appendix B are sufficient to determine that confirmation requests are properly addressed. In situations

where the auditor determines that the intermediary's controls that address the risk of interception and alteration do not also include controls related to validating the addresses of confirming parties, the Board also noted that the auditor would need to perform other procedures to comply with the requirements of the proposed standard.

The Board adopted the requirements relating to identifying confirming parties for confirmation requests as proposed, with certain modifications discussed below.

Several commenters indicated that the provisions of the proposed standard related to identifying confirming parties were sufficiently clear and appropriate. One commenter indicated that the Board should require the auditor to send confirmation requests directly to an individual, rather than allow the auditor to choose between sending the request either to an individual or an organization. In this commenter's view, sending a confirmation request directly to an individual could increase the reliability of audit evidence obtained through the confirmation process. One commenter indicated that the Board should amend paragraph .18 of the proposed standard to read "the auditor should direct confirmation requests to confirming parties (individuals or organizations) who are *expected to be* knowledgeable about the information to be confirmed and determine that the confirmation requests are appropriately addressed."

Because auditors often may have no or limited interaction with the personnel of confirming organizations, they may not be able to select an individual addressee for the confirmation request. As a result, the Board believes that allowing the auditor to address a confirmation request to an organization that is knowledgeable about the information to be confirmed is practicable and appropriate. Paragraph .20 of the proposed standard stated that the auditor should perform alternative procedures when the auditor is unable to identify a confirming party who, in response to a confirmation request, would provide relevant and reliable audit

evidence about the selected item.

The Board has modified this language, which appears in paragraph .11 of the new standard, to emphasize that if the auditor is unable to identify a confirming party for a selected item who would provide relevant and reliable audit evidence in response to a confirmation request, including considering any information about the potential confirming party discussed in paragraph .10, the auditor should perform alternative procedures in accordance with Appendix C. In addition, the Board has added a note to paragraph .11 of the new standard to reiterate that AS 1105.08 provides that the reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained.

These revisions are intended to underscore that auditors should consider information that may indicate that a potential confirming party has incentives or pressures to provide responses that are inaccurate or misleading, and remind auditors that the reliability of audit evidence depends not only on its nature and source, but also the circumstances under which it is obtained. For example, restrictions on access to a potential confirming party that cause the auditor to identify and send a confirmation request to a different confirming party or to perform alternative procedures may themselves raise questions as to the reliability of the audit evidence that the auditor subsequently obtains from the other confirming party or through performing alternative procedures. In addition, the revisions to paragraph .11 clarify that the paragraph applies to a confirming party for an individual item selected for confirmation, rather than more broadly to a group of confirming parties that might provide audit evidence with respect to relevant assertions for an entire account, such as accounts receivable.

Several commenters on the 2022 Proposal also indicated that the requirement to send a confirmation request directly to the confirming party and determine that the request is properly

addressed was sufficiently clear and appropriate. One of these commenters indicated that the standard should address procedures to verify the recipient's mailing or email address while the other commenters indicated there was no need to include specific procedures in the standard. Another commenter requested more guidance around verifying email addresses. One commenter indicated that there should be no specific requirement to check addresses, as such a requirement would not, in the commenter's view, deter those intent on deceiving auditors. Lastly, one commenter requested clarification as to whether an auditor should send either an initial confirmation request or a second request when the auditor is aware of information that indicates that the confirming party would be unlikely to respond.

The Board continues to believe that requiring auditors to determine that confirmation requests are appropriately addressed is critically important to the effectiveness of the confirmation process. The Board has noted above some of the ways in which an auditor might comply with this requirement but is not including such examples in the text of the new standard to avoid the possible misinterpretation that the examples describe the only steps an auditor could take in determining whether a confirmation request is properly addressed.

With respect to one commenter's suggestion that the Board clarify whether an auditor should send a confirmation request if the auditor is aware of information indicating that the confirming party would not respond, the Board believes the new standard is sufficiently clear. Paragraph .10 of the new standard states, in part, that if the auditor is aware of information about a potential confirming party's "willingness to respond," the auditor should consider this information, including its source, in selecting the confirming parties. Further, paragraph .11 of the new standard states that, if the auditor is unable to identify a confirming party for a selected item who would provide relevant and reliable audit evidence in response to a confirmation

request, the auditor should perform alternative procedures for the selected item in accordance with Appendix C of the new standard.

Using Negative Confirmation Requests

There are “positive” and “negative” types of confirmation requests. A positive confirmation request is a confirmation request in which the auditor requests a confirmation response. With a negative confirmation request, the auditor requests a confirmation response only if the confirming party disagrees with the information provided in the request. The auditor generally obtains significantly less audit evidence when using negative confirmation requests than when using positive confirmation requests. A confirming party might not respond to a negative confirmation request because it did not receive or open the request, or alternatively the confirming party might have read the request and agreed with the information included therein.

Because of the limited evidence provided when using negative confirmation requests, the 2022 Proposal provided that the auditor may not use negative confirmation requests as the sole substantive procedure for addressing the risk of material misstatement to a financial statement assertion. Instead, the 2022 Proposal provided that the auditor may use negative confirmation requests only to supplement audit evidence provided by other substantive procedures (e.g., examining subsequent cash receipts, including comparing the receipts with the amounts of respective invoices being paid; examining shipping documents; examining subsequent cash disbursements; or sending positive confirmation requests). In addition, Appendix B to the proposed standard provided examples of situations in which the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence. In contrast, under existing AS 2310, the auditor

may use negative confirmation requests where certain criteria are present and should consider performing other substantive procedures to supplement their use.

The Board adopted the requirements for using negative confirmation requests as proposed. Most commenters on this aspect of the 2022 Proposal expressed support for the proposed prohibition on using negative confirmation requests as the sole substantive procedure with a number of commenters stating that negative confirmation requests alone do not provide sufficient appropriate audit evidence.

Another commenter suggested that the word “generally” should be removed from paragraph .21 of the proposed standard to emphasize that a negative confirmation is not as persuasive as a positive confirmation. This commenter indicated that, in situations where the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence, auditors should be required to specifically document their consideration of certain examples included in paragraph .B1 of the proposed standard.

Lastly, a few commenters indicated that additional guidance on the use of negative confirmations, and specifically on the use of substantive analytical procedures to supplement the use of negative confirmations, was needed while another commenter indicated that the examples in Appendix B would assist auditors in applying the requirements related to the use of negative confirmation requests.

After considering the comments on the 2022 Proposal, the Board has determined that the requirements in the 2022 Proposal relating to the use of negative confirmation requests are both appropriate and sufficiently clear. For ease of reference, the examples of situations in which the use of negative confirmation requests, in combination with the performance of other substantive

audit procedures, may provide sufficient appropriate audit evidence now appear in paragraph .13 of the new standard rather than Appendix B. The Board is not including in the new standard additional examples of other substantive procedures that may be used to supplement negative confirmation requests, as some commenters had suggested. While such procedures may be appropriate in some circumstances, including such examples in the new standard could be misperceived as establishing a formal checklist, whereas determining the necessary nature, timing, and extent of audit procedures that provide sufficient appropriate audit evidence would depend on the facts and circumstances of each audit.

Paragraph .12 of the new standard retains the word “generally” (i.e., “[g]enerally, the auditor obtains significantly less audit evidence when using negative confirmation requests than when using positive confirmation requests”) to acknowledge that in some circumstances using positive confirmations may not provide the auditor with the amount of evidence that the auditor planned to obtain (e.g., if the auditor does not receive responses to some or all positive confirmation requests).

Maintaining Control over the Confirmation Process

(See paragraphs .14 - .17 and .B1 - .B2 of the new standard_

The Requirement for the Auditor to Maintain Control Over the Confirmation Process

The 2022 Proposal included a provision, consistent with AS 2310, that the auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted and altered. This is because the reliability of audit evidence provided by confirmation depends in large part on the auditor’s ability to control the integrity of confirmation requests and responses. The 2022 Proposal also provided that, as part of maintaining control, the auditor should send confirmation

requests directly to the confirming party and receive confirmation responses directly from the confirming party.

The Board adopted the requirements for maintaining control over the confirmation process as proposed, with one modification.

Commenters on this topic largely agreed that the auditor should maintain control over the confirmation process. One commenter stated that setting forth the requirement to maintain control over the confirmation process and the requirement to send confirmation requests directly to the confirming party in separate paragraphs might suggest that there are different responsibilities for the auditor. This commenter recommended combining the requirements to clarify that the auditor's responsibility is to send the confirmation directly while maintaining control of the process.

After considering the comments on the 2022 Proposal, the Board has determined that the proposed requirements are both appropriate and sufficiently clear, and adopted them as proposed, with the addition of a new paragraph that clarifies how an external auditor can use internal auditors in a direct assistance capacity as part of the confirmation process, as further discussed below. Paragraph .14 of the new standard establishes the auditor's responsibility for maintaining control over the confirmation process, and the other paragraphs in this section of the new standard specify auditor responsibilities regarding certain aspects of maintaining control, as discussed below. For example, consistent with the definition of "confirmation process,"³⁷ paragraph .15 of the new standard requires that the auditor select the items to be confirmed, send the confirmation requests and receive the confirmation responses. Selecting an item involves the

³⁷ The term "confirmation process" is defined in paragraph .A3 of the new standard as "[t]he process that involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions."

auditor identifying the information to be included on the confirmation request. Paragraph .16 of the new standard specifies that maintaining control over the confirmation process by the auditor involves sending the confirmation request directly to and obtaining the confirmation response directly from the confirming party.

Using and Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses

Background and Requirements

As discussed above, certain financial institutions and other companies have adopted the policy of responding to electronic confirmation requests from auditors only through another party that they, or the auditor, engage as an intermediary to facilitate the direct transmission of information between the auditor and the confirming party. The Board understands that such policies are intended to facilitate the timeliness and quality of confirmation responses provided by the confirming party to the auditor.

While the involvement of intermediaries is not discussed in existing AS 2310, the use of an intermediary does not relieve the auditor of the responsibility under PCAOB standards to maintain control over confirmation requests and responses. Because an intermediary's involvement may affect the integrity of information transmitted between the confirming party and the auditor, the 2022 Proposal provided that the auditor should evaluate the implications of such involvement for the reliability of confirmation requests and responses. Specifically, paragraphs .B2 and .B3 of the proposed standard provided that:

- The auditor's evaluation should address certain aspects of the intermediary's controls that address the risk of interception and alteration of communications between the auditor and the confirming party;

- The auditor’s evaluation should assess whether circumstances exist that give the company the ability to override the intermediary’s controls (e.g., through financial or other relationships); and
- The auditor should not use an intermediary if information obtained by the auditor indicates that (i) the intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses, (ii) the necessary controls are not designed or operating effectively, or (iii) circumstances exist that give the company the ability to override the intermediary’s controls.

The Board adopted the proposed requirements substantially as proposed, with certain modifications discussed below.

A few commenters on the 2022 Proposal indicated that it is not clear what an “intermediary” is and requested clarification. The Board is not adding a definition of the term “intermediary” in the new standard as it simply intends to use the term in describing a particular scenario under the new standard where a third party is engaged by the auditor or a confirming party to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. The Board believes that its intent in using the term “intermediary” is sufficiently clear.

Overall, several commenters indicated that the requirements in the 2022 Proposal to evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses were appropriate. However, as discussed below, a number of these commenters and other commenters stated that additional clarity may be required to ensure that the proposed revisions are operational in practice, or otherwise requested additional

guidance. Conversely, a few commenters expressed the view that requirements in the 2022 Proposal regarding the implications of using an intermediary were not appropriate or sufficiently clear. One of those commenters asserted that the requirement to assess the intermediary would result in significant additional work for auditors and that it is not currently common practice to directly assess intermediaries in this manner. As discussed in Section IV of the 2022 Proposal, firm methodologies reviewed by the staff generally include guidance on maintaining control over the confirmation process, using intermediaries to facilitate the electronic transmission of confirmation requests and responses, and assessing controls at the intermediaries. The evidence from the PCAOB staff's review does not suggest that the requirements in Appendix B of the new standard would create significant additional work for auditors, nor did the commenters provide evidence to the contrary.

Separately, as the 2022 Proposal provided that the auditor should not use an intermediary if information obtained by the auditor indicates that certain conditions are present, several commenters stated that the presence of indicators would not necessarily mean that the intermediary is not fit for use. For example, these commenters stated that in a situation where an intermediary's control is not designed or operating effectively, an auditor may be able to obtain an understanding of whether a specific control failure impacts the confirmation process and perform tests of other controls or other procedures at the intermediary to address the control failure.

Having considered the comments, the Board is clarifying in paragraph .B2 of the new standard that the auditor should not use an intermediary to send confirmation requests or receive confirmation responses if the auditor determines that (1) the intermediary has not implemented controls that are designed or operating effectively to address the risk of interception and

alteration of the confirmation requests and responses and the auditor cannot address such risk by performing other procedures beyond inquiry, or (2) circumstances exist that give the company the ability to override the intermediary's controls. In the 2022 Proposal, the prohibition was based on an indication, rather than determination, that such circumstances exist.

For example, when performing an evaluation required by paragraphs .17 and .B1 of the new standard, an auditor could obtain a SOC report stating that a particular access control at an intermediary is not designed or operating effectively. The auditor may then be able to identify and test other controls that could mitigate the control failure described in the SOC report. In this scenario, if the auditor determines that the identified controls are designed and operating effectively and mitigate the control failure, or the auditor has performed other procedures such as obtaining computer systems event logs generated by the intermediary that provide evidence there was no unauthorized access during the relevant period, the information in the SOC report in this scenario would not necessarily mean that the auditor is not allowed to use the intermediary under the new standard.

In addition, several commenters asserted that, if an auditor were not allowed to use an intermediary under proposed paragraph .B3 and the confirming party had a policy requiring the use of an intermediary for receiving and responding to auditor confirmation requests, an auditor may be unable to comply with the proposed requirement to confirm cash, even if relevant and reliable audit evidence were otherwise available. Considering these comments, the Board has modified paragraph .B2 of the new standard to state that in circumstances where the auditor, under paragraph .B2, should not use an intermediary to send confirmation requests or receive confirmation responses, the auditor should send confirmation requests without the use of an intermediary or, if unable to do so, perform alternative procedures in accordance with Appendix

C of the new standard. The Board believes that this modification and the adoption of a provision regarding obtaining audit evidence by directly accessing information maintained by a knowledgeable external source (see discussion below), address commenters' concerns that an auditor may not be able to comply with the requirement to confirm cash.

Certain commenters asked for additional guidance on what procedures an auditor should or could perform to comply with the requirements in Appendix B. Having considered these comments, the Board determined that the new standard, consistent with the 2022 Proposal, will not specify how the auditor should perform the particular procedures required by paragraphs .B1 and .B2 regarding evaluating the implications of using an intermediary. The new standard thus allows auditors to customize their approach based on the facts and circumstances of the audit engagement and the audit firm. For example, in obtaining an understanding of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses and determining whether they are designed and operating effectively, the auditor could (i) use, where available, a SOC report that evaluates the design and operating effectiveness of the relevant controls at the intermediary; or (ii) test the intermediary's controls that address the risk of interception and alteration directly.³⁸

Some commenters asked for guidance related to an acceptable window of time to be covered by "bridge letters."³⁹ Where an auditor uses an independent service auditor's report on a service organization's controls, such procedures may involve using a bridge letter. The new standard does not specify an appropriate window of time to be covered by a bridge letter or a

³⁸ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

³⁹ Some intermediaries provide a "bridge letter" or "gap letter" issued by the independent service auditor that addresses the period from the date of the service auditor's SOC report through a subsequent date, typically the most recent calendar year end.

permissible window of time between the date covered by a bridge letter and the period when the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses. Auditors should use their professional judgment based upon the facts and circumstances of the audit to determine the nature of procedures required to comply with paragraph .B1 of the new standard, including the note to paragraph .B1(b).

One commenter stated that paragraph .B2(b) of the proposed standard should have a specific documentation requirement. The Board believes that adding a specific documentation requirement is not necessary, as the auditor is required to document compliance with PCAOB standards under existing documentation requirements.⁴⁰

Lastly, the new standard modifies the language of the 2022 Proposal to provide in the note to paragraph .B1(b) of the new standard that, if the auditor performs procedures to determine that the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively at an interim date, the auditor should evaluate whether the results of the procedures can be used “during the period in which the auditor uses the intermediary” – rather than at “period end,” as described in the proposed standard – or whether additional procedures need to be performed to update the results. The Board believes that the modified provision more accurately describes the timeframe during which the results of the procedures may be used by an auditor. In addition, the modified provision clarifies that the auditor should consider the nature and extent of any changes in the intermediary’s process and controls during the period between the auditor’s procedures and the period the auditor uses the intermediary.

Interaction of New Standard and Proposed QC 1000

⁴⁰

See, e.g., paragraph .05 of AS 1215, *Audit Documentation*.

In November 2022 the Board issued for public comment a proposed quality control standard, referred to as proposed QC 1000, *A Firm's System of Quality Control*.⁴¹ Proposed QC 1000 addresses resources used by a registered public accounting firm that are sourced from third-party providers. An intermediary that facilitates direct electronic transmission of confirmation requests and responses is one example of a “third-party provider” under proposed QC 1000.

Under proposed QC 1000, a firm would consider the nature and extent of resources or services obtained from third-party providers in its risk assessment process and whether the use of third-party providers poses any quality risks to the firm in achieving its quality objectives. One of the required quality objectives relates to obtaining an understanding of how such resources or services are developed and maintained and whether they need to be supplemented and adapted as necessary, such that their use enables the performance of the firm's engagements in accordance with applicable professional and legal requirements and the firm's policies and procedures.⁴²

As noted above, the proposed standard on the auditor's use of confirmation included specific procedures related to the use of an intermediary, which included obtaining an understanding of the intermediary's controls that address the risk of interception and alteration of a confirmation request and response and determining whether such controls are designed and operating effectively.

A few commenters on the 2022 Proposal observed that firms may obtain and evaluate SOC reports centrally, rather than requiring that individual engagement teams obtain and evaluate the reports. One of these commenters suggested clarifying in the standard that the evaluations required by Appendix B may be performed, and the documentation may be retained

⁴¹ See *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Rel. No. 2022-006 (Nov. 18, 2022).

⁴² See paragraph .44.j of proposed QC 1000.

centrally, as part of the firm's quality control system. Another of these commenters suggested that the requirements related to the use of an intermediary be removed entirely from the proposed confirmation standard and instead be dealt with solely in the proposed quality control standards. One commenter stated that, depending on the identified quality risks, procedures performed in accordance with QC 1000 need not align with the financial statement period-end of each audit engagement performed by the firm, which the commenter asserted was implied by paragraph .B2(b) and a related note in the proposed standard. Lastly, a few commenters indicated that it would be beneficial to explicitly link the provisions of the confirmation standard regarding the use of an intermediary with QC 1000.

Having considered these comments, the Board believes that the requirements in the new standard related to the auditor's use of intermediaries, with the modifications discussed above to the requirements in the proposed standard, are sufficiently clear and appropriate. The auditor's evaluation of the intermediary's controls could be performed by an engagement team, an audit firm's national office, or a combination of both. Where the national office performs procedures relating to the intermediary (either as part of the firm's quality control activities or specifically to comply with the new standard), the engagement team would still need to consider the procedures performed by the national office and include in its audit documentation considerations specific to the individual audit engagement. For example, if a national office evaluated an intermediary's controls at an interim date, the engagement team would need to, in accordance with the note accompanying paragraph .B1(b) of the new standard, evaluate whether the results of the interim procedures could be used during the period in which the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses or whether they needed to be updated.

Using Internal Audit in the Confirmation Process

The 2022 Proposal identified certain activities in the confirmation process where the auditor may not use the assistance of the company's internal audit function. Under the 2022 Proposal, the auditor was not permitted to use internal auditors for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses, because using internal audit in a direct assistance capacity for such activities would not be consistent with the auditor's responsibility to maintain control over the confirmation process.

Existing AS 2310 does not include analogous provisions. It states instead that the auditor's need to maintain control does not preclude the use of internal auditors and that AS 2605, *Consideration of the Internal Audit Function*, provides guidance on considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor.⁴³

The Board adopted the proposed requirements substantially as proposed, with certain modifications discussed below.

A number of commenters, including investor-related groups, firms, and firm-related groups, agreed with the requirements proposed in the 2022 Proposal as being in line with the auditor's responsibility to maintain control over the confirmation process. Additionally, a few commenters observed that it is not current practice for auditors to use internal audit in a direct assistance capacity for selecting items to be confirmed, sending confirmation requests, or receiving confirmation responses and, therefore, that the requirements in the 2022 Proposal would not result in a significant change in practice. Conversely, one commenter stated that the proposed restrictions would impact current practice as it relates to direct assistance.

⁴³

See footnote 3 of AS 2310.

A significant number of commenters, including internal auditors and companies with internal audit functions, took exception to the provision in the 2022 Proposal to limit the external auditor's use of internal auditors in a direct assistance capacity in the confirmation process, and in some instances asserted that such limitations would be inconsistent with AS 2605. Many of these commenters also challenged the statement in the 2022 Proposal that "[i]nvolving internal auditors or other company employees in these activities [selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses] would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered." These commenters asserted that this language called into question internal auditors' competence, objectivity, and independence. Additionally, a few commenters expressed concern with the prescriptiveness of the proposed restrictions on the use of internal auditors in the confirmation process.

Having considered the comments received, the Board notes that the discussion in the 2022 Proposal was not intended to cast doubt on the qualifications, competence, or objectivity of internal auditors. Internal auditors can and often do play an important role in enhancing the quality of a company's financial reporting. At the same time, the Board continues to believe that in order to maintain control over the confirmation process the auditor should select items to be confirmed, send confirmation requests, and receive confirmation responses.

In addition, after considering the comments received, the Board is (i) relocating the requirements related to the auditor's use of internal audit in the confirmation process to the section of the new standard on maintaining control over the confirmation process and (ii) rephrasing the requirements in terms of the auditor's affirmative responsibilities, by describing procedures the auditor is required to perform. In contrast, the proposed standard described

procedures that internal auditors were not allowed to perform. As stated in footnote 7 of the new standard, auditors are permitted to use internal auditors in accordance with AS 2605, except for selecting items to confirm, sending confirmation requests, and receiving confirmation responses. The new standard does not impose any new limitations on how the internal auditors' work may affect the external auditor's audit procedures.⁴⁴ Instead, the new standard clarifies how an external auditor can use internal auditors in a direct assistance capacity as part of the confirmation process.⁴⁵

Evaluating Confirmation Responses and Confirmation Exceptions, and Addressing Nonresponses and Incomplete Responses
(See paragraphs .18 - .23 of the new standard)

Overall Approach

Under the 2022 Proposal, the auditor's responsibilities related to the confirmation process included evaluating the information received in confirmation responses and addressing nonresponses and incomplete responses. The 2022 Proposal provided that if the auditor is unable to determine whether the confirmation response is reliable, or in the case of a nonresponse or an incomplete response (i.e., one that does not provide the audit evidence the auditor seeks to obtain), the auditor should perform alternative procedures.⁴⁶ The 2022 Proposal built upon requirements in existing AS 2310 that discuss addressing information obtained from the performance of confirmation procedures.

⁴⁴ AS 2605.12 states that "the internal auditor's work may affect the nature, timing, and extent of the audit," including "procedures the auditor performs when obtaining an understanding of the entity's internal control (paragraph .13)," "procedures the auditor performs when assessing risk (paragraphs .14 through .16)," and "substantive procedures the auditor performs (paragraph .17)."

⁴⁵ AS 2605.27 discusses how the auditor may use internal auditors to provide direct assistance.

⁴⁶ Alternative procedures, including the relevant exception described in Appendix C of the new standard, are discussed below.

The relevant requirements in the new standard include certain modifications to the approach in the 2022 Proposal, as discussed in the sections below.

Evaluating the Reliability of Confirmation Responses

The 2022 Proposal was intended to provide additional direction beyond what is set forth in existing AS 2310 to assist the auditor's evaluation of the reliability of confirmation responses. Specifically, the 2022 Proposal (i) described information that the auditor should take into account when performing the evaluation, and (ii) provided examples of indicators that a confirmation response may have been intercepted or altered and thus may not be reliable. In particular, the 2022 Proposal provided that the auditor should take into account any information about events, conditions, or other information the auditor becomes aware of in assessing the reliability of the confirmation response.

Under existing PCAOB standards, the auditor is not expected to be an expert in document authentication but, if conditions indicate that a document (e.g., a confirmation response) may not be authentic or may have been altered, the auditor should modify the planned audit procedures or perform additional audit procedures to respond to those conditions and should evaluate the effect, if any, on the other aspects of the audit.⁴⁷ The 2022 Proposal did not alter these requirements, but specified for the confirmation process that, if the auditor were unable to determine that the confirmation response is reliable, the auditor's response should include performing alternative procedures.

The requirements for evaluating the reliability of confirmation responses were adopted substantially as proposed.

⁴⁷

See AS 1105.09.

Several commenters indicated that the provisions of the 2022 Proposal related to evaluating the reliability of confirmation responses were clear and appropriate. One commenter proposed modifications to the proposed requirements, including replacing the words “taking into account” with “considering” in paragraph .25 of the proposed standard to reflect the commenter’s perceived intent of the Board. One commenter asserted that paragraph .25 of the proposed standard could result in onerous documentation requirements in situations where there is a clear reason why a particular indicator is not necessarily indicative of interception or alteration of a confirmation request or confirmation response (e.g., a confirmation request is sent to a general email account but returned from an email account belonging to an individual monitoring the general email account). Another commenter proposed that the Board remove one of the examples of indicators that a confirmation response may have been intercepted or altered because it appeared to create a de facto requirement that an auditor treat a confirmation response as not reliable if the original confirmation request is not returned with the confirmation response.

In addition, one commenter suggested modifying proposed paragraph .26 of the proposed standard to provide that the auditor should perform alternative procedures if the auditor became aware of any of the factors identified in paragraph .25 and was unable to overcome those factors to determine that the confirmation response is reliable. Another commenter stated that the proposed standard should acknowledge that, in certain specified circumstances, an unreliable confirmation would likely result in a scope limitation.

Having considered the comments received, the Board notes that assessing the reliability of confirmation responses is a critical component of the confirmation process. If indicators of interception or alteration are present, it is important for the auditor to address them. When the auditor follows up on a particular indicator, an auditor may determine that the confirmation

requests and responses have not been intercepted or altered. For example, an auditor could verify that a difference in the confirming party's email address between the confirmation request and confirmation response occurred because the confirming party responds to confirmation requests from one central email address. The note to paragraph .18 of the new standard (paragraph .25 of the proposed standard) provides examples of information that the auditor should take into account if the auditor becomes aware of it. Under PCAOB standards, the auditor would document the procedures performed in response to information that indicates that a confirmation request or response may have been intercepted or altered. To minimize any confusion, the Board replaced the word "indicator" in the note with the phrase "information that indicates," which has the same meaning.

In addition, to clarify that the auditor performs alternative procedures for the selected item if the auditor is unable to determine that a confirmation response regarding that item is reliable, the Board has added the phrase "for the selected item" after the words "alternative procedures" in paragraph .19 of the new standard. The Board also revised the reference in paragraph .26 of the proposed standard to performing alternative procedures "as discussed in paragraph .31" to "in accordance with Appendix C" in paragraph .19 of the new standard to reflect that alternative procedures for a selected item may not be necessary under certain circumstances, as discussed below, and to reflect the relocation of the more detailed discussion of alternative procedures from the body of the standard to Appendix C.

AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, sets forth requirements regarding limitations on the scope of an audit,⁴⁸ including scope

⁴⁸*See* AS 3105.05-.15.

limitations relating to confirmation procedures with respect to accounts receivable.⁴⁹ One example of such a scope limitation would be the auditor's inability to confirm accounts receivable balances combined with an inability to perform other procedures in respect of accounts receivable to obtain sufficient appropriate audit evidence. The new standard does not repeat such existing requirements, as doing so would merely duplicate those requirements.

Evaluating Confirmation Exceptions and Addressing Nonresponses and Incomplete Responses

For various reasons, information in a confirmation response received by the auditor could differ from other information in the company's records obtained by the auditor. The 2022 Proposal provided that the auditor should evaluate the confirmation exceptions and determine their implications for certain aspects of the audit, as discussed below. The direction in the 2022 Proposal was more detailed than in existing AS 2310.

In particular, the 2022 Proposal provided that the auditor should evaluate whether confirmation exceptions individually or in the aggregate indicate a misstatement that should be evaluated in accordance with AS 2810. The 2022 Proposal did not, however, require investigating all confirmation exceptions to determine the cause of each confirmation exception. The 2022 Proposal also included a provision that the auditor should evaluate whether the confirmation exceptions individually, or in the aggregate, indicate a deficiency in the company's internal control over financial reporting ("ICFR").

With regards to nonresponses and potential nonresponses, the 2022 Proposal provided that the auditor should send a second positive confirmation request to the confirming party unless the auditor has become aware of information that indicates that the confirming party would be

⁴⁹

See AS 3105.07.

unlikely to respond to the auditor. Additionally, the 2022 Proposal specified that if a confirmation response is returned by the confirming party to anyone other than the auditor, the auditor should contact the confirming party and request that the response be re-sent directly to the auditor. If the auditor does not subsequently receive a confirmation response from the intended confirming party, the 2022 Proposal provided that the auditor should treat the situation as a nonresponse.

Further, in contrast with existing AS 2310, which does not address the auditor's responsibilities regarding incomplete responses, the 2022 Proposal provided that the auditor should perform alternative procedures if a confirmation response is not received or is incomplete.

The Board adopted the requirements for evaluating confirmation exceptions and addressing nonresponses as proposed, with certain modifications discussed below.

Some commenters indicated that the proposed provisions regarding evaluating confirmation exceptions and addressing nonresponses were sufficiently clear and appropriate. A few commenters stated that the Board should include requirements that limit an auditor's ability to assess confirmation exceptions as merely "isolated exceptions." Similarly, one commenter asserted that the Board should require auditors to resolve any confirmation exceptions by examining other third-party evidence such as purchase orders. In light of these comments, the Board has added a new note to paragraph .20 of the new standard that states that determining that a confirmation exception does not represent a misstatement that should be evaluated in accordance with AS 2810 generally involves examining external information, which may include information that the company received from knowledgeable external sources.

In the Board's view, in many circumstances examining external evidence under the above provision is necessary, as doing so is consistent with both the goal of obtaining relevant and

reliable audit evidence and the type of audit evidence sought from confirmation. For example, an auditor might send a confirmation request for a selected item to a knowledgeable confirming party regarding a \$20,000 accounts receivable invoice and the confirming party (i.e., the customer) indicates that the outstanding balance for this invoice at the date specified in the confirmation request is \$18,000. Having investigated the \$2,000 difference, the auditor learns that it does not represent a misstatement, as the customer overpaid for a different invoice but applied the overpayment to the invoice selected for confirmation and the company applied the overpayment differently. In this scenario, determining that there is not a \$2,000 misstatement for the selected item would involve the auditor examining audit evidence from knowledgeable external sources, such as applicable purchase orders and customer cash payments, in addition to information generated by the company, such as customer invoices.

The note to paragraph .20 of the new standard uses the word “generally” to acknowledge that in some circumstances examining external audit evidence may not be necessary. For example, an auditor may have included an incorrect figure in the confirmation request and later determined that the amount confirmed by the confirming party agrees to the amount in the company’s general ledger. Determining that such a confirmation exception does not represent a misstatement to be evaluated in accordance with AS 2810 would not require examining audit evidence from external sources.

One commenter suggested that the Board consider reminding auditors that, when using audit sampling, the auditor should project the misstatement results of the sample to the items from which the sample was selected in accordance with AS 2315. The Board considered this comment, but did not add a reminder regarding projecting the results of a sample as the new standard states in footnote 4 that AS 2315 addresses evaluating audit samples.

One commenter suggested that the Board restructure paragraph .27 of the proposed standard, as the auditor generally considers whether a confirmation exception is a misstatement and then determines whether there is a deficiency in internal control. In consideration of this comment, the Board has restructured paragraph .20 of the new standard to align with the typical order in which the auditor considers the two matters discussed therein (i.e., an auditor typically considers whether a confirmation exception indicates a misstatement that should be evaluated in accordance with AS 2810, *Evaluating Audit Results*, and then considers whether the confirmation exception represents a deficiency in the company's ICFR).

One commenter expressed the view that the Board should not require auditors to evaluate whether a confirmation exception constitutes a control deficiency if the exception was a result of a clerical error or caused by a timing difference. The Board continues to believe that requiring the auditor to evaluate exceptions in such circumstances is appropriate and the auditor should consider whether all confirmation exceptions are control deficiencies. A clerical error or timing difference could be indicative of a deficiency in a company's ICFR.

One commenter indicated that the proposed requirement about sending a second positive confirmation request unless the auditor has become aware of information that indicates that the confirming party would be unlikely to respond to the auditor was sufficiently clear and appropriate. However, several firms commented that the requirement was too prescriptive, with one commenter asserting that the requirement could result in unnecessary and potentially ineffective administrative effort. Additionally, a few commenters expressed concern that following up on a confirmation request would not constitute sending a second confirmation request under the proposed standard, but asserted that it should be so treated.

The Board considered the comments about the requirement to send a second positive confirmation request. The use of confirmation is not required under the new standard other than for cash and accounts receivable when they are significant accounts or disclosures. Under the new standard, for cash and accounts receivable, the auditor may perform other audit procedures to obtain audit evidence by directly accessing information maintained by a knowledgeable external source. Further, for accounts receivable, in certain situations the new standard allows the auditor to obtain external information indirectly (see discussion of cash and accounts receivable below).

Because the auditor may have a choice of the audit procedure to perform, the Board believes that the auditor will select confirmation in those situations where confirming parties will be more likely to respond to the auditor. In situations where a confirming party does not respond to a confirmation request, the Board has concluded it is appropriate to require the auditor, in the case of a nonresponse to a positive confirmation request, to follow up with the confirming party. The requirement to follow up with the confirming party is included in paragraph .21 of the new standard. The new standard does not prescribe a form of the auditor's follow-up. For example, following up using the same form of communication as in the original confirmation request (e.g., email, direct electronic transmission facilitated by an intermediary) would be appropriate under the new standard. In the case of an electronic confirmation request, a follow-up request could be in the form of a reminder or automated reminder.

If the auditor subsequently receives a confirmation response, the new standard provides that the auditor should evaluate that response in accordance with paragraphs .18-.19 and evaluate any confirmation exception in accordance with paragraph .20. If the auditor's follow-up does not

elicit a confirmation response, paragraph .23 of the new standard instructs the auditor to perform alternative procedures for the selected item in accordance with Appendix C of the new standard.

To clarify that the auditor performs alternative procedures for the selected item, the Board has added the phrase “for the selected item” after the words “alternative procedures” in paragraph .23 of the new standard. The Board also revised the reference in paragraph .30 of the proposed standard to performing alternative procedures “as discussed in paragraph .31” to refer to “in accordance with Appendix C” in paragraph .19 of the new standard to reflect that alternative procedures for a selected item may not be necessary under certain circumstances, as discussed below, and to reflect the relocation of the more detailed discussion of alternative procedures from the body of the standard to Appendix C.

Additional Considerations for Cash, Accounts Receivable, and Terms of Certain

Transactions

(See paragraphs .24 - .30 of the new standard)

In general, evidence obtained from a knowledgeable external source is more reliable than evidence obtained only from internal company sources. When cash or accounts receivable are significant accounts, there is a presumption in the new standard that the auditor should obtain audit evidence from a knowledgeable external source by performing confirmation procedures or using other means to obtain audit evidence by directly accessing information maintained by knowledgeable external sources. In addition, the new standard addresses other situations in which the auditor should consider the use of confirmation.

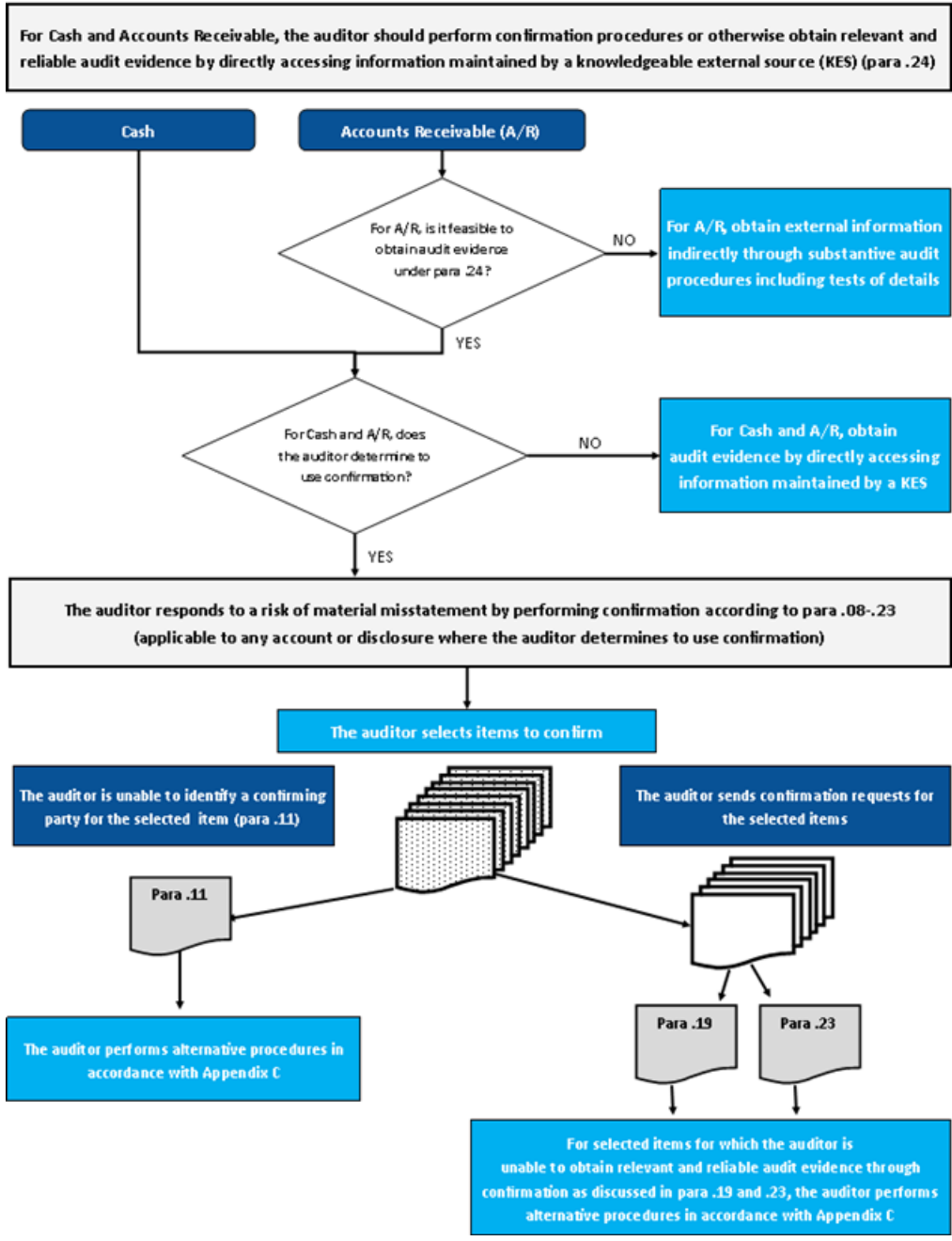
The Board discusses below the provisions of the new standard relating to confirming cash held by third parties, confirming accounts receivable, performing other audit procedures for accounts receivable when obtaining audit evidence directly from a knowledgeable external

source would not be feasible, communicating with the audit committee in certain situations, and confirming the terms of certain other transactions. To improve the flow of the requirements in the new standard, these provisions have been placed after the general provisions that describe the auditor's responsibilities related to the confirmation process (i.e., after paragraphs .08-.23).

Figure 1 depicts the relationship of the requirements in the new standard for cash and accounts receivable when they are significant accounts (paragraphs .24-.28) to the general provisions of the new standard applicable to the confirmation process (paragraphs .08-.23).⁵⁰

⁵⁰ The information in Figure 1 is intended to be for illustrative purposes and is not a substitute for the new standard; only the new standard provides the auditor with the definitive requirements.

Figure 1 - Additional Considerations for Cash and Accounts Receivable



Cash Held by Third Parties

Confirming Cash

The 2022 Proposal provided that the auditor should perform confirmation procedures when auditing cash and cash equivalents held by a third party. Existing AS 2310 does not address auditor responsibilities for confirming cash.

The Board noted in the 2022 Proposal that an auditor need not necessarily confirm all cash accounts in all cases. Under PCAOB standards, the alternative means of selecting items for testing are selecting all items, selecting specific items, and audit sampling.⁵¹ An auditor selects individual cash items to confirm following the relevant direction in PCAOB standards, including identifying and assessing the risk of misstatement and developing an audit response.⁵² The particular means or combination of means of selecting cash items to confirm depend on, for example, the characteristics of the cash items and the evidence necessary to address the assessed risk of material misstatement.⁵³

The 2022 Proposal emphasized that, in selecting the individual items of cash to confirm, the auditor should take into account the auditor's understanding of the company's cash management and treasury function, and the substance of the company's arrangements and transactions with third parties. For example, an auditor might select bank accounts with balances over a certain amount, accounts with a high volume of transactions, accounts opened or closed during the period under audit, or accounts the auditor identifies as particularly risk-prone. Alternatively, the auditor might determine it is appropriate to confirm all cash accounts. The auditor also follows the direction in PCAOB standards when determining whether performing

⁵¹ See AS 1105.22.

⁵² See, e.g., AS 2110 and AS 2301.

⁵³ See AS 1105.23 and AS 2301.03.

procedures in addition to confirmation is necessary to address the assessed risk of material misstatement relating to cash.⁵⁴

The Board adopted the proposed requirements to confirm cash, with certain modifications discussed below.

A number of commenters supported the proposed requirement for the auditor to confirm cash held by third parties. Some of these commenters stated that confirming cash has long been an audit best practice and that requiring cash confirmation would lead to more consistency in practice. In addition, several commenters stated that the standard was sufficiently risk-based (i.e., by allowing the auditor to select cash accounts and other financial relationships to confirm based on the risk of material misstatement associated with cash).

Several commenters asserted that a requirement to confirm cash was not sufficiently risk-based, despite the provisions in the 2022 Proposal that described that the auditor should take into account their understanding of the company's operations in making selections of individual cash items to confirm. In particular, several commenters stated that the proposed standard would require an auditor to confirm cash without regard to the level of risk that the auditor had determined for cash in their risk assessment or when other audit procedures could produce sufficient appropriate audit evidence. Other commenters expressed the view that the requirement to confirm cash, as well as accounts receivable, should be removed, with some of these commenters suggesting that the auditor should be able to determine the audit procedure that would be most effective in obtaining relevant and reliable audit evidence, without confirmation being the "default" procedure.

⁵⁴ See, e.g., AS 2301.09.

The Board continues to believe that a presumption to confirm cash is appropriate. As discussed above, this presumption to confirm cash is consistent with current practice. Consistent with the objective of the new standard, the requirement to confirm cash, as well as accounts receivable, only applies when the auditor has determined that that these accounts are significant accounts.

With respect to confirming cash, many commenters, primarily firms and firm-related groups, expressed concern that the 2022 Proposal did not contain a provision about overcoming the presumption to confirm cash. A number of commenters also expressed the view that auditors could obtain direct-access view of bank information (or would be able to do so in the future), which could provide a more effective means of directly obtaining external evidence than sending a confirmation.

The Board agrees that if the auditor is able to perform other audit procedures that allow the auditor to obtain audit evidence by directly accessing information maintained by knowledgeable external sources, such audit evidence would be at least as persuasive as audit evidence obtained through confirmation procedures. The Board therefore added to the presumption to confirm cash (and accounts receivable) in the new standard the phrase “or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.”

By way of example, the auditor might satisfy this requirement to obtain relevant and reliable audit evidence under the new standard by obtaining read-only access to information maintained by a financial institution concerning its transactions or balances with the company directly online through a secure website of the financial institution using credentials provided to the auditor by the financial institution.

The Term “Cash and Cash Equivalents Held by Third Parties”

The 2022 Proposal provided that the term “cash” comprised both cash and cash equivalents. Cash equivalents generally refer to short-term, highly liquid investments that are readily convertible to known amounts of cash and are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.⁵⁵ Such assets are commonly used by companies to manage their cash holdings. The 2022 Proposal also described that the requirements for confirming cash would apply to cash held by third parties, and not limited to cash held by financial institutions. In the Board’s view, this expansion of confirmation requirements was appropriate, as company funds can be held by third parties other than financial institutions, such as money transfer providers.

The Board adopted this provision as proposed in the 2022 Proposal.

There was one comment related to this aspect of the 2022 Proposal, suggesting that the new standard should specify that “third parties” are not limited to financial institutions. The Board believes the reference to “third parties” was sufficiently clear as proposed and, accordingly, has not expanded this description.

Confirming Other Financial Relationships

The 2022 Proposal provided that the auditor should consider confirming other financial relationships with the third parties with which the auditor determines to confirm cash. Such relationships can include lines of credit, other indebtedness, compensating balance arrangements, or contingent liabilities, including guarantees. As proposed, the auditor would be required under PCAOB standards to document the consideration given to the confirmation of other financial

⁵⁵ See, e.g., definition of “cash equivalents” in the Master Glossary of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification and of “cash equivalents” in the International Financial Reporting Standards (“IFRS”).

relationships and the conclusions reached.⁵⁶ Existing AS 2310 does not have an analogous requirement to confirm other financial relationships.

The Board adopted this provision as proposed, with certain modifications discussed below.

Several commenters stated that the requirements for the auditor to consider confirming other financial relationships were clear. One commenter suggested that confirming other financial relationships should be required, and that overcoming the presumption to confirm should be available only when the financial entity with which the company does business does not offer services that would give rise to other financial relationships.

A number of commenters asserted that auditors would be required to produce additional documentation of their considerations, even when a financial relationship(s) is not an area of significant risk of material misstatement. Some commenters recommended that the provision that the auditor “should consider” other financial relationships be changed to “may consider,” in order to allow for more auditor judgment in determining the audit procedures to perform.

The Board continues to believe that information about financial relationships, including off-balance sheet relationships, could be important for the audit, as it could be part of significant disclosures in a company’s financial statements. Accordingly, paragraph .29 of the new standard provides that, in addition to obtaining audit evidence from a knowledgeable external source regarding cash in accordance with paragraph .24, the auditor should consider sending

⁵⁶ See Note to PCAOB Rule 3101(a)(3), which states that “(i)f a Board standard provides that the auditor “should consider” an action or procedure, consideration of the action or procedure is presumptively mandatory, while the action or procedure is not,” and AS 1215.05-.06 (audit documentation should “[d]emonstrate that the engagement complied with the standards of the PCAOB” and must “document the procedures performed . . . with respect to relevant financial statement assertions”). See also *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Rel. No. 2004-006 (June 9, 2004), at 3 (“the auditor documents not only the nature, timing, and extent of the work performed, but also the professional judgments made by members of the engagement team and others”).

confirmation requests to that source about other financial relationships with the company, based on the assessed risk of material misstatement. The phrase “based on the assessed risk of material misstatement” was added to clarify that the auditor has flexibility in tailoring audit procedures to the level of assessed risk (e.g., by including or not including confirmation in the audit response based on the auditor’s assessed risk of material misstatement of other financial relationships). In addition, paragraph .29 retains the examples of other financial relationships that were included in the 2022 Proposal.

Accounts Receivable

Confirming Accounts Receivable

The 2022 Proposal carried forward the requirement in existing AS 2310 to confirm accounts receivable. Similar to existing AS 2310, the 2022 Proposal did not specify the extent of confirmation procedures for accounts receivable. As noted above, the timing and extent of confirmation procedures are part of the auditor’s response to the risks of material misstatement under PCAOB risk assessment standards. The 2022 Proposal instead required 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. For example, an auditor might assess the risk of material misstatement relating to accounts receivable higher for a company that is being audited for the first time by the auditor, or for accounts receivable from a newly acquired operation in a foreign location.

The Board adopted the proposed requirements to confirm accounts receivable, with certain modifications discussed below.

Most commenters on this aspect of the 2022 Proposal generally supported the retention of a presumption to confirm accounts receivable, and most of those commenters stated that the

requirement for the auditor to confirm accounts receivable was sufficiently clear and appropriate. Two investor-related groups stated that confirmation of cash and accounts receivable was necessary, in their view, to obtain persuasive, sufficient, and competent audit evidence.

On the other hand, a number of commenters, primarily firms and firm-related groups, expressed concerns about carrying forward the presumption for auditors to confirm accounts receivable from existing AS 2310. The common theme of those commenters was that requiring the auditor to use confirmation for certain accounts may not allow the auditor to exercise professional judgment in determining an appropriate response to the assessed risk of material misstatement for those accounts.

Regarding the selection of accounts receivable to confirm, several commenters agreed that the 2022 Proposal was sufficiently principles-based to allow auditors to use professional judgment in determining the extent of confirmation of accounts receivable.

The Board continues to believe that a presumption to confirm accounts receivable is appropriate to emphasize that audit evidence obtained from a knowledgeable external source is generally more reliable than evidence obtained only from internal company sources. Consistent with the objective of the new standard, the requirement to confirm cash and accounts receivable, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, only applies when the auditor has determined that these accounts are significant accounts.

As with cash balances discussed above, the Board believes that when the auditor is able to perform other audit procedures to obtain audit evidence about accounts receivable by directly accessing information maintained by knowledgeable external sources (e.g., information maintained by the receivable counterparty), such evidence would be at least as persuasive as

audit evidence through confirmation procedures. The Board therefore added to the presumption to confirm cash and accounts receivable in the new standard the phrase “or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.”

Audit evidence that an auditor obtains by accessing a third party’s information directly can be at least as persuasive as audit evidence obtained through confirmation procedures because the auditor is able to observe first-hand the information providing such evidence. As technology continues to develop, The Board believes it is important for the new standard to reflect that there may be additional opportunities for the auditor to obtain audit evidence directly beyond sending a confirmation request. The new standard would allow for future innovations in audit techniques that might involve the auditor obtaining evidence for accounts receivable by directly accessing information maintained by a counterparty or other knowledgeable external source. As noted in the new standard, consistent with selecting a confirming party, when selecting the knowledgeable external source providing the auditor with access to information directly, the auditor would be required to consider whether the knowledgeable external source would have any incentive or pressure to provide the auditor with access to information directly that is inaccurate or otherwise misleading.

Situations where it would not be feasible for the auditor to obtain audit evidence for accounts receivable directly from a knowledgeable external source, through confirmation procedures or other means, are discussed below.

The Term “Accounts Receivable”

The 2022 Proposal described “accounts receivable” as comprising receivables arising from the transfer of goods or services to a customer or from a financial institution’s loans.

Existing AS 2310 describes accounts receivable as the entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and a financial institution's loans. The 2022 Proposal was designed to apply to the same types of items as existing AS 2310, with a modified description to align more closely with the terminology of current accounting requirements, which have been updated since existing AS 2310 was written.⁵⁷

The Board adopted this provision as proposed.

Commenters on this aspect of the 2022 Proposal stated that the description of accounts receivable was clear. These commenters also noted that there was no need to further broaden the description to include additional types of receivables.

The description of accounts receivable in the new standard includes receivables that arise from the transfer of goods or services to a customer. These types of receivables generally arise from the company's ordinary revenue-generating activities, and include items for which revenue has been or will be recognized by a company, such as receivables from selling manufactured products or providing a service to customers. The description of accounts receivable also includes a financial institution's loans, including loans to customers that the institution has originated or purchased from another institution. Examples of financial institutions are banks, non-bank lenders, and mortgage companies that provide financing to customers.

**Situations When Obtaining Audit Evidence for Accounts Receivable Directly
Would Not Be Feasible**

Performing Other Substantive Procedures, Including Tests of Details

⁵⁷ See, e.g., FASB Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers*, and IFRS 15, *Revenue from Contracts with Customers*.

In the 2022 Proposal, the presumption to confirm accounts receivable could be overcome when the auditor determined that an audit response that only included substantive audit procedures other than confirmation would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through performing confirmation procedures. The 2022 Proposal did not carry forward the provisions in existing AS 2310 addressing overcoming the presumption to confirm accounts receivable under certain conditions, which are (i) immateriality, (ii) ineffectiveness of confirmation, or (iii) a certain combination of the assessed risk and expected results from other auditing procedures.⁵⁸

As discussed below, the new standard includes a provision to address situations when obtaining audit evidence directly from knowledgeable external sources, whether through confirmation procedures or other means, would not be feasible to execute.

Many commenters addressed the provision in the 2022 Proposal to overcome the presumption to confirm accounts receivable. A few commenters noted that the ability to overcome the presumption to confirm accounts receivable was clear and appropriate. As discussed below, many commenters focused on the proposed provision that evidence obtained through other substantive procedures should be “at least as persuasive as” evidence obtained through confirmation:

- A number of investor-related groups stated that the provision gave too much leeway to auditors to overcome the presumption to confirm accounts receivable. These commenters asserted that exceptions to confirming accounts receivable should only be available when other audit procedures would provide more persuasive or greater accumulated evidence than that obtained through confirmation. These commenters recommended additional

⁵⁸ See AS 2310.34.

requirements, such as allowing the auditor to overcome the presumption only if they document the evidence and basis for their conclusion and have communicated the conclusion to the audit committee and investors.

- Several firms and firm-related groups stated that the relevant provisions were not clear or more guidance would be needed about overcoming the presumption to confirm accounts receivable when other substantive procedures would be “at least as persuasive as” the evidence expected to be obtained through confirmation. A few commenters observed that the absence of a definition of the term “persuasive” in AS 1105 contributed to a lack of clarity as to the Board’s expectations and requested more guidance about how to measure or evaluate persuasiveness. Several commenters emphasized that, rather than focus the requirement for overcoming the presumption to confirm accounts receivable on whether audit evidence obtained through audit procedures other than confirmation is “at least as persuasive as” evidence expected to be obtained through confirmation, the Board should focus the requirement on obtaining evidence that is sufficient and appropriate to address the assessed risk of material misstatement or, as one commenter suggested, on the reliability of the audit evidence.
- Several commenters suggested that the Board retain provisions similar to those in existing AS 2310.34 for allowing the auditor to overcome the presumption to confirm accounts receivable. In addition, several firms and firm-related groups suggested that the auditor’s ability to overcome the presumption to confirm should be based on risk assessment, similar to the provision in existing AS 2310 addressing when the assessed level of inherent and control risk is low.
- Many firms and firm-related groups expressed concern that the criteria for overcoming

the presumption would result in auditors having to use confirmation even in situations where historically confirmations were determined by the auditor to be ineffective and not to provide persuasive audit evidence.

- One commenter stated that, if the proposed language were adopted, auditors would likely default to confirming accounts receivable over other audit procedures to avoid second-guessing of their determinations of the persuasiveness of audit evidence.
- Several commenters, primarily firms and firm-related groups, stated that the 2022 Proposal imposed a higher threshold than the existing standard for auditors to overcome the presumption to confirm accounts receivable without a corresponding increase to audit quality.

As previously discussed, the new standard creates a presumption that the auditor performs confirmation procedures or otherwise obtains relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. Under PCAOB standards, in general, evidence obtained directly by the auditor from a knowledgeable external source is more reliable than evidence obtained indirectly.⁵⁹ However, the Board appreciates that there are instances where the auditor determines that performing confirmation procedures in response to a risk of material misstatement related to accounts receivable would not be feasible. For example, commenters described situations involving a history of low response rates to confirmation requests in certain industries (e.g., healthcare, utilities), or where customers have been advised by a government agency to avoid providing personal or financial information in response to an unexpected request. The Board further understands that companies in other industries (e.g., large retailers, defense and aerospace companies that contract with the federal

⁵⁹ See AS 1105.08.

government) do not, as a matter of policy, respond to confirmation requests. There may also be instances in which the performance of confirmation procedures would not result in reliable audit evidence.

Accordingly, paragraph .25 allows the auditor to perform other substantive procedures in response to a risk of material misstatement, as long as such procedures include tests of details, if the auditor determines it is not feasible to obtain audit evidence directly from a knowledgeable external source pursuant to paragraph .24. Paragraph .25 specifically provides that the auditor's determination should be based on the auditor's experience, such as prior years' audit experience with the company or experience with similar engagements where the auditor did not receive confirmation responses, and the auditor's expectation of similar results if procedures were performed pursuant to paragraph .24. Any such determination would be performed as part of conducting the audit based on the available facts and circumstances at that time and properly supported in the audit documentation for the engagement.⁶⁰ In addition, as described below, for significant risks associated with accounts receivable, the auditor would be required to communicate with the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

This provision replaces the concept in the 2022 Proposal about obtaining audit evidence that was "at least as persuasive as" the evidence expected to be obtained through confirmation procedures. It also specifies that the auditor should perform other substantive procedures, including tests of details, in these situations to make clear that performing only substantive

⁶⁰*See AS 1215.05.*

analytical procedures would not be sufficient to overcome the presumption to confirm. These other substantive procedures should involve obtaining external information indirectly.

For accounts receivable, the auditor may be able to satisfy this requirement by obtaining information that is in the company's possession that the company received from one or more knowledgeable external sources.⁶¹ Examples of such external information may include, for example, subsequent cash receipts, shipping documents from third-party carriers, customer purchase orders, or signed contracts and amendments thereto. This information may be in electronic form (e.g., a purchase order initiated by a customer through a company's website) or in paper form (e.g., a signed contract).

Conversely, when performing other substantive procedures under this provision, it would not satisfy the requirements of the new standard to use or rely solely on the company's internally produced information. For example, an audit procedure that involves an automated matching analysis of a company's revenue, accounts receivable, and cash journal entries recorded by the company would be insufficient on its own because such an analysis only involves the company's internally produced information. On the other hand, when such internally produced information is evaluated in conjunction with external information that the company received from a knowledgeable external source, such as checks that the company received directly from customers or information on subsequent cash receipts that the company received from a financial institution, the procedures would involve audit evidence from a knowledgeable external source.

⁶¹ See also *Proposed Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form*, PCAOB Rel. No. 2023-004 (June 26, 2023) (proposing amendments to PCAOB auditing standards to specify auditor responsibilities regarding certain company-provided information that the auditor uses as audit evidence, including information that the company received from external sources).

Under existing PCAOB standards, the quantity of audit evidence needed is affected by its quality, including its reliability, and in general evidence obtained directly by the auditor is more reliable than evidence obtained indirectly. This applies to all information (including external information) used by the auditor in arriving at the conclusions on which the auditor's opinion is based. For example, as the quality of the evidence increases, the need for additional corroborating evidence decreases. The auditor should be mindful of these requirements when determining an appropriate audit response to a risk of material misstatement that involves obtaining external information indirectly under the new standard.

Further, when performing audit procedures that involve obtaining external information, the auditor should be mindful of other relevant PCAOB standards that address the documentation of the procedures performed and the relevance and reliability of the audit evidence obtained.⁶² Audit documentation must clearly demonstrate the work performed by the auditor. In addition, the reliability of that audit evidence depends on the nature and source of the evidence and the circumstances under which it is obtained.

*Communicating with the Audit Committee About the Auditor's Response
to Significant Risks for Cash and Accounts Receivable*

The 2022 Proposal included a requirement for the auditor to communicate to the audit committee⁶³ instances where the auditor had determined that the presumption to confirm accounts receivable had been overcome. In proposing that requirement, the Board considered the long-standing practice by auditors in the United States to confirm accounts receivable, and noted that a communication requirement when the presumption to confirm is overcome could enhance

⁶² See e.g., AS 1215.05-.06 and AS 1105.07-.08.

⁶³ The term "audit committee," as used in the new standard, has the same meaning as defined in Appendix A of AS 1301, *Communications with Audit Committees*.

the audit committee's understanding of the auditor's strategy. In this regard, existing standards require the auditor to communicate to the audit committee about the auditor's overall audit strategy, significant risks identified during risk assessment procedures, significant changes to the planned audit strategy, and significant difficulties encountered during the audit.⁶⁴ Existing AS 2310 does not have a requirement to communicate to the audit committee about overcoming the presumption to confirm accounts receivable.

The new standard contains a requirement for the auditor to communicate with the audit committee about the auditor's response to significant risks associated with cash or accounts receivable when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

Several commenters, primarily investor-related groups, supported the proposed requirement in the 2022 Proposal that the auditor communicate to the audit committee when an auditor overcomes the presumption to confirm accounts receivable. One of the commenters referred to a statement in the 2022 Proposal that a requirement to communicate to the audit committee when overcoming the presumption to confirm accounts receivable "may reinforce the auditor's obligation to exercise due professional care in making that determination." This commenter also noted that overcoming the presumption could result in a critical audit matter under AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.⁶⁵

⁶⁴ See AS 1301.09, .11, .23.

⁶⁵ A critical audit matter is defined in AS 3101.A2 as "[a]ny matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment."

Many commenters on this aspect of the 2022 Proposal, primarily firms and firm-related groups, disagreed with a specific requirement to communicate with the audit committee on this matter. These commenters asserted that such a requirement did not align with principles in AS 1301 to communicate with the audit committee about significant risks, including audit matters arising from the audit that are significant to the oversight of the company's financial reporting process. A number of these commenters also noted that, if there were a significant risk in accounts receivable or associated with a critical audit matter, the auditor would already be required to communicate these matters under AS 1301. Several other commenters indicated that they did not object to a more targeted requirement to communicate with the audit committee about overcoming the presumption to confirm when accounts receivable was assessed as a significant risk.

In addition, several commenters asserted that a requirement to communicate to the audit committee about overcoming the presumption to confirm would not improve audit quality, and could be detrimental if this communication became a compliance exercise for auditors, detracting them from performing effective audit procedures. A few commenters also stated there would not be a benefit to audit quality if the Board were to mandate that auditors treat instances of overcoming the presumption to confirm as a critical audit matter.

The 2022 Proposal stated that there may be some expectation by audit committees that the auditor would use confirmation as part of a planned audit response. One commenter encouraged the Board to perform outreach with audit committees to understand whether this expectation was, in fact, widespread and whether the proposed communication requirement would be relevant and meaningful.

Having considered the comments received, the Board does not believe it is necessary to require the auditor to inform the audit committee in every instance where the auditor performed substantive audit procedures other than confirmation to address the risk of material misstatement of cash or accounts receivable. However, the Board believes the auditor should inform the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source when responding to significant risks associated with either cash or accounts receivable.

This targeted requirement is consistent with the views expressed by several commenters, as discussed above. It is also consistent with the existing obligation of auditors under PCAOB standards to communicate to the audit committee an overview of the overall audit strategy and to discuss with the audit committee the significant risks of material misstatement identified during the auditor's risk assessment procedures.⁶⁶ In addition, as with other matters arising from the audit of financial statements and communicated or required to be communicated to the audit committee, the auditor is required to determine whether these matters are critical audit matters in accordance with AS 3101.⁶⁷

Confirming Terms of Certain Transactions

The 2022 Proposal provided that, for significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction. This provision updates a requirement in existing AS 2310.08 that the auditor should consider confirming the terms of certain transactions that are associated with high levels of risk. The 2022 Proposal used

⁶⁶ See AS 1301.09.

⁶⁷ See AS 3101.11-.12.

the terminology “significant risk” and “significant unusual transactions,” but the provision was intended to be similar to that in existing AS 2310.

The Board adopted the proposed requirements to consider confirming terms of certain transactions, with certain modifications discussed below.

Several commenters noted that the provision in the 2022 Proposal was sufficiently clear and appropriate. Other commenters suggested various modifications to the provision that they asserted would improve its clarity, such as elaborating on the meaning of the term “complex transaction” and stating that the provision applies when the assertions related to the significant risk of material misstatement can be adequately addressed through confirmation. Several commenters indicated that other audit procedures, not including confirmation, may adequately address an assessed significant risk over the existence assertion, such as obtaining and reviewing an original executed contract and verifying the execution of its terms over a period of time.

To provide additional clarity, the new standard provides that the auditor should consider confirming those terms of a complex transaction or significant unusual transaction that are associated with a significant risk of material misstatement, including a fraud risk. Under the new standard, examples of such terms may include terms relating to (i) oral side agreements, or undisclosed written or oral side agreements, where the auditor has reason to believe that such agreements exist, (ii) bill and hold sales, and (iii) supplier discounts or concessions. When such arrangements or agreements are part of a complex transaction or significant unusual transaction identified by the auditor, there may be a heightened risk that the transaction has been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets. Likewise, a complex transaction or a significant unusual transaction could have a heightened risk of error whereby confirmation could lead to identification of an additional term that, under an accounting

standard, might have accounting implications not previously recognized by either the company or the auditor. Accordingly, the auditor's confirmation of terms related to such arrangements or agreements may assist the auditor in evaluating the business purpose, or lack thereof, of the transaction.⁶⁸ These examples are not intended to be an exhaustive list. An auditor may identify other terms to confirm relating to a complex transaction or a significant unusual transaction if the auditor decides that confirmation could result in obtaining relevant and reliable audit evidence about that transaction.

One investor-related group recommended that the provision in the 2022 Proposal addressing the terms of complex transactions and significant unusual transactions should be mandatory and read "should" instead of "should consider." In contrast, other commenters asserted that the provision was unduly prescriptive. Several commenters recommended that the Board change the phrase "should consider" to "may consider" to allow for more auditor judgment in determining the audit procedures to perform to address significant unusual transactions or other complex transactions. The Board believes that the provision stating that the auditor "should consider" confirming terms of complex transactions or significant unusual transactions associated with a significant risk of material misstatement is sufficiently risk-based for the auditor to have flexibility in selecting the audit procedures that are best suited to address significant risks of material misstatement, depending on the facts and circumstances of individual transactions.

Another commenter suggested that the Board place additional emphasis on the auditor having a heightened degree of professional skepticism, similar to a provision in existing AS 2310.27, and that doing so would allow auditors to make appropriate judgments in determining

⁶⁸ See AS 2401.67.

whether facts and circumstances indicate that confirmation procedures may not produce sufficient appropriate evidence to address the assessed risks. The Board did not include additional language in the new standard about the auditor's potential need to exercise a heightened degree of professional skepticism related to confirmation because the auditor's obligation to apply professional skepticism is relevant to all aspects of the audit.⁶⁹

Performing Alternative Procedures for Selected Items

(See paragraphs .C1 – .C2 of the new standard)

The 2022 Proposal provided that the auditor should perform alternative procedures in certain scenarios involving identifying confirming parties or evaluating the reliability of confirmation responses, as well as in scenarios involving nonresponses and incomplete responses.⁷⁰ This range of scenarios was broader than under existing AS 2310, which provides that, with certain exceptions, the auditor should apply alternative procedures where the auditor has not received replies to positive confirmation requests. In addition, existing AS 2310 provides examples of alternative procedures, and requires the auditor to evaluate the combined evidence provided by confirmation and any alternative procedures and send additional confirmation requests or perform other audit tests, as needed, to obtain sufficient appropriate audit evidence.

The 2022 Proposal provided examples of alternative procedures that may provide relevant and reliable audit evidence regarding accounts receivable, accounts payable, and the terms of a transaction or agreement. These provisions expanded upon the examples of alternative procedures discussed in existing AS 2310.

⁶⁹ See AS 1015.07.

⁷⁰ See paragraphs .20 (inability to identify a confirming party), .26 (unreliable response), and .30 (nonresponse or incomplete response) of the proposed standard.

The 2022 Proposal did not specify whether performing alternative procedures for the items the auditor was unable to confirm, alone or in combination with other audit procedures, is necessary to obtain sufficient appropriate audit evidence. Under the 2022 Proposal, the auditor would make that determination based on the facts and circumstances of the audit. Further, an auditor might determine that, without obtaining a reliable confirmation response, the auditor is unable to obtain sufficient appropriate audit evidence for a relevant assertion through performing alternative procedures for the items the auditor could not confirm, other audit procedures, or both (e.g., if the auditor observes conditions during the confirmation process that indicate a heightened fraud risk). In such scenarios, the 2022 Proposal provided that the auditor would consider the impact on the audit opinion in accordance with AS 3105.

The 2022 Proposal also provided that performing alternative procedures may not be necessary where items selected for confirmation for which the auditor was not able to complete audit procedures would not – if misstated – change the outcome of the auditor’s evaluation of the effect of uncorrected misstatements performed in accordance with AS 2810.17.⁷¹ For example, following the direction in AS 2810.17, under the 2022 Proposal an auditor may have determined that an item that the auditor was unable to confirm would not be material individually or in combination with other misstatements. In such situations, the auditor would not have been required to perform alternative procedures.⁷² Existing AS 2310 includes an analogous exception.

⁷¹ The auditor’s evaluation of materiality under AS 2810.17 takes into account both relevant quantitative and qualitative factors.

⁷² In certain circumstances, auditors may have obligations independent of the Board’s auditing standards to perform either confirmation procedures or other auditing procedures. *See, e.g.*, Section 30(g) of the Investment Company Act of 1940, 15 U.S.C. § 80a-29(g) (providing that the auditor’s report on the financial statements of a registered investment company “shall state that such independent public accountants have verified securities owned, either by actual examination, or by receipt of a certificate from the custodian, as the Commission may prescribe by rules and regulations”).

The Board adopted the requirements substantially as proposed, with certain modifications discussed below.

In the 2022 Proposal, the additional discussion of alternative procedures appeared in the main body of the proposed standard (paragraph .31). To enhance the readability of these provisions and facilitate their implementation, the Board has relocated them to Appendix C, which includes one paragraph that describes when performing other audit procedures may be necessary (paragraph .C1) and a second paragraph that provides further direction as to when alternative procedures are required under the new standard and includes examples of alternative procedures (paragraph .C2).

In addition, to remind auditors that the auditor's assessment of risks of material misstatement, including fraud risks, should continue throughout the audit, including the confirmation process, paragraph .C1 of the new standard states that, when the auditor is unable to obtain relevant and reliable audit evidence about the selected item through confirmation, the auditor should evaluate the implications for the auditor's assessment of the relevant risks of material misstatement, including fraud risks.

Several commenters indicated that the circumstances in the 2022 Proposal under which the auditor generally would be required to perform alternative procedures were sufficiently clear and appropriate. However, multiple commenters suggested that the Board include an example of an alternative procedure for cash. In consideration of these comments, the Board has incorporated an example of an alternative procedure that may provide relevant and reliable audit evidence regarding cash, which involves the auditor verifying information about the company's cash account maintained in a financial institution's information system by viewing this information directly on a secure website of the financial institution. In this example, the auditor

might verify such information by determining the validity of the financial institution's website and viewing the information directly on the secure website. The information viewed by the auditor could be accessed either by the auditor, using login credentials provided by the company, or by company personnel. This additional example is intended to address some commenters' misperception that the 2022 Proposal would not allow the auditor to perform alternative procedures in the event that a positive confirmation request related to cash does not result in a confirmation response.

Several commenters asserted that the note in the 2022 Proposal identifying situations where alternative procedures may not be necessary was not clear, with one commenter indicating that the analogous exception in existing AS 2310 was clearer because it addressed audit sampling. In consideration of these comments, the Board has revised the note to paragraph .C2 of the new standard to clarify how the exception from performing alternative procedures for selected items should be applied and revised the footnote in the paragraph to further explain how the exception is applied in scenarios involving audit sampling.

The following example further illustrates applying this provision in an audit: An auditor selects a sample of 50 accounts receivable invoices for confirmation and receives confirmation responses for 45 invoices that do not indicate a need for the auditor to perform alternative procedures. For two nonresponses, the auditor performs alternative procedures and obtains relevant and reliable audit evidence identifying no misstatements. For the three remaining nonresponses, the auditor does not perform alternative procedures because the auditor appropriately determines that, even if the amounts associated with the invoices were projected as 100 percent misstatements to the population from which the sample was selected and added to any other accounts receivable misstatements (i.e., accounts receivable misstatements identified

through audit procedures other than confirmation), the outcome of the auditor's evaluation performed in accordance with AS 2810.17 would not change.

Another commenter recommended that, for nonresponses, the Board require that the auditor "must" perform alternative procedures that include examining third-party evidence. This commenter also suggested that the Board revise the example of alternative procedures for accounts receivable by removing the phrase "one or more," such that the auditor would perform all of the procedures identified in the example (i.e., examining subsequent cash receipts, shipping documents, and other supporting documentation).

Having considered these comments, the Board believes that, with the modifications discussed above, the requirements in paragraph .C1 of the new standard provide appropriate direction regarding when alternative procedures are required. Additionally, the Board believes that including examples in paragraph .C2 of alternative procedures that may provide relevant and reliable audit evidence about selected items, without mandating specific procedures, is appropriate, as it is impracticable to describe specific procedures for all scenarios that could occur in an audit.

Additionally, as discussed above, the Board has modified paragraph .B2 of the new standard to provide that in circumstances where the auditor should not use an intermediary to send confirmation requests or receive confirmation responses, the auditor should send confirmation requests without the use of an intermediary or, if unable to do so, perform alternative procedures in accordance with Appendix C of the new standard. In light of this modification, the Board has added a reference to paragraph .B2 to Appendix C of the new standard.

Evaluating Results

(See paragraph .31 of the new standard)

The 2022 Proposal did not carry forward a requirement, included in existing AS 2310, for the auditor to evaluate in the aggregate audit evidence obtained from performing confirmation procedures and any alternative procedures. Excluding this requirement from the 2022 Proposal was intended to avoid the duplication of certain requirements of AS 2810 that discuss the auditor's responsibilities for evaluating audit results and determining whether the auditor has obtained sufficient appropriate audit evidence.

As discussed above, however, paragraph .24 of the new standard allows the auditor to perform audit procedures other than confirmation for cash and accounts receivable to obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. The Board therefore decided to remind the auditor in paragraph .31 of the new standard that the auditor should evaluate the combined audit evidence provided by confirmation procedures, alternative procedures, and other procedures to determine whether sufficient appropriate audit evidence has been obtained in accordance with AS 2810.

Other Matters

This section addresses certain additional matters that were also discussed in the 2022 Proposal. In addition, this section discusses definitions included in the new standard and related amendments to PCAOB auditing standards.

Management Requests Not to Confirm

Consistent with existing AS 2310, the 2022 Proposal did not address, nor does the new standard address, situations in which management requests that the auditor not confirm one or more items.

Several commenters agreed with the approach in the 2022 Proposal and indicated that auditor responsibilities in such situations are already addressed by existing PCAOB standards.

One commenter suggested that the Board consider adding a requirement that, if management requests an auditor not to confirm a certain item, the auditor should both request management to indicate the reason for the request and, as appropriate, consider whether the request is indicative of a risk of material misstatement. Another commenter agreed that the potential scope limitation or fraud risk from a management request not to confirm is addressed in other PCAOB standards, but expressed the view that including guidance in the new standard unique to confirmation would be appropriate. A different commenter did not suggest changes to the Board's approach, but observed that management requests not to confirm are primarily relevant in the financial services industry and that it had experienced infrequent management requests not to confirm in other industries.

Having considered the comments received, the Board believes that existing PCAOB standards appropriately address situations involving management requests not to confirm. In particular, AS 1301 requires that the auditor communicate to the audit committee disagreements with management⁷³ and difficulties encountered in performing the audit, including unreasonable management restrictions encountered by the auditor on the conduct of the audit (e.g., an unreasonable restriction on confirming transactions or balances).⁷⁴ AS 3105 also sets forth requirements regarding limitations on the scope of an audit,⁷⁵ including scope limitations relating to confirmation.⁷⁶

Further, AS 2110 and AS 2401 describe the auditor's responsibilities regarding identifying, assessing, and responding to fraud risks. For example, AS 2401.09 states that fraud

⁷³ See AS 1301.22.

⁷⁴ See AS 1301.23.

⁷⁵ See AS 3105.05-.17.

⁷⁶ See AS 3105.07.

may be concealed by withholding evidence. A management request to limit audit testing by not obtaining external audit evidence through confirmation could be relevant to the auditor's consideration of fraud risk factors, including the consideration of management incentives, opportunities, and rationalization for perpetrating fraud. Considering the applicability of existing provisions to situations involving management requests not to confirm, as discussed above, the Board believes that including analogous requirements in the new standard could lead to unnecessary duplication of existing requirements and potential confusion.

Restrictions and Disclaimers

The requirements in the proposed standard relating to the auditor's evaluation of the reliability of confirmation responses included a reminder, in the form of a footnote, of the auditor's responsibilities under AS 1105 as they relate to restrictions and disclaimers. A similar reminder does not exist in existing AS 2310.

The Board is including this reference to AS 1105.08 as proposed, in a footnote to paragraph .18 of the new standard. No comments were received on this aspect of the 2022 Proposal. In accordance with AS 1105.08, the auditor should evaluate the effect of restrictions, limitations, or disclaimers in confirmation responses on the reliability of audit evidence.⁷⁷

Direct Access

The 2022 Proposal did not describe direct access as a confirmation procedure. Existing AS 2310 currently does not address such a procedure, but the 2010 Proposal had provided that direct access could be considered a confirmation procedure in certain circumstances.

A few commenters on the 2022 Proposal either agreed with, or indicated that they did not object to, the Board's stated position that direct access does not constitute a confirmation

⁷⁷ See AS 1105.08.

procedure. However, several firms and firm-related groups stated that, when properly executed, audit evidence obtained by the auditor through direct access can provide persuasive evidence about the existence of cash. One commenter recommended that the PCAOB consider aligning with the AICPA's position on this matter by acknowledging that the auditor's direct access to information held by a confirming party may meet the definition of a confirmation procedure when, for example, the confirming party provides the auditor with the electronic access codes or other information necessary to access a secure website where data that addresses the subject matter of the confirmation is held.

Having considered these comments, the Board adopted the new standard as proposed in relation to direct access.

While direct access does not constitute a confirmation procedure under the new standard, the new standard provides that the auditor may obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, as discussed above.

Definitions

To operationalize the requirements included in the 2022 Proposal, the proposal included definitions for “confirmation exception,” “confirmation process,” “confirmation request,” “confirmation response,” “confirming party,” “negative confirmation request,” “nonresponse,” and “positive confirmation request.”

The Board adopted the definitions as proposed, with certain modifications discussed below.

Several commenters stated that, in general, the definitions in the 2022 Proposal were sufficiently clear and appropriate. Other commenters either did not provide comments on the proposed definitions or suggested certain modifications, as discussed below.

Some commenters stated that the Board should modify the proposed definition of “nonresponse” to reflect that a nonresponse includes a situation where the auditor does not receive a confirmation response to a positive confirmation request directly from the intended confirming party. Having considered this comment, the Board is aligning the definition of “nonresponse” with the definition of “confirmation response” and the requirements of paragraph .16 of the new standard. This modification clarifies that a confirmation response that is not received directly from the confirming party would constitute a nonresponse. The Board has also modified the definition of “negative confirmation request” to use the defined term “confirmation request” rather than “request.”

One commenter proposed modifications to the definitions of “confirmation exception” and “confirmation process” to specify that (i) sending a confirmation request may include transmitting the request in electronic form and (ii) only differences between a confirmation response and information the auditor obtained from the company that the auditor had originally sought to confirm constitute a confirmation exception. Having considered the comment, the Board notes that the proposed definition of “confirmation process” intentionally did not prescribe the method or methods by which confirmation requests can be sent and by which confirmation responses can be received, as the standard is intended to apply to all methods of sending and receiving confirmation requests and responses. Further, the Board believes that any instance where information in a confirmation response differs from information the auditor obtained from the company, even if the information in the confirmation response was not information that the auditor originally sought to confirm, should constitute a confirmation exception. Accordingly, the Board adopted the definition of “confirmation exception” as proposed and adopted the definition of “confirmation process” as proposed, with one modification to include “selecting

one or more items to be confirmed” in the definition to align with the requirements specifically related to the confirmation process in the new standard.

The 2022 Proposal also indicated that an oral response to a confirmation request was a nonresponse. One commenter stated that a video recording of a call between an auditor and an individual at a confirming party ought not be considered less reliable audit evidence than a written response from an organization. Another commenter suggested that the PCAOB define the term “confirmation” because the 2022 Proposal stated that an oral response was a nonresponse but did not provide guidance as to whether other forms of response would be evidence of confirmation.

As the Board continues to believe that obtaining direct written communication, in paper or electronic form, from a confirming party is necessary for a response to constitute a confirmation response, the Board has not made further modifications to the definition in the new standard beyond those described above. Accordingly, a video recording of a call between an auditor and an individual at a confirming party or an oral response would constitute nonresponses under the new standard, although the auditor could still consider the relevance and reliability of the audit evidence provided by a video recording or an oral response when determining the nature and extent of alternative procedures required to be performed under the new standard.

Amendments to Related PCAOB Auditing Standards

The Board adopted amendments to several existing PCAOB auditing standards to align with the new standard.

Amendments to AS 1105

(See paragraph .18 of AS 1105, as amended)

The 2022 Proposal included proposed amendments to AS 1105 to (i) align the description of a “confirmation response” in AS 1105 with the definition of the same term included in the 2022 Proposal and (ii) clarify that the terms “confirmation response,” “confirmation request,” and “confirming party,” as used in AS 1105, have the same meaning as defined in Appendix A of the 2022 Proposal.

The Board adopted the amendments as proposed.

Existing AS 1105.18 states that “[a] confirmation response represents a particular form of audit evidence obtained by the auditor from a third party in accordance with PCAOB standards.” The 2022 Proposal used the defined term “confirming party” in lieu of “third party.” One commenter suggested retaining the phrase “third party” in AS 1105.18 to provide further clarity. The Board is not using this term because the new standard describes a confirming party as “a third party, whether an individual or an organization, to which the auditor sends a confirmation request,” thus making it clear that a confirming party is a third party.

Another commenter suggested that the Board strike the word “independent” from AS 1105.08, which states that “[e]vidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources.” This commenter asserted that, although confirmation evidence may be more reliable, it is not truly “independent.” The Board is not striking the word “independent” from AS 1105.08 as it believes the concept expressed in AS 1105.08 is well understood by auditors and does not purport to be a definitive statement about the “independence” of evidence from a confirming party.

Amendments to AS 1301

(See Appendix B to AS 1301, as amended)

The 2022 Proposal included a proposed requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination. The 2022 Proposal included a conforming amendment to AS 1301 that would refer to the proposed requirement.

The Board adopted the conforming amendment to AS 1301 that refers to the audit committee communication requirement contained in the new standard. The required communication with the audit committee about the auditor's response to significant risks associated with cash or accounts receivable when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source is discussed above.

Amendments to AS 2401

(See paragraphs .54 and .66A of AS 2401, as amended)

The 2022 Proposal included a proposed amendment to AS 2401 to refer to the title of the confirmation standard as proposed in the 2022 Proposal (i.e., "The Auditor's Use of Confirmation").

The Board adopted the amendment as proposed and adopted an additional conforming amendment to AS 2401, as discussed below.

One commenter suggested that the Board consider a conforming amendment to AS 2401 to acknowledge a requirement in proposed paragraph .15 to consider confirming terms of the transaction for significant risks of material misstatement associated with either a complex transaction or significant unusual transaction. Having considered the comment, the Board adopted a conforming amendment to the note to AS 2401.66A to remind the auditor of the

requirement in paragraph .30 of the new standard that for significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk.

Amendments to AS 2510

(See paragraph .14 of AS 2510, as amended)

AS 2510.14 includes a statement that “if inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian.” The 2022 Proposal included a proposed amendment to AS 2510 to remind auditors that AS 2310 establishes requirements for the auditor’s use of confirmation.

The Board adopted the amendment as proposed.

One commenter stated that the Board should address the confirmation of inventory in the new standard instead of making conforming amendments to AS 2510. The Board continues to believe that including requirements related to inventory in a single standard is appropriate. However, the Board acknowledges that AS 2510.14 includes two requirements related to the confirmation of inventory. First, AS 2510.14 provides that “[i]f inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian.” Second, AS 2510.14 further states that the auditor should perform one or more of four additional procedures, as considered necessary by the auditor, if such inventories represent a significant proportion of current or total assets. One such procedure is to confirm pertinent details of pledged receipts with lenders (on a test basis, if appropriate), if warehouse receipts have been pledged as collateral. The Board has added a cross-

reference to AS 2510 in footnote 4 of the new standard to clarify that AS 2510 also includes auditor responsibilities relevant to the auditor's use of confirmation.

Amendments to AS 2605

(See paragraphs .22 and .27 of AS 2605, as amended)

AS 2605.22 includes a statement that “for certain assertions related to less material financial statement amounts where the risk of material misstatement or the degree of subjectivity in the valuation of the audit evidence is low, the auditor may decide, after considering the circumstances and the results of work (either test of controls or substantive tests) performed by internal auditors on those particular assertions, the audit risk has been reduced to an acceptable level and that testing of the assertions directly by the auditor may not be necessary.” The paragraph then includes assertions about the existence of cash, prepaid assets, and fixed-asset additions as examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence.

The 2022 Proposal included a proposed amendment to strike the word “cash” from AS 2605.22 to avoid confusion, as the 2022 Proposal required the auditor to perform confirmation procedures in respect of cash.

In addition, the 2022 Proposal included a proposed amendment to acknowledge in paragraph .27 of AS 2605, which discusses using internal auditors to provide direct assistance to the auditor, the proposed restrictions on the use of internal audit in a direct assistance capacity in the confirmation process.

The Board adopted the amendments substantially as proposed, with certain modifications discussed below.

One commenter indicated that the proposed amendment to AS 2605.22 (i.e., striking the word “cash” from the list of accounts that might have a low risk of material misstatement), inappropriately assumed that there is always a heightened risk of fraud related to cash accounts in all audit engagements. Having considered the comment, the Board notes that neither the 2022 Proposal nor the new standard suggests that there is heightened risk of fraud associated with cash in every engagement. However, the Board believes that where an auditor identifies a risk of material misstatement for cash (i.e., where cash is a significant account) it is necessary for the auditor to perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source in respect of cash. Accordingly, the Board continues to believe that the conforming amendment to AS 2605.22 is appropriate.

Another commenter indicated that the proposed amendment to AS 2605.27 would not be necessary should the Board adopt the commenter’s other recommendation to remove the proposed restrictions regarding the use of internal audit in the new standard. As discussed above, the Board continues to believe that in order to maintain control over the confirmation process the auditor should select items to be confirmed, send confirmation requests, and receive confirmation responses. The Board modified the conforming amendments to AS 2605.27, however, to align with paragraph .15 of the new standard.

Effective Date

The Board determined that the amendments will take effect, subject to approval by the SEC, for audits of financial statements for fiscal years ending on or after June 15, 2025.

As part of the 2022 Proposal, the Board sought comment on the amount of time auditors would need before the proposed standard and related amendments would become effective, if

adopted by the Board and approved by the SEC. Many commenters, primarily firms and firm-related groups, supported an effective date of no earlier than two years after SEC approval, which some commenters indicated would give firms the necessary time to update firm methodologies and to develop and implement training. Additionally, as part of recommending an effective date no earlier than two years after SEC approval, a number of commenters observed that confirmation procedures are often performed as part of interim procedures and that, as a result, the new standard will impact engagement teams during the period under audit. Some commenters also stated that intermediaries involved in the confirmation process may also need to update their processes and controls as a result of the new standard. One commenter supported an effective date three years after SEC approval, while citing reasons similar to those expressed by commenters who supported an effective date of no earlier than two years after SEC approval.

The Board recognizes the preferences expressed by commenters. Nonetheless, having considered the requirements of the new standard, as well as the extent of differences between the new standard and AS 2310 and our understanding of firms' current practices, the Board believes that the effective date for fiscal years ending on or after June 15, 2025, will provide auditors with a reasonable period of time to implement the new standard and related amendments, without unduly delaying the intended benefits resulting from these improvements to PCAOB standards, and is consistent with the Board's mission to protect investors and protect the public interest.

D. Economic Considerations and Application to Audits of Emerging Growth Companies

The Board is mindful of the economic impacts of its standard setting. This section describes the economic baseline, need, and expected economic impacts of the new standard, as well as alternative approaches considered by the Board. Because there are limited data and research findings available to estimate quantitatively the economic impacts of the new standard, the economic analysis is largely qualitative in nature.

Baseline

Important components of the baseline against which the economic impact of the new standard can be considered are described above, including the Board’s existing standard governing the audit confirmation process, firms’ current practices when performing confirmation procedures, and observations from the Board’s inspections program and enforcement cases. The Board discusses below two additional components that inform its understanding of the economic baseline: (i) the PCAOB staff’s analysis of audit firm methodologies and the use of technology-based tools in the confirmation process, and (ii) a summary of academic and other literature on the confirmation process.

Auditing Practices Related to the Confirmation Process

Through its inspection and other oversight activities, the PCAOB has access to sources of information that help inform its understanding of how firms currently engage in the confirmation process. As part of this standard-setting project, the PCAOB staff has reviewed a selection of firms’ audit methodologies, as well as other information about firms’ use of technology-based tools when performing confirmation procedures. While this information is not a random sample that can be extrapolated accurately across all registered public accounting firms, the Board is able to make some general inferences that help inform development of the economic baseline.

PCAOB Staff Analysis of Audit Methodologies

PCAOB staff has reviewed the methodologies of selected registered public accounting firms to determine how they currently address the confirmation process and the extent to which changes to those methodologies will be necessary to implement the new standard. Specifically, the staff compared methodologies of selected global network firms (“GNFs”)⁷⁸ and some

⁷⁸

GNFs are the member firms of the six global accounting firm networks (BDO International Ltd.,

methodologies commonly used by U.S. non-affiliate firms (“NAFs”),⁷⁹ which are smaller than GNFs, to existing AS 2310 as well as to the new standard. The review focused on the following aspects of the new standard which represent more notable changes relative to existing AS 2310:

- Substantive procedures for confirming cash and cash equivalents (paragraphs .24, .26, and .29);
- Substantive procedures for confirming accounts receivable (paragraphs .24-.25 and .27);
- The auditor’s use of negative confirmation requests (paragraphs .12-.13);
- Maintaining control over the confirmation process, including when an intermediary is used (paragraphs .14-.17 and .Appendix B); and
- Other areas addressed in the new standard, including the evaluation of the reliability of confirmation responses (paragraphs .18-.19), and the performance of alternative procedures (Appendix C).

For the GNF methodologies reviewed, PCAOB staff observed that the methodologies generally reflect requirements in existing AS 2310 and other auditing standards on external confirmation, such as ISA 505 and AU-C 505. In addition, some of the methodologies already incorporate certain concepts included in the new standard, although revisions to the methodologies will nonetheless be needed to implement the new standard.

Specifically, some GNF methodologies, but not all, include requirements for confirmation of cash and cash equivalents held by third parties similar to the new requirements

Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Ltd., and PricewaterhouseCoopers International Ltd.).

⁷⁹ NAFs are both U.S. and non-U.S. accounting firms registered with the Board that are not GNFs. Some of the NAFs belong to international networks.

described in the new standard. Other GNF methodologies suggest, but do not require, that engagement teams consider specific confirmation procedures for cash and cash equivalents held by third parties. GNF methodologies for confirmation of accounts receivable are generally consistent with existing AS 2310. Some also include guidance that is similar in certain respects to the requirements in the new standard when the auditor is unable to obtain relevant and reliable audit evidence through confirmation procedures. With respect to negative confirmation requests, GNF methodologies acknowledge that negative confirmation requests provide less persuasive evidence than positive confirmation requests. However, some GNF methodologies still allow the use of negative confirmation requests as the sole substantive procedure under certain conditions.⁸⁰

The PCAOB staff also observed that GNF methodologies generally include guidance on maintaining control over the confirmation process, using intermediaries to facilitate the electronic transmission of confirmation requests, and assessing controls at the intermediaries. The firms' guidance in this area focuses on the performance of audit procedures to ensure that the electronic confirmation process occurs in a secure and controlled environment and that confirmation responses received are reliable. For example, the methodologies of some firms provide that an auditor may obtain a SOC report that would assist the engagement team in assessing the design and operating effectiveness of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses. Finally, although current GNF methodologies include guidance on the other areas being modernized or clarified in the new standard, GNFs may be required to make certain modifications to their methodologies to conform to the new standard, such as whether to perform alternative procedures.

⁸⁰ See AS 2310.20 for these conditions.

For the NAF methodologies reviewed, the PCAOB staff observed that the methodologies generally align with existing AS 2310 across each of the areas studied, but include some guidance related to the new requirements in the new standard. For example, in some of the NAF methodologies, the confirmation of cash and cash equivalents held by third parties is a consideration but not a requirement. In other NAF methodologies, the confirmation of cash and cash equivalents held by third parties and negative confirmation requests are not discussed at all. NAF methodologies for confirmation of accounts receivable are generally consistent with existing AS 2310. Some include guidance that is similar in certain respects to the requirements described in the new standard when the auditor is unable to obtain relevant and reliable audit evidence through confirmation procedures.

The NAF methodologies also generally include guidance on maintaining control, using intermediaries in the confirmation process, and assessing controls at the intermediaries. Similar to GNF methodologies, NAF guidance in this area focuses on the performance of audit procedures to ensure that the electronic confirmation process occurs in a secure and controlled environment and that confirmation responses received are reliable. For example, a firm's methodology may provide that an auditor may obtain a SOC report that would assist the engagement team in assessing the design and operating effectiveness of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses.

Commenters on the 2022 Proposal did not provide additional information on firm methodologies beyond the staff's analysis. In general, the PCAOB staff's review indicates that all firms will likely need to revise their methodologies to some extent to implement the new standard. For example, all firms will need to update their methodologies to ensure that negative

confirmation requests are not used as the sole source of audit evidence. NAF methodologies will likely require more revisions than the GNF methodologies, which have incorporated certain concepts included in the new standard.

Use of Technology-Based Tools

The PCAOB staff has also reviewed information collected through PCAOB oversight activities on firms' use of technology-based tools in the confirmation process. The staff's review focused primarily on the use of technology-based tools by GNFs, but also encompassed certain technology-based tools used by some NAFs. In addition, the review encompassed information on both proprietary technology-based tools that firms have developed internally and third-party or "off-the-shelf" tools that firms purchase and use (in certain cases, with further customizations) to assist in performing confirmation procedures as part of the audit process. The staff found that the number of technology-based tools used in the confirmation process varies across firms, and also varies based on the facts and circumstances of specific engagements. Generally speaking, firms allow engagement teams to select a tool but do not provide that the use of one or more tools is required.

Both GNFs and NAFs within the scope of the PCAOB staff's review use third-party tools to automate certain confirmation procedures, or to independently verify balances, terms of arrangements, or other information under audit. GNFs appear to be more likely to invest in customizing off-the-shelf tools they have purchased to their particular environment. For example, such modifications may permit a firm to automate the reconciliation of confirmed balances to client records. In comparison, NAFs tend to use the off-the-shelf tools without customization.

The PCAOB staff's review also found that GNFs have developed proprietary applications to facilitate various aspects of the confirmation process, whether conducted manually or

electronically. These applications may facilitate the preparation of confirmation requests, their dissemination to recipients (including the preparation of logs to track confirmation requests and receipts), and the analysis of confirmation responses to determine their completeness and accuracy. GNFs have also developed tools used when auditing specific accounts, other than cash and accounts receivable, where confirmation may provide audit evidence. For example, tools are used to prepare, log, and track confirmation requests and responses for various deposit, loan, and liability accounts.

As discussed above, auditors or confirming parties may engage an intermediary to facilitate the direct electronic transmission of confirmation requests and responses between the auditor and the confirming party.⁸¹ In one area, market forces have influenced firms' willingness to use an intermediary: a majority of financial institutions will only respond to confirmation requests through a centralized process and with a specified intermediary. As a result, all firms' methodologies required, and in practice firms did use, the specified intermediary in these circumstances.

The PCAOB staff has observed diverse practices related to the procedures auditors perform to support their reliance on an intermediary's controls when establishing direct communication between the auditor and the confirming party.⁸² In some situations where the procedures performed included obtaining a SOC report, the staff has observed insufficient evaluation of SOC reports, lack of consideration of the period covered and complementary user

⁸¹ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

⁸² *Id.*

entity controls, and insufficient coordination of procedures performed centrally by the audit firm and by the engagement team.⁸³

These observations suggest that there may be a need for uniform guidance for situations involving the use of intermediaries. For example, enhanced procedures to be performed when auditors place reliance on an intermediary's controls could help address the risk of interception and alteration of communications between the auditor and the company and address the risk of override of the intermediary's controls by the company.

Commenters did not provide information about firms' use of technology-based tools that contradicted the staff's assessment. One commenter stated that some larger audit firms have established confirmation centers to centralize the sending and receiving of confirmation requests. Another commenter cited a study that noted the use of robotic process automation for confirming accounts receivable by a GNF.⁸⁴

Literature on the Confirmation Process

There is limited data on auditor confirmation decisions and research findings on the confirmation process.⁸⁵ The literature documents that confirmation is "extensively used" and that confirmation responses received directly from a third party are often perceived by practitioners to be among "the most persuasive forms of audit evidence."⁸⁶ Consistent with the PCAOB staff's observations from PCAOB oversight activities,⁸⁷ studies find that the use of electronic

⁸³ *Id.*

⁸⁴ See Feiqi Huang and Milos A. Vasarhelyi, *Applying Robotic Process Automation (RPA) in Auditing: A Framework*, 35 *Internal Journal of Accounting Information Systems* 100433, 100436 (2019).

⁸⁵ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 254 (2008).

⁸⁶ *See id.* at 253.

⁸⁷ *See Spotlight: Data and Technology Research Project Update* (May 2021), available at

confirmation has become prevalent.⁸⁸ One study also observes that current U.S. auditing standards do not fully address how auditors should authenticate confirmations sent or received electronically, and asserts that there is a need for audit guidance related to electronic forms of evidence.⁸⁹ Further, an earlier study reviews enforcement actions described in the SEC’s Accounting and Auditing Enforcement Releases and concludes that additional direction regarding when cash and accounts receivable confirmation requests are required or recommended may be needed.⁹⁰ Additionally, the literature suggests that more guidance may be necessary to identify when the risk is sufficiently low to justify the use of negative confirmation requests in certain areas.⁹¹ Moreover, an article on bank confirmation advocates a risk-based approach to the determination of confirmation procedures.⁹² Finally, a study finds that “anecdotal evidence and some research suggest confirmation response rates are declining.”⁹³ Commenters did not provide information contradicting the staff’s summary of the relevant literature.

Accordingly, the academic literature is consistent with the conclusion that the Board’s auditing requirements for the confirmation process should (i) accommodate electronic

<https://pcaobus.org/resources/staff-publications>. See also *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

⁸⁸ See, e.g., Paul Caster, Randal J. Elder, and Diane J. Janvrin, *An Exploration of Bank Confirmation Process Automation: A Longitudinal Study*, 35 *Journal of Information Systems* 1, 5 (2021).

⁸⁹ See *id.* at 2.

⁹⁰ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 261-62 (2008).

⁹¹ See *id.* at 266.

⁹² See L. Ralph Piercy and Howard B. Levy, *To Confirm or Not to Confirm-Risk Assessment is the Answer*, 91 *The CPA Journal* 54, 54 (2021).

⁹³ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 254 (2008). The PCAOB staff has also observed that the use of electronic confirmation may affect the confirmation response rate. See *Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>.

communications and address the implications of using an intermediary, (ii) address the confirmation of cash and accounts receivable, (iii) limit the use of negative confirmation requests, and (iv) align with the PCAOB's risk assessment standards.

Need

Several attributes of the audit market support a need for the PCAOB to establish effective audit performance standards. First, the company under audit, investors, and other financial statement users cannot easily observe the services performed by the auditor or the quality of the audit. This leads to a risk that, unbeknownst to the company, investors, or other financial statement users, the auditor may perform a low-quality audit.⁹⁴

Second, the federal securities laws require that an issuer retain an auditor for the purpose of preparing or issuing an audit report. While the appointment, compensation, and oversight of the work of the registered public accounting firm conducting the audit is, under the Act, entrusted to the issuer's audit committee,⁹⁵ there is nonetheless a risk that the auditor may seek to satisfy the interests of the issuer audit client rather than the interests of investors and other financial statement users.⁹⁶ This risk can arise out of an audit committee's identification with the

⁹⁴ See, e.g., Monika Causholli and Robert W. Knechel, *An Examination of the Credence Attributes of an Audit*, 26 *Accounting Horizons* 631, 632 (2012):

During the audit process, the auditor is responsible for making decisions concerning risk assessment, total effort, labor allocation, and the timing and extent of audit procedures that will be implemented to reduce the residual risk of material misstatements. As a non-expert, the auditee may not be able to judge the appropriateness of such decisions. Moreover, the auditee may not be able to ascertain the extent to which the risk of material misstatement has been reduced even after the audit is completed. Thus, information asymmetry exists between the auditee and the auditor, the benefit of which accrues to the auditor. If such is the case, the auditor may have incentives to: Under-audit, or expend less audit effort than is required to reduce the uncertainty about misstatements in the auditee's financial statements to the level that is appropriate for the auditee.

⁹⁵ See Section 301 of the Act, 15 U.S.C § 78f(m). As an additional safeguard, the auditor is also required to be independent of the audit client. See 17 CFR 210.2-01.

⁹⁶ See, e.g., Joshua Ronen, *Corporate Audits and How to Fix Them*, 24 *Journal of Economic Perspectives* 189 (2010).

company or its management (e.g., for compensation) or through management's exercise of influence over the audit committee's supervision of the auditor, which can result in a *de facto* principal-agent relationship between the company and the auditor.⁹⁷ Effective auditing standards help to address these risks by explicitly assigning responsibilities to the auditor that, if executed properly, are expected to lead to high-quality audits that satisfy the interests of audited companies, investors, and other financial statement users.

This section discusses the specific problem that the new standard is intended to address and explains how the new standard is expected to address it.

Problem to be Addressed

Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

In situations where audit evidence can be obtained from a knowledgeable external source, the resulting audit evidence is likely to be more reliable than audit evidence obtained only from internal company sources. For evidence obtained through confirmation to be reliable, the confirmation process must be properly executed. Proper execution involves assessing the reliability of a confirmation response and performing robust, additional alternative procedures when the auditor is unable to determine that a confirmation response is reliable. Similarly, proper execution may entail the performance of alternative procedures when the auditor is unable to identify a confirming party, the auditor does not receive a confirmation response from the intended confirming party, or the confirmation response is incomplete.

⁹⁷ See *id.*; see also, e.g., Liesbeth Bruynseels and Eddy Cardinaels, *The audit committee: Management watchdog or personal friend of the CEO?*, 89 *The Accounting Review* 113 (2014). Cory Cassell, Linda Myers, Roy Schmardebeck, and Jian Zhou, *The Monitoring Effectiveness of Co-Opted Audit Committees*, 35 *Contemporary Accounting Research* 1732 (2018); Nathan Berglund, Michelle Draeger, and Mikhail Sterin, *Management's Undue Influence over Audit Committee Members: Evidence from Auditor Reporting and Opinion Shopping*, 41 *Auditing: A Journal of Practice* 49 (2022).

As discussed above, the PCAOB staff has observed situations where auditors did not perform procedures to assess the reliability of confirmation responses or, where applicable, perform sufficient alternative procedures.⁹⁸ In addition, the staff has noted that, in the case of some financial reporting frauds, the company's misconduct possibly could have been detected at an earlier point in time had the auditor made an appropriate assessment of the reliability of confirmation responses received, or performed additional procedures needed to obtain reliable audit evidence.⁹⁹ These observations suggest a need for enhancements to auditing standards to more clearly address those situations where confirmation can be expected to provide reliable audit evidence, including the requirements for evaluating the reliability of confirmation responses and, if appropriate, performing alternative procedures.

Developments in Practice

There are areas of the confirmation process where developments in practice have outpaced existing requirements in the Board's auditing standards. In particular, existing AS 2310 does not reflect significant changes in technology and the methods by which auditors perform the confirmation process, including the use of electronic communication and the involvement of third-party intermediaries.

Regulatory standards that do not reflect changes in practice may lead to inconsistency in their application, potential misinterpretation, and ineffective regulatory intervention. For example, the PCAOB staff has observed diverse practices and audit deficiencies related to the procedures performed by auditors to support their use of an intermediary to facilitate the

⁹⁸ See above for observations from the PCAOB's audit inspections and from SEC enforcement cases.

⁹⁹ See also Diane Janvrin, Paul Caster, and Randy Elder, *Enforcement Release Evidence on The Audit Confirmation Process: Implications for Standard Setters*, 22 *Research in Accounting Regulation* 1, 10 (2010).

electronic transmission of confirmation requests and confirmation responses with confirming parties.¹⁰⁰

How the New Standard Addresses the Need

The new standard helps address the need by (i) strengthening requirements in certain areas to focus on the need to obtain reliable audit evidence from the confirmation process; and (ii) modernizing existing AS 2310 to accommodate certain developments in practice, including the use of electronic communications and intermediaries. The new standard is expected to promote consistent and effective practice relating to the confirmation process in audits subject to PCAOB standards, reducing the risk of low-quality audits caused by (i) the lack of observability of audit quality and (ii) the influence of the auditor-client relationship discussed above.

Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new standard strengthens the Board's requirements in certain areas to focus on the need to obtain reliable audit evidence when executing the confirmation process. Specifically, the new standard includes a presumption for the auditor to confirm certain cash and cash equivalents held by third parties, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. In addition, the new standard strengthens the requirements for evaluating the reliability of confirmation responses. It also continues to emphasize the importance of maintaining control over the confirmation process and provides additional examples of information that indicates that a confirmation request or response may have been intercepted and altered. When confirmation responses are deemed to be unreliable, the auditor is directed to perform alternative procedures to obtain audit evidence.

¹⁰⁰ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

Moreover, as discussed above, electronic communications likely have reduced the efficacy of negative confirmation requests. Under the new standard, the auditor is not able to use negative confirmation requests as the sole substantive procedure for addressing the risk of material misstatement for a financial statement assertion.

Developments in Practice

Under the new standard, the requirement to maintain control over the confirmation process addresses both traditional and newer, more prevalent forms of communication between the auditor and confirming parties, including emailed confirmation requests and responses and intermediaries facilitating electronic communication of confirmation requests and responses. The new standard is intended to apply to methods of confirmation currently in use and to be flexible enough to apply to new methods that may arise from technological changes in auditing in the future.

The new standard emphasizes that in general, evidence obtained from a knowledgeable external source is more reliable than evidence obtained only from internal company sources. For cash and accounts receivable, if the auditor is able to perform audit procedures other than confirmation that allow the auditor to obtain audit evidence by directly accessing information maintained by knowledgeable external sources, such audit evidence could be as persuasive as audit evidence obtained through confirmation procedures, and the new standard allows the auditor to perform such procedures. Accordingly, to the extent that there are newer tools available to auditors now or in the future that enable them to obtain such audit evidence directly, the new standard would accommodate their use and future development.

Economic Impacts

This section discusses the expected benefits and costs of the new standard and potential unintended consequences. Overall, the Board expects that the economic impact of the new standard, including both benefits and costs, will be relatively modest, especially for those firms that have already incorporated into practice some of the new requirements. The Board also expects that the benefits of the new standard will justify the costs and any unintended negative effects.

Benefits

The Board expects the new standard to improve the consistency and effectiveness of the confirmation process, reducing the risk of low-quality audits caused by (i) the lack of observability of audit quality and (ii) the influence of the auditor-client relationship discussed above. Specifically, there exists a risk that, unbeknownst to the company under audit, investors, or other financial statement users, the auditor may perform a low-quality audit since audit quality is difficult to observe. In addition, some auditors may aim to satisfy the interests of the company or their own financial interests rather than the interests of investors and other financial statement users — interests that may lead them to perform insufficiently rigorous confirmation procedures to minimize the burden on clients and their counterparties to respond to confirmations, or to minimize audit costs.

The new standard helps to mitigate these risks in the audit confirmation process by strengthening and modernizing the requirements for the auditor regarding the design and execution of the confirmation process. Specifically, a confirmation process designed and executed under the new standard should benefit investors and other users of financial statements by reducing the likelihood that financial statements are materially misstated, whether due to error

or fraud. Some commenters explicitly stated that the requirements described in the 2022 Proposal would improve the consistency of confirmation practices and enhance audit quality.

The enhanced quality of audits and financial information available to financial markets should also increase investor confidence in financial statements. In general, investors may use the more reliable financial information to improve the efficiency of their capital allocation decisions (e.g., investors may reallocate capital from less profitable companies to more profitable companies). Investors may also perceive less risk in capital markets generally, leading to an increase in the supply of capital. An increase in the supply of capital could increase capital formation while also reducing the cost of capital to companies.¹⁰¹

Auditors also are expected to benefit from the new standard, because the additional clarity provided by the new standard (e.g., the accommodation of current practices, including the use of electronic communications and intermediaries) will reduce regulatory uncertainty and the associated compliance costs. Specifically, the new standard provides auditors with a better understanding of their responsibilities and the Board's expectations.

The following discussion describes the benefits of key changes to existing confirmation requirements that are expected to impact auditor behavior. As discussed above, the changes aim to (1) enhance the auditor's focus on obtaining reliable audit evidence from the confirmation process, and (2) accommodate certain developments in practice. As further discussed below, the changes that enhance the auditor's focus on obtaining reliable audit evidence are expected to strengthen confirmation procedures for cash held by third parties, promote consistency in practice, improve the reliability of confirmation responses, improve the quality of audit evidence,

¹⁰¹ See, e.g., Hanwen Chen, Jeff Zeyun Chen, Gerald J. Lobo, and Yanyan Wang, *Effects of audit quality on earnings management and cost of equity capital: Evidence from China*, 28 *Contemporary Accounting Research* 892, 921 (2011); Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research* 385, 410 (2007).

and increase the auditor's likelihood of identifying potential financial statement fraud. The changes that accommodate developments in practice are expected to clarify the auditor's responsibilities regarding the use of electronic communications in the confirmation process, standardize the procedures that auditors perform to support their use of intermediaries, and allow for the use or development of more sophisticated and effective technology-based auditing tools. To the extent that a firm has already implemented certain of the provisions of the new standard into its firm methodology, the benefits described below will be reduced.

Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new standard should benefit investors and other users of a company's financial statements by placing additional emphasis on the auditor's need to obtain reliable audit evidence when performing confirmation procedures. In this regard, the new standard: (1) identifies certain accounts for which the auditor should perform confirmation procedures, (2) enhances the requirements for assessing the reliability of confirmation responses, (3) addresses the performance of alternative procedures when the auditor is unable to obtain relevant and reliable audit evidence through confirmation, (4) strengthens requirements regarding the use of negative confirmation requests, and (5) specifies certain activities in the confirmation process that should be performed by the auditor and not by other parties.

Specifically, the new presumption for the auditor to confirm certain cash and cash equivalents held by third parties or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source may reduce the risk of material errors in financial statements and strengthen investor protection to the extent that auditors are not already confirming cash pursuant to their existing audit methodologies.¹⁰² This

¹⁰²

As discussed above, the PCAOB staff's review of firm methodologies indicated that some firms

requirement also specifies that the extent of audit evidence to obtain through cash confirmation procedures should be based on the auditor's understanding of the company's cash management and treasury function.

The standard does not require that all cash accounts or all accounts receivable should be selected for confirmation. The auditor's assessment of the risk of material misstatement is an important consideration when designing audit procedures, including the use of confirmation. Consistent with the objective of the new standard, the requirement to confirm cash and accounts receivable, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, only applies when the auditor has determined that these accounts are significant accounts. Further, for both cash and accounts receivable, the new standard specifies that the auditor should take into account the auditor's understanding of the substance of a company's arrangements and transactions with third parties when selecting the individual items to confirm. These provisions in the new standard should encourage the auditor to determine the extent of confirmation procedures with regard to an assessment of the risk of material misstatement and avoid more work than necessary to obtain sufficient appropriate audit evidence.

However, to the extent that cash or accounts receivable fall within the scope of the new standard, the new standard strengthens the requirement to obtain relevant and reliable audit evidence, whether through performing confirmation procedures or otherwise obtaining audit evidence by directly accessing information maintained by a knowledgeable external source. At the same time, the new standard also addresses situations where, based on the auditor's

are already confirming cash balances, while other firms' methodologies do not require auditors to perform procedures beyond those required by AS 2310. The growth in corporate cash holdings also highlights the need to confirm cash and cash equivalents. *See, e.g.,* Kevin Amess, Sanjay Banerji, and Athanasios Lampousis, *Corporate Cash Holdings: Causes and Consequences*, 42 *International Review of Financial Analysis* 421, 422 (2015).

experience, confirmation would not be feasible for accounts receivable. The additional clarity provided by these requirements in the new standard should reduce uncertainty in auditor responsibilities and promote consistency in practice with respect to the confirmation of cash and accounts receivable.

The new standard strengthens requirements addressing the reliability of confirmation responses by describing information that the auditor should take into account when evaluating the reliability of confirmation responses and providing examples of information that indicates that a confirmation request or response may have been intercepted or altered. These requirements are expected to improve the reliability of confirmation responses and therefore increase the quality of the audit evidence obtained by the auditor.

The requirement to communicate to the audit committee instances where, for significant risks associated with cash or accounts receivable, the auditor did not perform confirmation procedures or obtain audit evidence by directly accessing information maintained by a knowledgeable external source is expected to reinforce the auditor's obligation to exercise due professional care in determining not to perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

The new standard also expands on the existing requirement to address the auditor's potential need to apply alternative procedures. The enhanced requirements for alternative procedures provide a greater level of detail and clarity to auditors for situations that are not currently addressed explicitly in existing AS 2310, potentially raising the quality of evidence obtained by auditors.

Under the new standard, the auditor may only use negative confirmation requests to supplement other substantive audit procedures; negative confirmation requests may not be used

as the sole substantive audit procedure. As discussed above, the amount of electronic correspondence has increased dramatically over the years, leading to an increased likelihood that a negative confirmation request would not be appropriately considered by the confirming party and, therefore, would provide less persuasive audit evidence. The new standard addresses this issue by providing examples of situations in which negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence. As negative confirmation requests cannot be the sole source of audit evidence obtained, insofar as the new standard affects practice, the overall quality of audit evidence obtained by the auditor likely will increase.¹⁰³

Overall, the additional requirements and examples discussed above are expected to improve the reliability of confirmation responses and, therefore, increase the quality of the audit evidence obtained by the auditor. By introducing a new requirement to confirm certain cash balances (or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source) and enhancing the requirements for evaluating the reliability of confirmation responses, the new standard may also increase the auditor's likelihood of identifying potential financial statement fraud. Early detection of accounting fraud is an important aspect of investor protection because such fraud can cause significant harm to investors in the companies engaged in fraud, as well as indirect harm to investors in other companies.¹⁰⁴ In addition, by clarifying and strengthening the auditor's

¹⁰³ The Board understands through its oversight activities that few, if any, GNFs use negative confirmation requests as the sole substantive procedure in practice. As discussed above, however, the PCAOB staff's firm methodology review suggests that all the GNFs and NAFs reviewed will need to update their methodologies to ensure that negative confirmation requests are not used as the sole source of audit evidence.

¹⁰⁴ See Yang Bao, Bin Ke, Bin Li, Y. Julia Yu, and Jie Zhang, *Detecting Accounting Fraud in Publicly Traded US Firms Using a Machine Learning Approach*, 58 *Journal of Accounting Research* 199, 200 (2020).

responsibilities, including by specifying additional situations where alternative procedures may be necessary and providing additional examples of information that indicates that a confirmation request or response may have been intercepted and altered, the new standard takes into account past inspection findings by the Board that auditors did not obtain sufficient appropriate audit evidence when using confirmation.

One commenter on the proposing release expressed the view that the proposed standard would not achieve a significant reduction in inspection findings or improvements to audit quality because adverse inspection findings have historically focused on a failure to appropriately execute existing requirements. As discussed above, however, the need for this rulemaking is not limited to noncompliance with the current standard detected through our inspections program, but also reflects undetected financial reporting frauds and developments in practice. The Board continues to believe, therefore, that the rule will achieve its intended benefits, which include increased clarity from the new standard.

Developments in Practice

The new standard modernizes existing AS 2310 by accommodating certain developments in practice, including the use of electronic communications and intermediaries.

Specifically, the new standard accommodates changes in how communications occur between the auditor and confirming parties. It clarifies the auditor's responsibilities by taking into account current confirmation practices among auditors and acknowledging differing methods of confirmation. These methods include longstanding methods, such as the use of paper-based confirmation requests and responses sent via postal mail. They also include methods that have become commonplace since the existing standard was adopted, including confirmation requests and responses communicated via email and the use of intermediaries to facilitate the

direct electronic transmission of confirmation requests and responses. This additional clarity may enhance the reliability of audit evidence by decreasing the risk that a confirmation request or response is intercepted and altered. In addition, the new standard includes requirements specific to an intermediary's controls that mitigate the risk of interception and alteration. The requirements are expected to standardize the procedures auditors perform to support their use of intermediaries and reduce audit deficiencies in this area.

With regard to both cash and accounts receivable, the new standard accommodates the potential for future evolution of audit tools by allowing auditors to directly obtain access to relevant and reliable audit evidence from knowledgeable external sources other than through confirmation without the involvement of the company. This change allows for the use or development of technology-based auditing tools, subject to the requirement that they provide audit evidence by directly accessing information maintained by knowledgeable external sources about the relevant financial statement assertion. Accordingly, this change could potentially improve the efficiency and effectiveness of the audit.

Some commenters on the 2022 Proposal questioned the benefits of the proposed requirements, arguing that the auditor's inability under the proposed standard to overcome the presumption to confirm cash and a high threshold to overcome the presumption to confirm accounts receivable unduly restricted the ability to use professional judgment to determine the appropriateness of confirmation procedures. While the Board agrees that professional judgment plays an important role in the execution of audit procedures, the Board's experience indicates that it is also important for investor protection that auditors obtain relevant and reliable audit evidence for both cash and accounts receivable when they are significant accounts. With regard to accounts receivable, the new standard retains the presumption to perform audit procedures to

obtain relevant and reliable evidence through confirmation, or otherwise by directly accessing information maintained by a knowledgeable external source, so would not decrease or remove the auditor's current responsibility. Furthermore, the new standard includes a provision to address situations when obtaining audit evidence directly from knowledgeable external sources, whether through confirmation procedures or other means, would not be feasible to execute for accounts receivable. Accordingly, the new standard strikes a balance intended to benefit investors by recognizing the value of professional judgment generally with respect to the use of confirmation while ensuring that cash and accounts receivable, when they are significant accounts, are subject to confirmation or other audit procedures designed to obtain relevant and reliable audit evidence from knowledgeable external sources.

Costs

The Board expects the costs associated with the new standard to be relatively modest. The PCAOB staff's review of audit firm methodologies related to the confirmation process indicates that some firms have already incorporated into practice some of the new requirements. For example, the methodologies of some GNFs include requirements for confirmation of cash that are similar to the requirements in the new standard. Both the GNF and NAF methodologies reviewed generally include guidance on maintaining control over the confirmation process and the use of intermediaries to facilitate the electronic transmission of confirmation requests and responses.

To the extent that audit firms need to make changes to meet the new requirements, they may incur certain fixed costs (i.e., costs that are generally independent of the number of audits performed) to implement the new standard. These include costs of updating audit methodologies and tools, and costs to prepare training materials and conduct internal training. GNFs are likely

to update methodologies using internal resources, whereas NAFs are more likely to purchase updated methodologies from external vendors. The costs of updating these methodologies likely depend on the extent to which the new requirements have already been incorporated in the firms' current methodologies. For firms that have implemented confirmation procedures like those required by the new standard, the costs of updating methodologies may be lower than for firms that currently do not have such procedures. In this regard, large firms may also benefit from economies of scale. As mentioned above, one commenter indicated that some larger audit firms have already established confirmation centers to centrally process the sending of confirmation requests and receiving of confirmation responses. For these firms, costs to implement the new standard may be further diminished as these firms may benefit from lower training costs and more efficient performance of the enhanced procedures. Smaller audit firms may not have adequate resources to establish such confirmation centers and may not recognize similar efficiency gains. The commenter observed that the establishment of confirmation centers within audit firms would require significant resources, which smaller audit firms may not have.

In addition, audit firms may incur certain engagement-level variable costs related to implementing the new standard. For example, the requirement to confirm certain cash balances or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source could impose engagement-level costs on some auditors if additional procedures need to be performed. Similarly, limiting the use of negative confirmation requests to situations where the auditor is also performing other substantive audit procedures could lead to additional time and effort by the auditor to perform the other audit procedures.

The magnitude of the variable costs likely depends on the extent to which existing practice differs from the new requirements. As discussed above, the PCAOB staff's review of firm methodologies, which included the methodologies of certain NAFs, suggests that the new standard likely will lead to a greater impact on confirmation procedures performed by smaller firms. Because the new standard generally applies a risk-based approach (i.e., by providing that the use of confirmation may be part of the auditor's response to the assessed risks of material misstatement), the costs of performing the additional procedures are unlikely to be disproportionate to the benefits.

To the extent that auditors incur higher costs to implement the new standard and are able to pass on at least part of the increased costs through an increase in audit fees, companies being audited could incur an indirect cost.¹⁰⁵ Moreover, confirming parties could incur additional costs from supporting the confirmation process as a result of the enhanced requirements of the new standard, although the additional costs are expected to be limited. One commenter agreed that confirming parties may incur additional costs as they may have to allocate resources to respond to confirmation requests. As discussed above, however, confirmation is already commonly used by audit firms, and the Board therefore does not expect confirming parties to incur significant additional costs to respond to confirmation requests as a result of the new standard.

Some requirements under the new standard may result in more costs than others. The following discussion describes the potential costs associated with specific changes to existing confirmation requirements.

¹⁰⁵ One commenter stated that the cost of audit would increase if auditors were required to send confirmations on any and all information that can be confirmed by external parties. While the Board notes that the new standard does not require confirmations on any and all information that can be confirmed, it agrees that companies being audited can incur indirect costs to the extent that auditors pass on at least part of the increased costs in terms of increased audit fees to companies.

Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new standard: (1) identifies certain accounts for which the auditor should perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, (2) enhances the requirements for assessing the reliability of confirmation responses, (3) addresses the performance of alternative procedures when the auditor is unable to obtain relevant and reliable audit evidence through confirmation, (4) strengthens requirements regarding the use of negative confirmation requests, and (5) specifies certain activities in the confirmation process that should be performed by the auditor and not by other parties.

For some firms, the requirement in the new standard to confirm certain cash balances or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source could be expected to result in the revision of firm methodologies and the performance of additional audit procedures. As discussed above, the methodologies of some GNFs already include requirements for cash confirmation that are similar to the new requirement described in the new standard. In addition, the risk-based approach in the new requirement should encourage the auditor to determine the extent of confirmation with regard to an assessment of the risks of material misstatement and conduct only the work necessary to obtain sufficient audit evidence.

Commenters on the 2022 Proposal asserted that confirming cash balances under the proposed standard would lead to increased costs, given the lack of discretion and ability to overcome the presumption in the proposed standard. In addition, some commenters on the 2022 Proposal asserted that the “at least as persuasive as” threshold in the proposed standard for overcoming the presumption to confirm accounts receivable would limit the auditor’s use of

professional judgment and could result in greater costs without a commensurate benefit to audit quality.

As discussed above, there is a presumption in the new standard that the auditor should obtain audit evidence from a knowledgeable external source by performing confirmation procedures or using other means to obtain audit evidence by directly accessing information maintained by knowledgeable external sources. In addition, the new standard provides that if, based on the auditor's experience, it would not be feasible for the auditor to obtain audit evidence about accounts receivable pursuant to paragraph .24, the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details. Insofar as the final standard does not otherwise provide auditors with the discretion to avoid obtaining audit evidence directly from a knowledgeable external source for cash, and the only exception applicable to accounts receivable is for situations where obtaining audit evidence directly from a knowledgeable external source would not be feasible, firms may, therefore, incur additional costs to comply with the presumptive requirements of the new standard for cash and accounts receivable. These costs, however, are necessary to the achievement of the standard's intended benefits of emphasizing the quality and strength of the audit evidence to be obtained from knowledgeable external sources.

The new standard also requires the auditor to evaluate the reliability of confirmation responses and provides examples of information that indicate that a confirmation response may have been intercepted and altered. The costs associated with this requirement, however, are expected to be limited. First, the Board's auditing standards already require the auditor to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's report, and to evaluate the combined evidence provided by confirmation and other auditing procedures

performed when the auditor has not received replies to confirmation requests (i.e., nonresponses) to determine whether sufficient evidence has been obtained about all the applicable financial statement assertions.¹⁰⁶ Second, the methodologies of some firms reflect application material in ISA 505 regarding factors (similar to indicators in the new standard) that may indicate doubts about the reliability of a confirmation response. One of these factors is analogous to the requirement in the new standard (i.e., the confirmation response appears not to come from the originally intended confirming party), which may further limit the potential costs for firms that have incorporated this factor in their methodologies. One commenter on the 2022 Proposal stated that the proposed standard's requirement for evaluating the reliability of confirmation responses might cause the auditor to need to authenticate confirmation responses, which would add significant expense to the audit. However, as discussed above, AS 1105 already establishes the requirements for evaluating the reliability of audit evidence, and the new standard does not change those requirements.

The requirement for the auditor to communicate with the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by knowledgeable external sources for significant risks associated with either cash or accounts receivable could impose a modest incremental cost. Some commenters on the 2022 Proposal had expressed concern about the proposed requirement to communicate with the audit committee in all instances where the presumption to confirm accounts receivable had been overcome, which could be detrimental if the communication became a mere compliance exercise for auditors and audit committees. The new standard's

¹⁰⁶ See AS 1105.04; AS 2310.33.

requirement to communicate with the audit committee, however, is more risk-based and therefore, the Board continues to believe that the incremental costs will be modest.

Insofar as the new standard identifies additional situations in which the auditor generally would be required to perform alternative procedures, firms may incur additional costs. Specifically, the new standard extends the requirement in existing AS 2310 to perform alternative procedures in relation to nonresponses to positive confirmation requests to other situations, including the auditor's inability to identify a confirming party and the receipt of an unreliable response.

In contrast with existing AS 2310, negative confirmation requests may not be used as the sole substantive audit procedure under the new standard. This limitation reflects, among other things, the increase in the volume of electronic correspondence since existing AS 2310 was issued and the increasing likelihood that a recipient of a negative confirmation request would not consider the request. As a result, auditors may have to perform other substantive audit procedures for certain financial statement assertions. Although the Board understands through its oversight activities that few, if any, GNFs use negative confirmation requests as the sole substantive procedure in practice, as discussed above, the PCAOB staff's firm methodology review suggests that all the GNFs and NAFs reviewed will need to review their methodologies to ensure that negative confirmation requests are not used as the sole source of audit evidence.

Developments in Practice

As discussed above, the new standard includes requirements that clarify the procedures auditors should perform to support their use of intermediaries to facilitate the direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. These requirements may lead to modifications to firm methodologies. Further, the required

procedures may involve additional auditor time and effort. The resulting costs likely depend on the extent to which the new requirements have already been incorporated in a firm's current methodologies. One commenter expressed concern that the proposed requirement to assess the intermediary's controls would result in significant additional work for auditors because it is not currently common practice to directly assess intermediaries in this manner. The PCAOB staff's review of firm methodologies discussed above did not suggest that the requirements in Appendix B of the new standard would create significant additional work for auditors. In particular, both the GNF and NAF methodologies reviewed generally already include guidance on maintaining control over the confirmation process and the use of intermediaries, which may limit the costs. In addition, the Board notes that the requirements in the new standard relate to relevant controls that address the risk of interception and alteration of confirmation requests and responses and that some intermediaries currently make information about relevant internal controls available to auditors through a SOC report.

If the auditor is able to obtain audit evidence by directly accessing information maintained by knowledgeable external sources instead of confirmation, such audit evidence could be at least as persuasive as audit evidence obtained through confirmation procedures, and the new standard allows the auditor to perform such procedures. This provision is not expected to impose new costs on firms, as firms would only obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source to the extent that technological advancements render it more efficient than performing confirmation procedures. Thus, to the extent that the auditor is able to replace confirmation procedures with obtaining audit evidence by directly accessing information maintained by a knowledgeable external source, the new standard could reduce costs for firms.

Potential Unintended Consequences

In addition to the benefits and costs discussed above, the new standard could have unintended economic impacts. The following discussion describes potential unintended consequences the Board has considered and, where applicable, factors that mitigate the negative consequences, such as steps the Board has taken or the existence of other countervailing forces.

Potential Decline in Auditors' Usage of Confirmation

An unintended consequence of the new standard would occur if, contrary to the Board's expectation, there were a significant reduction in the use of confirmation procedures by auditors in circumstances where confirmation would provide relevant and reliable audit evidence.

Under the new standard, auditors retain the ability to use confirmation as one procedure, among others, to audit one or more financial statement accounts or disclosures. At the same time, the new standard strengthens the requirements for an auditor regarding evaluating the reliability of confirmation responses and addressing confirmation exceptions and incomplete responses, including performing alternative procedures to obtain audit evidence. Further, the new standard describes the types of procedures the auditor should perform in evaluating the effect of using an intermediary on the reliability of confirmation requests and responses, including determining whether relevant controls of the intermediary are designed and operating effectively. In addition, the new standard does not allow the auditor to use negative confirmation requests as the sole substantive procedure. As a result, when not required to use confirmation, auditors might decline to use confirmation and use other audit procedures more frequently than under existing AS 2310 if they perceive there could be more time or cost involved in the confirmation process relative to the performance of other procedures.

This potential unintended consequence is mitigated, however, by the requirement that the auditor should perform confirmation procedures for cash and accounts receivable, or otherwise

obtain audit evidence by directly accessing information maintained by knowledgeable external sources. In addition, the Board's standards already provide that the auditor should evaluate whether the combined evidence provided by confirmation and other auditing procedures provide sufficient evidence about the applicable financial statement assertions. Several of the changes to existing requirements in the new standard align with the Board's understanding of current practice. For example, many audit firms' methodologies include guidance on maintaining control and the use of intermediaries. Additionally, the potential unintended consequence may be mitigated to the extent that a firm has experienced efficiencies from using newer audit tools for confirmation through reduced time or costs. Further, the Board does not anticipate that the requirements of the new standard will cause a significant change in the timing or extent of confirmation procedures for auditors, as the Board has not amended the requirements of AS 2301, which is the auditing standard that addresses those matters. Accordingly, the Board does not believe that the new standard will lead to a significant decline in the use of confirmation.

Potential Misinterpretation of the Requirements in the New Standard Relating to the Confirmation of Cash and Accounts Receivable

An unintended consequence of the presumed requirement in the new standard to confirm cash and accounts receivable would arise if auditors misinterpreted the language in the new standard as requiring the confirmation of cash and accounts receivable in all situations. For example, the new standard does not carry forward a provision included in existing AS 2310 that an auditor could overcome the presumption to confirm accounts receivable if, among other things, "[t]he use of confirmations would be ineffective." It is possible that some auditors might misinterpret the elimination of this language as precluding the exercise of auditor judgment with respect to the confirmation of accounts receivable. Some commenters on the 2022 Proposal

appeared to misinterpret the proposed requirement and suggested that confirmation would be required in all situations. For example, one commenter asserted that using confirmation regardless of risk assessment may promote a checklist mentality that does not contribute to audit quality and an audit approach that may be less efficient and effective.

The Board does not intend, however, that an auditor send confirmation requests for accounts receivable in all situations or when such procedures do not provide relevant and reliable audit evidence. If the auditor has not determined cash or accounts receivable to be a significant account, the new standard does not require the confirmation of cash or accounts receivable. Moreover, to clarify the Board's intent, it has modified the language in the proposed standard in several respects. First, paragraph .25 of the new standard addresses situations when obtaining audit evidence about accounts receivable directly from knowledgeable external sources, whether through confirmation procedures or other means, would not be feasible to execute. If it is not feasible for the auditor to obtain audit evidence about accounts receivable directly from a knowledgeable external source, the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details.

In addition, the Board is not adopting paragraph .07 of the proposed standard, which referred to situations where evidence obtained through the confirmation process "generally is more persuasive than audit evidence obtained solely through other procedures" and may have contributed to a misperception that the Board was proposing to require confirmation in all circumstances. In the Board's view, the language in the new standard acknowledges the role of professional judgment in the auditor's selection of audit procedures to obtain sufficient appropriate audit evidence, while retaining a presumption to confirm cash and accounts receivable or otherwise obtain relevant and reliable audit evidence by directly accessing

information maintained by a knowledgeable external source. This should mitigate the potential unintended consequence described above.

Alternatives Considered

The development of the new standard involved considering a number of alternative approaches to address the problems described above. This section explains: (i) why standard setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (ii) other standard-setting approaches that were considered; and (iii) key policy choices made by the Board in determining the details of the new standard-setting approach.

Why Standard Setting Is Preferable to Other Policy-Making Approaches

The Board's policy tools include alternatives to standard setting, such as issuing additional interpretive guidance, or increasing our focus on inspections or enforcement of existing standards. The Board considered whether providing guidance or increasing inspection or enforcement efforts would be effective mechanisms to address concerns with the auditor's use of confirmation.

Interpretive guidance inherently provides additional information about existing standards. Inspection and enforcement actions take place after insufficient audit performance (and potential investor harm) has occurred. Devoting additional resources to interpretive guidance, inspections, or enforcement activities, without improving the relevant performance requirements for auditors, would at best focus auditors' performance on existing standards and would not provide the benefits discussed above associated with improving the standards. The new standard, on the other hand, is designed to improve existing requirements for the auditor's use of confirmation. For example, the new standard, unlike existing AS 2310, includes requirements relating to the

confirmation of cash accounts, imposes additional limitations on the use of negative confirmation requests, clarifies the circumstances in which auditors would be expected to perform alternative procedures, and includes explicit provisions addressing the auditor's responsibility for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses.

Other Standard-Setting Alternatives Considered

Several alternative standard-setting approaches were also considered, including:

(i) making amendments to the existing standard; and (ii) adopting an approach based on ISA 505, with certain modifications to reflect the PCAOB's statutory responsibilities with respect to audits of public companies and registered broker-dealers.

Amendments to Existing Standard

The Board considered, but decided against, limiting the amendments to AS 2310 solely to modifications relating to changes in technology that have affected the confirmation process. While this approach could result in fewer changes to firms' audit methodologies, the Board believes there are a number of other areas discussed throughout this release, beyond amending AS 2310 to reflect the increasing use of technology in the confirmation process, where the existing standard should be improved.

Standard Based on ISA 505

Some commenters on the 2009 Concept Release and the 2010 Proposal suggested that the Board should consider adopting ISA 505, the IAASB's standard on audit confirmation, which was issued in 2008. The Board has taken the requirements and application material of ISA 505 into account in developing the new standard (e.g., the ISA 505 application material relating to the use of a third party to coordinate and provide responses to confirmation requests).

The Board concluded, however, that the new standard should also establish certain requirements that are not included in ISA 505 (e.g., requirements to confirm cash and accounts receivable or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source), and should not include certain provisions that are described in ISA 505 (e.g., regarding management's refusal to allow the auditor to send a confirmation request). In addition, audit practices have continued to evolve since ISA 505 was issued in 2008, and the Board believes that the new standard should reflect these developments (e.g., by addressing electronic communication and the use of intermediaries in the requirements of the standard rather than in application materials).

Key Policy Choices

Given a preference for replacing existing AS 2310 in its entirety, the Board considered different approaches to addressing key policy issues.

Use of Confirmation Procedures for Specific Accounts

The new standard provides that when addressing an assessed risk of material misstatement of cash and cash equivalents held by third parties, as well as of accounts receivable that arise from the transfer of goods or services to a customer or a financial institution's loans, the auditor should perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. In addition, under the new standard, when obtaining audit evidence from a knowledgeable external source regarding cash, the auditor should consider sending confirmation requests to that source about other financial relationships with the company, based on the assessed risk of material misstatement. Also, when the auditor has identified a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the

transaction that are associated with a significant risk of material misstatement, including a fraud risk. The new standard does not specify other significant accounts or disclosures that the auditor should confirm or consider confirming. The Board considered several alternatives to this approach, as discussed below.

First, the Board considered an approach that would have no requirement for the auditor to confirm specified accounts or transactions. In the Board's view, this approach might result in the selection by some auditors of audit procedures that provide less relevant and reliable audit evidence than confirmation with respect to cash and accounts receivable (e.g., if an auditor mistakenly assessed the risk of material misstatement too low for cash or accounts receivable). Further, confirmation of cash and accounts receivable is already a standard practice for many auditors and is consistent with the concept that audit evidence obtained from a knowledgeable external source is more reliable than evidence obtained only from internal company sources. Accordingly, the Board has decided against an approach that does not require the confirmation of any accounts and disclosures in the new standard.

In addition, the Board considered including in the new standard a requirement that the auditor should confirm other accounts in addition to cash and accounts receivable, such as investments. The Board has decided against this approach because it would limit auditor judgment in circumstances where the performance of other auditing procedures might provide relevant and reliable audit evidence, could be viewed as unduly prescriptive, and would not allow the auditor to take company-specific facts and circumstances into account. Instead, under the new standard, the auditor could decide to perform confirmation procedures with respect to financial statement assertions relating to other accounts and disclosures but is not required to do so.

The Board also considered an additional requirement that the auditor should perform confirmation procedures in response to significant risks that relate to relevant assertions, when such assertions can be adequately addressed by confirmation procedures. However, the Board believes that such a requirement would be inconsistent with the Board's risk assessment standards, which allow for auditor judgment in determining the audit response to significant risks identified by the auditor. The Board has not included this provision in the new standard.

Management Requests Not to Confirm

The Board considered addressing situations where management requests that the auditor not confirm one or more items in the new standard. Specifically, the Board considered requiring the auditor to obtain an understanding of the reasons for management's request, perform alternative procedures as discussed in Appendix C of the new standard, and communicate the request to the audit committee. In addition, the Board considered a requirement that the auditor should evaluate the implications for the auditor's report if the auditor determines that management's request impairs the auditor's ability to obtain sufficient appropriate audit evidence or indicates that one or more fraud risk factors are present. For the reasons discussed above, the Board has decided not to include such provisions in the new standard.

Special Considerations for Audits of Emerging Growth Companies

Pursuant to Section 104 of the Jumpstart Our Business Startups Act ("JOBS Act"), rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of EGCs, as defined in Section 3(a)(80) of the Exchange Act, unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency,

competition, and capital formation.”¹⁰⁷ As a result of the JOBS Act, the rules and related amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about characteristics of EGCs.¹⁰⁸ As of the November 15, 2021, measurement date, PCAOB staff identified 3,092 companies that self-identified with the SEC as EGCs and filed audited financial statements in the 18 months preceding the measurement date.

Confirmation is a longstanding audit procedure used in nearly all audits, including audits of EGCs. The discussion of benefits, costs, and unintended consequences above is generally applicable to audits of EGCs. The economic impacts of the new standard on an EGC audit depend on factors such as the audit firm’s current methodologies, the audit firm’s ability to distribute implementation costs across engagements, and the auditor’s assessed risk of material misstatement.

EGCs are likely to be newer companies, which may increase the importance to investors of the external audit to enhance the credibility of management disclosures.¹⁰⁹ Further, compared

¹⁰⁷ See Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of the Act, as added by Section 104 of the JOBS Act, also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The new standard does not fall within either of these two categories.

¹⁰⁸ For the most recent EGC report, see *White Paper on Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2021* (Jan. 5, 2023) (“EGC White Paper”), available at <https://pcaobus.org/resources/other-research-projects>.

¹⁰⁹ Researchers have developed a number of proxies that are thought to be correlated with information asymmetry, including small issuer size, lower analyst coverage, larger insider holdings, and higher research and development costs. To the extent that EGCs exhibit one or more of these properties, there may be a greater degree of information asymmetry for EGCs than for the broader population of companies, which increases the importance to investors of the external audit to enhance the credibility of management disclosures. See, e.g., Mary E. Barth, Wayne R. Landsman, and Daniel J. Taylor, *The JOBS Act and Information Uncertainty in IPO Firms*, 92 *The*

to non-EGCs, EGCs are more likely to be audited by NAFs.¹¹⁰ As discussed above, NAFs are expected to make more changes to their methodologies and practice to comply with the new standard. Therefore, all else equal, the benefits of the higher audit quality resulting from the new standard may be larger for EGCs than for non-EGCs, including improved efficiency of market capital allocation, lower cost of capital, and enhanced capital formation.¹¹¹ In particular, because investors who face uncertainty about the reliability of a company's financial statements may require a larger risk premium that increases the cost of capital to companies, the improved audit quality resulting from applying the new standard to EGC audits could reduce the cost of capital to those EGCs.¹¹²

While the associated costs may also be higher for EGC audits than for non-EGC audits, because of the scalability of the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures. Moreover, if any of the new

Accounting Review 25, 25 (2017); Steven A. Dennis and Ian G. Sharpe, *Firm Size Dependence in the Determinants of Bank Term Loan Maturity*, 32 *Journal of Business Finance and Accounting* 31, 59 (2005); Michael J. Brennan and Avanidhar Subrahmanyam, *Investment Analysis and Price Formation in Securities Markets*, 38 *Journal of Financial Economics* 361, 363 (1995); David Aboody and Baruch Lev, *Information Asymmetry, R&D, and Insider Gains*, 55 *Journal of Finance* 2747, 2755 (2000); Raymond Chiang and P. C. Venkatesh, *Insider Holdings and Perceptions of Information Asymmetry: A Note*, 43 *Journal of Finance* 1041, 1047 (1988); Molly Mercer, *How Do Investors Assess the Credibility of Management Disclosures?*, 18 *Accounting Horizons* 185, 194 (2004). Furthermore, research has shown that reduced disclosure requirements for EGCs are associated with lower audit effort. The academic literature has also documented evidence of lower audit quality for EGCs. To the extent that the new standard will increase auditor effort, EGCs are expected to benefit from higher audit quality. See, e.g., Tiffany J. Westfall and Thomas C. Omer, *The Emerging Growth Company Status on IPO: Auditor Effort, Valuation, and Underpricing*, 37 *Journal of Accounting and Public Policy* 315, 316 (2018); Essam Elshafie, *The Impact of Reducing Reporting Requirements on Audit Quality, Auditor Effort and Auditor Conservatism*, 35 *Accounting Research Journal* 756, 756 (2022).

¹¹⁰ EGC White Paper at 22.

¹¹¹ The enhanced quality of audits and financial information available to financial markets may result in investors perceiving less risk in capital markets. This, in turn, may lead to an increase in the supply of capital which could increase capital formation. See, e.g., Hanwen Chen, Jeff Zeyun Chen, Gerald J. Lobo, and Yanyan Wang, *Effects of audit quality on earnings management and cost of equity capital: Evidence from China*, 28 *Contemporary Accounting Research* 892, 921 (2011); Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research* 385, 410 (2007).

¹¹² For a discussion of how increasing reliable public information about a company can reduce risk premium, see David Easley and Maureen O'Hara, *Information and the Cost of Capital*, 59 *The Journal of Finance* 1553, 1578 (2004).

amendments were determined not to apply to the audits of EGCs, auditors would need to address differing audit requirements in their methodologies, or policies and procedures, with respect to audits of EGCs and non-EGCs, which would create the potential for confusion. The new standard could impact competition in an EGC product market if the indirect costs to audited companies disproportionately impact EGCs relative to their competitors. However, as discussed above, the costs associated with the new standard are expected to be relatively modest. Therefore, the impact of the new standard on competition, if any, is expected to be limited. Overall, the new standard is expected to enhance audit quality and contribute to an increase in the credibility of financial reporting by EGCs.

Accordingly, and for the reasons explained above, the Board is requesting that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the new standard to audits of EGCs. One commenter specifically supported the application of the 2022 Proposal to EGCs.

III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Within 45 days of the date of publication of this notice in the *Federal Register* or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents, the Commission will:

- (A) By order approve or disapprove such proposed rules; or
- (B) Institute proceedings to determine whether the proposed rules should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's internet comment form (<https://www.sec.gov/rules/pcaob>); or
- Send an email to rule-comments@sec.gov. Please include file number PCAOB-2023-02 on the subject line.

Paper comments:

- Send paper comments in triplicate to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to file number PCAOB-2023-02. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<https://www.sec.gov/rules/pcaob>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC, 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from

publication submitted material that is obscene or subject to copyright protection. All submissions should refer to File Number PCAOB-2023-02 and should be submitted on or before [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

By the Commission.

Vanessa A. Countryman,

Secretary.



**Proposed Auditing Standard – The Auditor’s
Use of Confirmation, and Other Proposed
Amendments to PCAOB Standards**

PCAOB Release No. 2022-009
December 20, 2022

PCAOB Rulemaking
Docket Matter No. 028

Summary: The Public Company Accounting Oversight Board (“PCAOB” or the “Board”) is proposing to replace its auditing standard related to an auditor’s use of confirmation, AS 2310, *The Confirmation Process*, with a new proposed standard, AS 2310, *The Auditor’s Use of Confirmation*, and to make conforming amendments to certain related PCAOB auditing standards. This proposing release follows a previous public comment period on amendments that were proposed in a 2010 Board release. The new proposed standard is designed to improve the quality of audits when confirmation is used by the auditor and to reflect changes in the means of communication and in business practice since the standard was originally issued.

Public

Comment: Interested persons may submit written comments to the Board. Comments should be sent by e-mail to comments@pcaobus.org or through the Board’s website at www.pcaobus.org. Comments may also be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 028 in the subject or reference line and should be received by the Board by February 20, 2023.

Board

Contacts: Barbara Vanich, Chief Auditor, Office of the Chief Auditor (202/207-9363, vanichb@pcaobus.org);
Dima Andriyenko, Acting Deputy Chief Auditor, Office of the Chief Auditor (202/207-9130, andriyenkod@pcaobus.org);
Lisa Busedu, Associate Chief Auditor, Office of the Chief Auditor (646/437-5126, busedul@pcaobus.org);
David Hardison, Associate Chief Counsel, Office of the Chief Auditor (202/591-4168, hardisond@pcaobus.org).

Staff

Contributors: Dani Verbeck, Assistant Chief Auditor;
Michael Gurbutt, Acting Director, Office of Economic and Risk Analysis;
Tian Liang, Associate Director, Economic Analysis;
Tasneem Raihan, Financial Economist, Economic Analysis.

TABLE OF CONTENTS

I.	EXECUTIVE SUMMARY	4
II.	BACKGROUND	5
	A. EXISTING STANDARD.....	8
	B. CURRENT PRACTICE	9
	C. REASONS TO IMPROVE AUDITING STANDARDS	13
III.	DISCUSSION OF THE NEW PROPOSED STANDARD: AS 2310 THE AUDITOR’S USE OF CONFIRMATION	14
	A. OVERVIEW OF NEW PROPOSED STANDARD	14
	B. INTRODUCTION AND OBJECTIVE	16
	C. RELATIONSHIP OF THE CONFIRMATION PROCESS TO THE AUDITOR’S IDENTIFICATION AND ASSESSMENT OF AND RESPONSE TO THE RISKS OF MATERIAL MISSTATEMENT	17
	D. CONFIRMING CERTAIN ACCOUNTS AND TERMS OF TRANSACTIONS.....	20
	E. DESIGNING CONFIRMATION REQUESTS.....	28
	F. MAINTAINING CONTROL OVER THE CONFIRMATION PROCESS	34
	G. EVALUATING CONFIRMATION RESPONSES AND CONFIRMATION EXCEPTIONS, AND ADDRESSING NONRESPONSES AND INCOMPLETE RESPONSES.....	37
	H. PERFORMING ALTERNATIVE PROCEDURES	40
	I. USING INTERNAL AUDIT IN THE CONFIRMATION PROCESS	42
	J. OTHER MATTERS	44
IV.	ECONOMIC ANALYSIS	47
	A. BASELINE.....	47
	B. NEED	52
	C. ECONOMIC IMPACTS.....	56
	D. ALTERNATIVES CONSIDERED	66
V.	SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES	70
VI.	EFFECTIVE DATE	72
VII.	APPENDICES	72
VIII.	OPPORTUNITY FOR PUBLIC COMMENT	72

APPENDICES

APPENDIX 1 – NEW PROPOSED AUDITING STANDARD

APPENDIX 2 – PROPOSED AMENDMENTS TO RELATED PCAOB AUDITING STANDARDS

I. EXECUTIVE SUMMARY

We are proposing to replace AS 2310, *The Confirmation Process*, in its entirety with a new standard, AS 2310, *The Auditor's Use of Confirmation* ("new proposed standard") to strengthen and modernize the requirements for the confirmation process. As described in the new proposed standard, the confirmation process involves sending a confirmation request directly to a confirming party (e.g., a financial institution), evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions. If properly designed and executed by the auditor, the confirmation process may provide important evidence that auditors obtain as part of an audit of a company's financial statements.

Why the Board is Proposing These Changes Now

AS 2310 is an important standard for audit quality and investor protection, as the audit confirmation process touches nearly every audit. The standard was initially written over 30 years ago and has had minimal amendments since its adoption by the PCAOB in 2003.

The Board previously considered updating AS 2310 by issuing a concept release in 2009 and a proposal in 2010 for a new auditing standard that would supersede AS 2310. While the Board did not amend or replace AS 2310 at that time due to changing priorities, subsequent developments – including the increasing use of electronic communications and third-party intermediaries in the confirmation process – have led us to conclude that enhancements to AS 2310 and modifications to the approach proposed in 2010 could improve the quality of audit evidence obtained by auditors. In addition, we have also observed continued inspection findings related to auditors' use of confirmation, as well as enforcement actions involving failures to adhere to requirements in the existing auditing standard regarding confirmation, such as the requirement for the auditor to maintain control over the confirmation process. Accordingly, having considered these developments and input from commenters, we have revisited the previously proposed changes and are issuing the new proposed standard and conforming amendments to other PCAOB auditing standards.

Key Provisions of the New Proposed Standard

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. Further, the new proposed standard would be more expressly integrated with the Board's risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor's responsibilities for obtaining relevant and reliable audit evidence through the confirmation process. Key proposals in the new proposed standard would:

- Include a new requirement regarding confirming cash held by third parties, and carry forward the existing requirement regarding confirming accounts receivable;
- State that the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence (and include examples of situations where the auditor may use negative confirmation requests to supplement other substantive audit procedures);
- Identify situations in which alternative audit procedures should be performed by the auditor (and include examples of such alternative procedures that may provide relevant and reliable audit evidence); and
- Clarify that there are certain activities in the confirmation process for which the auditor may not use internal auditors to provide direct assistance.

This release provides background on the Board’s standard-setting project, discusses the new proposed standard, and includes an economic analysis that further considers the need for standard setting and the anticipated economic impacts of our proposed approach. The release also includes two appendices. Appendix 1 sets forth the text of the new proposed standard. Appendix 2 includes conforming amendments to other PCAOB auditing standards.

Requesting Public Comment on Our Proposal

We are seeking comment on all aspects of the new proposed standard and conforming amendments to other PCAOB auditing standards. Throughout the release, we have included detailed questions soliciting your feedback on specific aspects of our proposal. You are encouraged to comment on any or all topics, respond to any or all questions, provide feedback in areas not covered by specific questions, and provide any evidence, including data or your practical experiences, that informs your views.

Instructions on how to comment, including by e-mail or postal mail, can be found on the cover sheet of this release. The release, previous releases, and previous comments can be found at the [docket page](#) of PCAOB Rulemaking Docket Matter No. 028.

II. BACKGROUND

Confirmation can be an important source of evidence obtained as part of an audit of a company’s financial statements,¹ and has long been used by auditors. For example, one early auditing treatise noted the importance of confirmation for cash deposits, accounts receivable,

¹ See, e.g., paragraph 08 of AS 1105, *Audit Evidence* (providing that “[e]vidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources”).

and demand notes.² In addition, confirmation of accounts receivable has been a required audit procedure in the United States since 1939, when the American Institute of Accountants³ adopted Statement on Auditing Procedure No. 1 ("SAP No. 1") as a direct response to the *McKesson & Robbins* fraud case, which involved fraudulently reported inventories and accounts receivable that the independent auditors failed to detect through procedures other than confirmation.⁴

SAP No. 1 required confirmation of accounts receivable by direct communication with customers in all independent audits of financial statements, subject to the auditor's ability to overcome the presumption to confirm accounts receivable for certain reasons. Following the adoption of SAP No. 1, the accounting profession also adopted a requirement in 1942, which remained in effect until the early 1970s, that auditors should disclose in the auditor's report when confirmation of accounts receivable was not performed.

The AICPA's subsequent revisions to its auditing standards included the promulgation of AU sec. 330, *The Confirmation Process*, which was adopted in 1991 and took effect in 1992. The PCAOB adopted AU sec. 330 (now AS 2310) as an interim standard in 2003.⁵

In 2009 the Board issued a concept release seeking public comment on the potential direction of a standard-setting project that could result in an amendment to the Board's existing standard on the confirmation process or a new auditing standard that would supersede the existing standard.⁶ The 2009 Concept Release discussed existing requirements and posed questions about potential amendments to those requirements. The Board received 24 comment letters on the 2009 Concept Release. Commenters generally were supportive of the Board's updating the existing confirmation standard given the significance of the changes in the

² Robert H. Montgomery, *Auditing Theory and Practice* 91 (confirmation of cash deposits), 263 (confirmation of accounts receivable), and 353 (confirmation of demand notes) (1912).

³ The American Institute of Accountants was the predecessor to the American Institute of CPAs ("AICPA").

⁴ See *In the Matter of McKesson & Robbins, Inc.*, SEC Rel. No. 34-2707 (Dec. 5, 1940).

⁵ Shortly after the Board's inception, the Board adopted the existing standards of the AICPA, as in existence on Apr. 16, 2003, as the Board's interim auditing standards. See *Establishment of Interim Professional Auditing Standards*, PCAOB Rel. No. 2003-006 (Apr. 18, 2003). AU sec. 330 was one of these auditing standards. As of Dec. 31, 2016, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated number system, at which time AU sec. 330 was designated AS 2310. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Rel. No. 2015-002 (Mar. 31, 2015).

⁶ *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*, PCAOB Rel. No. 2009-002 (Apr. 14, 2009) ("2009 Concept Release").

business environment since the promulgation of the standard by the AICPA particularly with respect to changes in the means of communication.

Having considered the input from commenters, in 2010, the Board proposed an auditing standard that, if adopted, would have superseded the existing confirmation standard.⁷ The 2010 Proposal was intended to strengthen the existing standard by, among other things, expanding certain requirements and introducing new requirements. The Board received 28 comment letters on the 2010 Proposal. In general, commenters supported updating the existing standard to address relevant developments in audit practice, including greater use of e-mailed confirmation requests and responses and the involvement of third-party intermediaries. At the same time, some commenters asserted that the proposed requirements in the 2010 Proposal were unduly prescriptive (i.e., included too many presumptively mandatory requirements) and would result in a significant increase in the volume of confirmation requests without a corresponding increase in the quality of audit evidence obtained by the auditor. The Board did not adopt the 2010 Proposal.

We have considered comments received on the 2009 Concept Release and the 2010 Proposal in developing the new proposed standard. In addition, since the 2010 Proposal, the Board has continued to monitor developments relating to the use of confirmation through its oversight and research activities. In 2011, the PCAOB issued a staff practice alert that included examples of conditions and situations involving confirmation that indicate heightened fraud risk in certain companies in emerging markets.⁸ In 2021, the PCAOB issued a staff Spotlight discussing, among other things, the use of technology in the confirmation process.⁹ In addition, in 2022, the PCAOB issued a staff Spotlight that specifically discussed observations and reminders on the use of a service provider in the confirmation process.¹⁰

This rulemaking proposal builds upon the Board's prior work and would specify the auditor's responsibilities regarding the confirmation process (i.e., the process of sending a confirmation request directly to a confirming party, evaluating information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or

⁷ *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*, PCAOB Rel. No. 2010-003 (July 13, 2010) ("2010 Proposal").

⁸ *See Audit Risks in Certain Emerging Markets*, Staff Audit Practice Alert No. 8 (Oct. 3, 2011), available at https://pcaobus.org/Standards/QandA/2011-10-03_APA_8.pdf.

⁹ *See Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>.

¹⁰ *See Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

more financial statement assertions).¹¹ The remainder of this section presents additional background information on the proposed rulemaking, including an overview of existing requirements addressing the confirmation process, a description of current practice, and a discussion of our reasons for proposing the new proposed standard at this time.¹²

A. Existing Standard

This section discusses key provisions of the existing PCAOB auditing standard that addresses the confirmation process.

In 2003, the Board adopted the standard now known as AS 2310, *The Confirmation Process* (at that time, AU sec. 330), when it adopted the AICPA's standards then in existence. Existing AS 2310 indicates that confirmation is the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions. For example, an auditor might request a company's customers to confirm balances owed at a certain date, or request confirmation of a company's accounts or loans payable to a bank at a certain date.

Key provisions of existing AS 2310 include the following:

- A presumption that the auditor will request confirmation of accounts receivable. The standard states that confirmation of accounts receivable is a generally accepted auditing procedure and provides the situations in which the auditor may overcome the presumption.
- 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.
- Procedures relating to the use of both positive and negative confirmation requests. A positive confirmation request directs the recipient to send a response back to the auditor stating the recipient's agreement or disagreement with information stated in the request, or furnishing requested information. A negative confirmation request

¹¹ Under PCAOB standards, financial statement assertions can be classified into the following categories: existence or occurrence, completeness, valuation or allocation, rights and obligations, and presentation and disclosure. See, e.g., AS 1105.11.

¹² A PCAOB staff document that compares the new proposed standard with the analogous requirements under International Standard on Auditing 505, *External Confirmations* ("ISA 505"), issued by the International Auditing and Assurance Standards Board ("IAASB"), and AU-C Section 505, *External Confirmations* ("AU-C 505"), issued by the Auditing Standards Board of the AICPA, is available on the Board's website in Docket 028.

directs the recipient to respond back to the auditor only when the recipient disagrees with information in the auditor's request. The standard states that "[n]egative confirmation requests may be used to reduce audit risk to an acceptable level when (a) the combined assessed level of inherent and 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 consideration."¹³ If negative confirmation requests are used, the auditor should consider performing other substantive procedures to supplement their use.¹⁴

- A requirement for the auditor to maintain control over confirmation requests and responses by establishing direct communication between the intended recipient and the auditor.
- Procedures to consider when the auditor does not receive a written confirmation response via return mail, including how the auditor should evaluate the reliability of oral and facsimile responses to written confirmation requests. The standard provides that, when confirmation responses are in other than a written format mailed to the auditor, additional evidence may be necessary to establish the validity of the respondent.
- A requirement that the auditor should perform alternative auditing procedures when the auditor has not received a response to a positive confirmation request.
- Requirements for the auditor's evaluation of the results of confirmation procedures and any alternative procedures performed by the auditor. These provisions include the requirement that, if the combined evidence provided by confirmation, alternative procedures, and other procedures is not sufficient, the auditor should request additional confirmations or extend other tests, such as tests of details or analytical procedures.

B. Current Practice

This section discusses our understanding of current practice based on, among other things, observations from oversight activities of the Board, and enforcement actions of the U.S. Securities and Exchange Commission ("SEC" or "Commission").

¹³ See AS 2310.20.

¹⁴ *Id.*

1. Overview of Current Practice

The audit confirmation process touches nearly every financial statement audit conducted under PCAOB auditing standards. This is due in part to the presumption in AS 2310 that the auditor will confirm accounts receivable, which include claims against customers that have arisen from the sale of goods or services in the normal course of business and a financial institution's loans, unless certain exemptions apply. In addition, audit methodologies of many larger audit firms affiliated with global networks recommend or require confirming cash accounts. The use of confirmation is also a common practice for auditing a financial institution's customer deposits. In recent years, however, there has been an increased wariness about phishing attempts and some customers might not understand or trust an unsolicited confirmation request from an auditor.

AS 2310 was written at a time when paper-based confirmation requests and responses were the prevailing means of communication. Since then, e-mailed confirmation requests and responses, and the use of technology-enabled confirmation tools, including the use of intermediaries to facilitate the confirmation process, have become commonplace. For example, numerous financial institutions in the United States, and an increasing number of international banks, mandate the use of an intermediary as part of the confirmation process and will not otherwise respond to an auditor's confirmation request.

As noted above, AS 2310 provides that the auditor should maintain control over the confirmation process. In practice, complying with this requirement involves sending the confirmation request to the confirming party via mail or e-mail directly by the auditor, without involving company personnel. The auditor's confirmation request generally specifies that any correspondence should be sent directly to the auditor's location (or e-mail) to minimize the risk of interference by company personnel. When an intermediary facilitates direct electronic communications between the auditor and the confirming party, the auditor is still required to maintain control over the confirmation process. Procedures performed by audit firms to address this requirement vary depending on facts and circumstances. Some auditors have used an Independent Service Auditor's Report on Service Organization Controls ("SOC report") to evaluate the design and operating effectiveness of the intermediary's controls relevant to sending and receiving confirmations.

Under the existing standard, auditors can use positive confirmation requests and, provided certain conditions are met, negative confirmation requests. A positive confirmation request either asks the recipient to respond directly to the auditor about whether the recipient agrees with information that is stated in the request or asks the recipient to provide the requested information by filling in a blank form. In comparison, a negative confirmation request directs the recipient to respond only when the recipient disagrees with the information included in the request. In practice, negative confirmation requests have typically been used to obtain audit evidence related to the completeness of deposit liabilities and other accounts of a similar nature and, less frequently, to obtain evidence related to the existence of accounts

receivable. In some cases, auditors use a combination of positive and negative confirmation requests.

2. Observations from Inspections and Enforcement Actions

This section discusses observations from PCAOB oversight activities and SEC enforcement actions, including (1) PCAOB inspections of registered public accounting firms, and (2) enforcement actions relating to deficient confirmation procedures performed by the auditor.

Inspections. Over the past several years, PCAOB inspections indicated that some auditors did not fulfill their responsibilities under the existing standard when performing confirmation procedures. The shortcomings have been noted at large and small domestic firms, and at large firms with domestic and international practices. For example, some auditors did not: (1) consider performing procedures to verify the source of confirmation responses received electronically; (2) perform sufficient alternative procedures; (3) restrict the use of negative confirmation requests to situations where the risk of material misstatement was assessed as low; or (4) maintain appropriate control over the confirmation process, including instances where company personnel were involved in either sending or receiving confirmations.

Enforcement actions. Over the years, there have been a number of enforcement actions by the PCAOB and the SEC alleging that auditors failed to comply with PCAOB standards related to the confirmation process. Enforcement actions have been brought against large and small firms, and against U.S. and non-U.S. firms.

For example, PCAOB enforcement cases have involved allegations that auditors failed to: (1) perform appropriate confirmation procedures to address a fraud risk;¹⁵ (2) adequately respond to contradictory audit evidence obtained from confirmation procedures;¹⁶ (3) perform

¹⁵ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Whitley Penn LLP*, PCAOB Rel. No. 105-2020-002 (Mar. 24, 2020); *In the Matter of PMB Helin Donovan, LLP*, PCAOB Rel. No. 105-2019-031 (Dec. 17, 2019); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015).

¹⁶ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

appropriate confirmation procedures and alternative procedures for accounts receivable;¹⁷ or (4) maintain proper control over the confirmation process.¹⁸

In several confirmation-related enforcement cases, the SEC alleged that the deficient confirmation procedures by the auditors involved companies that had engaged in widespread fraud, where properly performed confirmation procedures might have led to the detection of the fraudulent activity.¹⁹

Further, in a number of proceedings, the SEC alleged that the auditors failed to perform confirmation procedures in circumstances where such procedures would have been appropriate, or the auditors had falsely represented that such procedures were performed.²⁰ In some actions, the SEC alleged that confirmation procedures were not properly designed²¹ or, more frequently, that the auditors failed to adequately evaluate responses to confirmation requests and perform alternative or additional procedures in light of exceptions, nonresponses, or responses that should have raised issues as to their reliability.²² Several of these proceedings were brought in recent years, suggesting that problems persist in this area.

¹⁷ *In the Matter of Whitley Penn LLP*, PCAOB Rel. No. 105-2020-002 (Mar. 24, 2020); *In the Matter of PMB Helin Donovan, LLP*, PCAOB Rel. No. 105-2019-031 (Dec. 17, 2019); *In the Matter of Wander Rodrigues Teles*, PCAOB Rel. No. 105-2017-007 (Mar. 20, 2017); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

¹⁸ *See, e.g., In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

¹⁹ *See, e.g., In the Matter of Ravindranathan Raghunathan, CPA*, SEC Rel. No. 34-93133 (Sept. 27, 2021); *In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020); *In the Matter of Schulman Lobel Zand Katzen Williams & Blackman, LLP A/K/A Schulman Lobel LLP*, SEC Rel. No. 34-88653 (Apr. 15, 2020); *In the Matter of William Joseph Kouser Jr., CPA*, SEC Rel. No. 34-80370 (Apr. 4, 2017).

²⁰ *See, e.g., In the Matter of Winter, Kloman, Moter & Repp, S.C.*, SEC Rel. No. 34-83168 (May 4, 2018); *In the Matter of Edward Richardson, Jr., CPA*, SEC Rel. No. 34-80918 (June 14, 2017).

²¹ *See, e.g., In the Matter of Ravindranathan Raghunathan, CPA*, SEC Rel. No. 34-93133 (Sept. 27, 2021); *In the Matter of Winter, Kloman, Moter & Repp, S.C.*, SEC Rel. No. 34-83168 (May 4, 2018); *In the Matter of Edward Richardson, Jr., CPA*, SEC Rel. No. 34-80918 (June 14, 2017).

²² *See, e.g., In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020); *In the Matter of Schulman Lobel Zand Katzen Williams & Blackman, LLP A/K/A Schulman Lobel LLP*, SEC Rel. No. 34-88653 (Apr. 15, 2020); *In the Matter of Anton & Chia, LLP*, SEC Rel. No. 34-87033 (Sept. 20, 2019); *In the Matter of Edward Richardson, Jr., CPA*, SEC Rel. No. 34-80918 (June 14, 2017); *In the Matter of William Joseph Kouser Jr., CPA*, SEC Rel. No. 34-80370 (Apr. 4, 2017).

C. Reasons to Improve Auditing Standards

Since the AICPA's standard on the confirmation process took effect in 1992, there has been a significant change in the auditing environment. Electronic communications between auditors and confirming parties have become ubiquitous. Many auditors and confirming parties now engage third-party intermediaries to facilitate the electronic transmission of confirmation requests and responses between auditors and confirming parties. The means by which an auditor communicates with confirming parties have also changed, and the use of e-mail and other electronic forms of communication is prevalent. We are proposing to modify the standard to further support the auditor's use of electronic forms of communication between the auditor and the confirming party.

We also believe that our auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence. Traditionally, auditors have used confirmation in circumstances where reliable evidence about financial statement assertions could be obtained directly from a third party that transacts with the company (e.g., to confirm the existence of cash or accounts receivable). Generally, audit evidence from the confirmation process has been viewed as more reliable than evidence obtained through other audit procedures available to the auditor,²³ especially where the auditor identified a risk of fraud, chose not to test controls, or determined that controls could not be relied on. However, the staff's research indicates that some audit firms may have developed or may yet develop audit techniques that enable the auditor to obtain sufficient appropriate audit evidence for the same assertions by performing substantive audit procedures that do not include confirmation, as discussed in more detail below. To reflect these developments, the existing standard could be modified to allow the performance of other procedures for accounts receivable in situations where the auditor is able to obtain audit evidence that is at least as persuasive as evidence obtained through confirmation.

While information obtained through the confirmation process can be an important source of audit evidence, the confirmation process must be properly executed for the evidence obtained to be relevant and reliable. The enforcement actions discussed in Section II.B and other recent high-profile financial reporting frauds have also called attention to the importance of well-executed confirmation procedures, including the confirmation of cash.²⁴ In addition,

²³ The confirmation process involves obtaining audit evidence from a confirming party. Under PCAOB standards, in general, evidence obtained from a knowledgeable source that is independent from the company is more reliable than evidence obtained only from internal company sources. *See, e.g., AS 1105.08.*

²⁴ *See, e.g., In the Matter of Mancera, S.C., SEC Rel. No. 34-90699 (Dec. 17, 2020) (failure by auditors to properly evaluate confirmation responses to requests for information on cash balances of a Mexican homebuilder subsequently found to have engaged in a "multi-billion dollar financial fraud"). See also Olaf Storbeck, Tabby Kinder, and Stefania Palma, EY failed to check Wirecard bank statements*

PCAOB oversight activities have identified instances in which auditors did not obtain sufficient appropriate audit evidence when using confirmation.

We believe that the new proposed standard would contribute to enhancing audit quality by clarifying and strengthening the requirements for the auditor's use of confirmation. This would also emphasize the importance of obtaining relevant and reliable external evidence. The new proposed standard would include a new requirement regarding confirming certain cash balances and enhancing requirements addressing the reliability of confirmation responses. We believe that the quality of audit evidence obtained through the confirmation process can be further enhanced by clarifying the auditor's responsibilities to evaluate the reliability of evidence obtained through confirmation responses and, when necessary, to obtain audit evidence through alternative procedures.

Question:

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?

III. DISCUSSION OF THE NEW PROPOSED STANDARD: AS 2310 THE AUDITOR'S USE OF CONFIRMATION

A. Overview of New Proposed Standard

We are proposing to replace the existing auditing standard on the confirmation process with the new proposed standard, which would replace the existing standard, AS 2310, in its entirety. The new proposed standard is designed to enhance existing confirmation requirements by:

- *Including more principles-based requirements that are designed to apply to all methods of confirmation.* The new proposed standard is designed to enhance requirements that apply to longstanding methods (such as the use of paper-based confirmation requests and responses sent via regular mail), methods that have been adopted by auditors since existing AS 2310 was issued (such as the use of e-mail or an intermediary to facilitate direct electronic transmission of confirmation requests and responses), and methods that are yet to emerge (thus encouraging audit innovation).

for 3 years, Financial Times (June 26, 2020) (potential failure by auditors to confirm cash balances purportedly held by Wirecard AG, a German company whose securities were not registered with the SEC, directly with a Singapore-based bank).

- *Expressly integrating the requirements for the auditor's use of confirmation with the requirements of the Board's risk assessment standards, including AS 1105.* The new proposed standard would more clearly specify certain risk-based considerations and emphasize the auditor's responsibilities for obtaining relevant and reliable audit evidence through confirmation.
- *Emphasizing the use of confirmation procedures in certain situations.* The new proposed standard would (i) add a new requirement that the auditor should perform confirmation procedures for cash held by third parties, (ii) carry forward the existing requirement that the auditor should perform confirmation procedures for accounts receivable, and (iii) carry forward the existing requirement to consider confirming the terms of certain transactions.
- *Addressing when the presumption to confirm accounts receivable may be overcome.* The new proposed standard would specify that an auditor may overcome the presumptively mandatory responsibility regarding confirming accounts receivable, and perform other substantive procedures instead of confirmation, 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.²⁵
- *Reflecting the relatively insignificant amount of audit evidence obtained when using negative confirmation requests.* Under the new proposed standard, the use of negative confirmation requests may provide sufficient appropriate audit evidence only when combined with other substantive audit procedures. The new proposed standard would include examples of situations in which the use of negative confirmation requests in combination with other substantive audit procedures may provide sufficient appropriate audit evidence.
- *Providing more specific direction for circumstances where the auditor is unable to obtain relevant and reliable audit evidence through confirmation.* The new proposed standard would identify situations where other procedures should be performed by the auditor as an alternative to confirmation. The new proposed standard would include examples of such alternative procedures that may provide relevant and reliable audit evidence.

²⁵ Under PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*, the auditor must comply with requirements that establish presumptively mandatory responsibilities unless the auditor demonstrates that alternative actions followed by the auditor in the circumstances were sufficient to achieve the objectives of the standard.

- *Identifying the activities in the confirmation process for which the auditor may not use internal auditors to provide direct assistance.* The new proposed standard states that an internal auditor should not select the items to be confirmed, send confirmation requests, or receive confirmation responses.

Questions:

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? If so, what type of information would be useful to investors and how might it be provided?
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 confirmation process? If so, how?

B. Introduction and Objective

See paragraphs .01 and .02 of the new proposed standard in Appendix 1

The new proposed standard would establish requirements for the auditor's use of confirmation. The confirmation process involves sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions. Confirmation is one of the specific audit procedures described in PCAOB standards that an auditor could perform when addressing a risk of material misstatement.²⁶ As is the case with other audit procedures, information obtained through confirmation may support and corroborate management's assertions or it may contradict such assertions.²⁷

AS 2110, *Identifying and Assessing Risks of Material Misstatement*, establishes requirements regarding the process of identifying and addressing the risks of material misstatement of the financial statements, and AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding designing and implementing appropriate responses to the risks of material misstatement. Where the auditor determines to use confirmation as part of the auditor's response, the new proposed standard would address the auditor's responsibilities for designing and executing the confirmation process to obtain relevant and reliable audit evidence. If the auditor uses sampling in the confirmation process, the auditor should use AS 2315, *Audit Sampling*, which discusses planning, performing, and evaluating audit samples. Auditor responsibilities regarding inquiries concerning litigation,

²⁶ See, e.g., AS 1105.14 and .18.

²⁷ See AS 1105.02.

claims, and assessments are addressed in AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

The objective included in the new proposed standard is based on the objective proposed in 2010, which provided that the auditor's objective in designing and performing confirmation procedures is to obtain relevant and reliable audit evidence. Existing AS 2310 does not include an objective. Commenters on the 2010 Proposal either supported or did not object to having an objective in the standard, and some commenters suggested changes to the proposed objective. Some of those commenters who suggested changes noted that the objective in the 2010 Proposal was too generic as it could be used for other standards. Having considered these and other comments, we decided to carry forward the proposed objective and add that audit evidence is obtained about one or more relevant financial statement assertions of a significant account or disclosure.

Question:

4. Is the objective of the new proposed standard clear? If not, how should it be clarified?

C. Relationship of the Confirmation Process to the Auditor's Identification and Assessment of and Response to the Risks of Material Misstatement

See paragraphs .03 - .07 of the new proposed standard in Appendix 1

The new proposed standard would apply to situations where the auditor determines to use confirmation to address a risk of material misstatement. Paragraphs .03 - .07 of the new proposed standard are intended to outline how the new proposed standard would work alongside the PCAOB standards on risk assessment, which were adopted after the 2010 Proposal was issued.

Fundamental to the PCAOB's risk assessment standards is the concept that as risk increases, so does the amount of evidence that the auditor should obtain.²⁸ Further, evidence obtained from a knowledgeable source outside the company generally is more reliable than evidence obtained only from internal company sources.²⁹ When properly designed and executed, the confirmation process can be an effective and efficient way of obtaining relevant and reliable external audit evidence, including in situations where the auditor identifies an elevated risk of material misstatement due to error or fraud.

²⁸ See AS 1105.05.

²⁹ See AS 1105.08.

As is the case with performing other audit procedures under PCAOB standards, the auditor is required to exercise professional skepticism when gathering and evaluating audit evidence from confirmation, including when identifying information to confirm, identifying confirming parties, evaluating confirmation responses, and addressing nonresponses.³⁰ Requirements related to exercising professional skepticism in combination with requirements in other PCAOB standards are designed to reduce the risk of confirmation bias, a phenomenon wherein decision makers have been shown to actively seek out and assign more weight to evidence that confirms their hypothesis, and ignore or underweight evidence that could disconfirm their hypothesis.³¹

Performing confirmation procedures can efficiently and effectively provide evidential matter about certain financial statement assertions, including existence, occurrence, completeness, and rights and obligations. For example, confirmation may provide audit evidence related to the existence of cash, accounts receivable, and financial instruments, or the completeness of debt. However, the confirmation process generally provides less relevant evidence about the valuation assertion (e.g., the confirming party may not intend to repay in full the amount owed, or the custodian may not know the value of shares held in custody). Confirmation could also be used to obtain audit evidence about the terms of contractual arrangements (e.g., by verifying supplier discounts or concessions, corroborating sales practices, or substantiating oral arrangements and guarantees). Information in confirmation responses may indicate the existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor.

In many situations, confirmation could provide audit evidence that is more persuasive than evidence obtained solely through other substantive procedures. This may occur, for example, where the auditor has determined not to test company controls or has found controls to be ineffective. In situations involving fraud risks and significant unusual transactions, audit evidence obtained through the confirmation process generally is more persuasive than audit evidence obtained solely through other procedures.

In some situations, an auditor may determine that evidence obtained through confirmation may constitute sufficient appropriate audit evidence for a particular assertion, while in other situations performing audit procedures in addition to confirmation may be necessary to obtain sufficient appropriate audit evidence. For example, for significant unusual sales transactions and the resulting accounts receivable balances, an auditor might confirm significant terms of the transactions and the receivable balances with the transaction counterparties, and perform additional substantive procedures such as examination of shipping documents and subsequent cash receipts. Determining the nature, timing, and extent of

³⁰ See paragraph .07 of AS 1015, *Due Professional Care in the Performance of Work*.

³¹ For a discussion of confirmation bias, see, e.g., Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 *Review of General Psychology*, 175 (1998).

confirmation procedures, and any other additional audit procedures, is part of designing and implementing the auditor's response to the assessed risk of material misstatement.

The 2010 Proposal would have provided that the auditor should send confirmation requests in response to significant risks that related to assertions that could be "adequately addressed" through confirmation. Some commenters on the 2010 Proposal either supported or did not object to the proposed approach. Many other commenters, however, viewed the requirement as overly prescriptive and inconsistent with PCAOB standards on risk assessment, which were adopted after the 2010 Proposal was issued. These commenters recommended that the standard allow for the use of professional judgment in determining the most effective and efficient approach to obtain sufficient appropriate audit evidence in response to the assessed risk. Having considered these comments, we have removed the requirement to send confirmation requests in response to significant risks.

As discussed in Section III.D, we continue to believe that confirmation procedures would generally provide more persuasive audit evidence than other procedures (without confirmation) for cash and accounts receivable. Accordingly, the new proposed standard would provide that the auditor should perform confirmation procedures for these accounts. In addition, the new proposed standard would specify that for significant risks of material misstatement associated with either a complex transaction or significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction.

Questions:

5. Does the new proposed standard provide for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard?
6. Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?
7. As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?
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?

9. Are there ways in which the new proposed standard should be changed to further align with the PCAOB's risk assessment standards? If so, how should the new proposed standard be changed?

D. Confirming Certain Accounts and Terms of Transactions

See paragraphs .09 - .15 of the new proposed standard in Appendix 1

1. Cash Held by Third Parties

i. Confirming Cash

Under the new proposed standard, when auditing cash and cash equivalents held by a third party ("cash"), the auditor should perform confirmation procedures. Existing AS 2310 does not separately address auditor responsibilities for confirming cash. The 2010 Proposal would have provided that the auditor should perform confirmation procedures for cash with financial institutions.

Several commenters on the 2010 Proposal asked the Board to clarify whether the auditor would be required to confirm all cash accounts. In the view of some commenters, the auditor should be allowed to select cash items and other financial relationships to confirm based on the assessed risk of material misstatement associated with cash. In the view of one commenter, requiring the auditor to send confirmation requests in all instances might shift the auditor's focus away from areas of higher risk. Another commenter suggested that addressing the risk could also involve performing audit procedures other than confirmation.

Having considered the comments, we note that an auditor need not necessarily confirm all cash accounts in all cases. Under PCAOB standards, the alternative means of selecting items for testing are selecting all items, selecting specific items and audit sampling.³² As with other confirmation procedures under the new proposed standard, an auditor would select individual cash items to confirm following the relevant direction in PCAOB standards, including identifying and assessing the risk of misstatement and developing an audit response.³³ The particular means or combination of means of selecting cash items to confirm would depend on, for example, the characteristics of the cash items and the evidence necessary to address the assessed risk of material misstatement.³⁴

The new proposed standard would emphasize that, in selecting the individual items of cash to confirm, the auditor should take into account the auditor's understanding of the company's cash management and treasury function, and the substance of the company's

³² See AS 1105.22.

³³ See, e.g., AS 2110 and AS 2301.

³⁴ See AS 1105.23 and AS 2301.03.

arrangements and transactions with third parties. For example, an auditor might select bank accounts with balances over a certain amount, accounts with a high volume of transactions, accounts opened or closed during the period under audit, or accounts the auditor identifies as particularly risk-prone. Alternatively, the auditor might determine it is appropriate to confirm all cash accounts. The auditor would also follow the direction in PCAOB standards when determining whether performing procedures in addition to confirmation is necessary to address the assessed risk of material misstatement relating to cash.

Unlike with the requirement to confirm accounts receivable, which is discussed below, the new proposed standard would not address overcoming the presumption to confirm cash. In general, the Board is not aware of other types of substantive procedures that would provide audit evidence that is as persuasive as audit evidence obtained through confirmation of cash.

ii. The Term “Cash and Cash Equivalents Held by Third Parties”

Under the new proposed standard, the term “cash” would comprise cash and cash equivalents. The 2010 Proposal used the term “cash” without specifying the types of assets to which it refers. Some commenters on the 2010 Proposal recommended expressly extending the applicability of the proposed requirements to confirm cash with financial institutions to cash equivalents. Cash equivalents generally refer to short-term, highly liquid investments that are readily convertible to known amounts of cash and are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.³⁵ Such assets are commonly used by companies to manage their cash holdings. Having considered the comments on the 2010 Proposal, we are proposing that the term “cash” in the new proposed standard refers to both cash and cash equivalents.

In the new proposed standard, the requirements for confirming cash would apply to cash held by third parties. The analogous requirements in the 2010 Proposal would have applied more narrowly to cash held by financial institutions. We believe that this expansion of confirmation requirements in the new proposed standard is appropriate, as company funds can be held by third parties other than financial institutions, such as money transfer providers.

iii. Confirming Other Financial Relationships

Under the new proposed standard, the auditor should consider confirming other financial relationships with the third parties with which the auditor determines to confirm cash. Such relationships can include lines of credit, other indebtedness, compensating balance arrangements, or contingent liabilities, including guarantees. Under PCAOB standards, the auditor would be required to document the consideration given to the confirmation of other

³⁵ See, e.g., definition of “cash equivalents” in the Master Glossary of the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification and of “cash equivalents” in the International Financial Reporting Standard (“IFRS”) Glossary.

financial relationships and the conclusions reached.³⁶ Existing AS 2310 does not have an analogous requirement. The 2010 Proposal would have provided that the auditor should confirm financial relationships like those mentioned above and, in addition, confirm whether certain other information came to the attention of the confirming party.

As discussed above, commenters on the 2010 Proposal recommended establishing more risk-based requirements for confirming cash and other financial relationships. Having considered the comments, we believe that information about financial relationships, including off-balance sheet relationships, could be important for the audit, as it could be part of significant disclosures in a company's financial statements. We also believe that an auditor should be able to take into account the facts and circumstances of the company in determining whether to inquire of a particular confirming party about financial relationships other than the company's cash holdings.

Accordingly, the requirement in the new proposed standard to consider confirming other financial relationships is designed to allow the auditor to tailor the confirmation procedures based on the auditor's understanding of the company. For example, a third party – which under the new proposed standard could be an entity other than a traditional financial institution – may simply not offer services that would give rise to the financial relationships discussed in the standard, or the nature of a company's business with a third party may indicate that no such financial relationships exist. In other situations, however, based on the auditor's understanding of the company's arrangements and transactions with third parties, the auditor could identify a risk of potential undisclosed relationships. Addressing this risk could necessitate the auditor sending confirmation requests to one or more of the parties involved.

Questions:

10. Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

³⁶ See Note to PCAOB Rule 3101(a)(3), which states that “(i)f a Board standard provides that the auditor “should consider” an action or procedure, consideration of the action or procedure is presumptively mandatory, while the action or procedure is not,” and paragraphs .05-.06 of AS 1215, *Audit Documentation* (audit documentation should “[d]emonstrate that the engagement complied with the standards of the PCAOB” and must “document the procedures performed ... with respect to relevant financial statement assertions”). See also *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Rel. No. 2004-006 (June 9, 2004), at 3 (“the auditor documents not only the nature, timing, and extent of the work performed, but also the professional judgments made by members of the engagement team and others”).

11. Are there substantive audit procedures other than confirmation that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash? If so, please describe these procedures.
12. For other financial relationships with the confirming party, is the requirement in the new proposed standard that the auditor should consider confirmation sufficiently clear and appropriate?
13. Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

2. Accounts Receivable

i. Confirming Accounts Receivable

The new proposed standard would carry forward the requirement to confirm accounts receivable. This approach to confirming accounts receivable is similar to the approach in existing AS 2310, except for certain differences in describing the circumstances under which the presumption could be overcome.

The 2010 Proposal also included a presumptively mandatory requirement for confirming accounts receivable but, unlike existing AS 2310 and the new proposed standard, did not specify circumstances in which the presumption could be overcome. One commenter on the 2010 Proposal supported excluding the auditor's ability to overcome the presumption by expressing the view that confirmation provides better audit evidence for the existence assertion than other audit procedures, even if the auditor expects a low response rate. A number of other commenters were critical about not specifying circumstances in which the presumption to confirm accounts receivable could be overcome. In the view of such commenters, sending confirmation requests could be ineffective, for example, where response rates are low, for certain industries (e.g., healthcare, utilities), or for companies that have a stated policy of not replying to auditor confirmation requests. Some commenters expressed concern about the auditor's potential inability under the 2010 Proposal to apply auditor judgment in selecting accounts receivable to confirm. Having considered the comments, we believe that it would be beneficial to clarify in the new proposed standard how the presumption to confirm accounts receivable may be overcome.

Under the new proposed standard, the auditor could overcome the presumption to confirm accounts receivable (including in situations described by commenters) when the auditor determines that an audit response that only includes substantive audit procedures other than confirmation would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through performing confirmation procedures. An auditor's determination would necessarily involve careful judgment when considering the assessed risk of material misstatement (including the consideration of potential fraud risk and management

bias) and the relative amount and quality of audit evidence that could be obtained from effective confirmation procedures in comparison with audit evidence that could be obtained from audit procedures that do not include confirmation.

For example, an auditor may have determined from firsthand experience that sending positive confirmation requests to a company's customers has not resulted in obtaining relevant and reliable audit evidence, because of poor rates of response, as well as unreliable responses, from the customers contacted by the auditor. Accordingly, for the upcoming audit, the auditor may design and implement an audit approach that does not involve the use of confirmation. Instead, the new audit approach may involve inspecting the details of transactions posted to accounts receivable, cash, and revenue, analyzing their correlation, examining third-party evidence (such as purchase orders submitted by the customers and customer payments reported by the bank), and testing the relevant controls.

Obtaining and examining appropriate third-party evidence increases the quality of the audit evidence obtained. In the example above, the auditor's approach includes examining third-party evidence, which could result in obtaining audit evidence of higher quality than an audit approach that does not include third-party evidence. At the same time, paragraph .19 of the new proposed standard would make clear that the auditor should consider information that may indicate a potential confirming party has incentives or pressures to provide responses that are inaccurate or otherwise misleading.

As noted, the necessary nature, timing, and extent of audit procedures performed in lieu of confirmation would depend on the facts and circumstances of the company and the audit. Under PCAOB standards, as the risk of material misstatement increases, the amount of evidence that the auditor should obtain also increases.³⁷ In the above example, as the risk increases, the auditor could increase the number of individual transactions for which the auditor examines third-party evidence. Further, the auditor may determine that to obtain audit evidence that is at least as persuasive as evidence from confirmation, the auditor may need to apply the other procedures to a greater number of items than the auditor would otherwise address through confirmation. The auditor's determinations (including the basis for the determinations) would be required to be documented in the working papers and a failure to do so would violate PCAOB standards.³⁸

The new proposed standard would include a requirement for the auditor to communicate to the audit committee³⁹ instances where the auditor has determined that the presumption to confirm accounts receivable has been overcome. Considering the long-standing

³⁷ See AS 1105.05.

³⁸ See AS 1215.06.

³⁹ The term "audit committee," as used in the new proposed standard, has the same meaning as defined in Appendix A of AS 1301, *Communications with Audit Committees*.

practice by auditors in the United States to confirm accounts receivable, there may be some expectation by audit committees that the auditor would use confirmation as part of a planned audit response. We believe that a new communication requirement when the presumption to confirm is overcome would enhance the audit committee's understanding of the auditor's strategy. Effective two-way communications between the auditor and the audit committee throughout the audit assist both the auditor and the audit committee in understanding matters relevant to the audit. The proposed communication requirement would complement the auditor's existing obligations to communicate to the audit committee about the auditor's overall audit strategy, significant changes to the planned audit strategy, and significant difficulties encountered during the audit.⁴⁰ In addition, the proposed communication requirement may reinforce the auditor's obligation to exercise due professional care before determining that the presumption to confirm accounts receivable has been overcome. As with other matters arising from the audit of financial statements and communicated or required to be communicated to the audit committee, the auditor would determine whether these matters are critical audit matters in accordance with AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.⁴¹

It is possible that an auditor would not be able to design and implement other procedures that provide audit evidence that is at least as persuasive as the auditor might expect to obtain through performing confirmation procedures. This may occur, for example, if an auditor identifies indicators of fraudulent financial reporting or instances of management's override of internal controls around the relevant assertions. If the auditor is unable to obtain sufficient appropriate audit evidence for a relevant assertion through performing confirmation procedures or other substantive procedures, the auditor would need to determine whether a limitation on the scope of the audit exists and evaluate the implications for the auditor's report.⁴²

The new proposed standard would not carry forward the provisions addressing materiality or a combination of risk assessments that are currently available to overcome the presumption to confirm accounts receivable,⁴³ as these matters would be considered by the auditor as part of identifying and assessing the risks of material misstatement and designing and implementing an audit response under PCAOB risk assessment standards. Further, instead of providing examples of situations in which the use of confirmation for accounts receivable would be ineffective, the new proposed standard would establish a principle that would be applicable in any situation involving accounts receivable – i.e., the auditor obtains audit

⁴⁰ See AS 1301.23.

⁴¹ See AS 3101.11-.12.

⁴² See paragraphs .05 through .09 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*.

⁴³ See AS 2310.34.

evidence that is at least as persuasive as the auditor might expect to obtain through performing confirmation procedures and reduces audit risk to an appropriately low level.⁴⁴

Similar to existing AS 2310 and the 2010 Proposal, the new proposed standard would not specify the extent of confirmation procedures for accounts receivable. As noted above in Section III.B, the timing and extent of confirmation procedures are part of the auditor's response to the risks of material misstatement under PCAOB risk assessment standards. The new proposed 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. For example, an auditor might assess the risk of material misstatement relating to accounts receivable higher for a company that is being audited for the first time by the auditor, or for accounts receivable from a newly acquired operation in a foreign location.

ii. The Term "Accounts Receivable"

Under the new proposed standard, accounts receivable would comprise receivables arising from the transfer of goods or services to a customer or from a financial institution's loans. The new proposed standard is designed to apply to the same types of items as existing AS 2310, which describes accounts receivable as the entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and a financial institution's loans. The new proposed standard would update the existing description to align more closely with the terminology of current accounting requirements, which have been updated since existing AS 2310 was written.⁴⁵

Accordingly, the new proposed standard would apply to receivables that arise from a company contracting with a customer to provide goods or services that are an output of the company's ordinary revenue-generating activities. Such receivables would include, for example, items for which revenue has been or will be recognized by a company, such as receivables from selling manufactured products, or from providing a service to customers. They would also include a financial institution's loans to customers that the institution has originated or purchased from another institution. Examples of financial institutions are banks, non-bank lenders, and mortgage companies that provide financing to customers.

The 2010 Proposal would have modified the approach in AS 2310 by establishing confirmation procedures for "receivables that arise from credit sales, loans or other transactions." That change was proposed "because confirmation of receivables can provide audit evidence regarding the occurrence assertion for revenue and can potentially address the

⁴⁴ See, e.g., paragraph .03 of AS 1101, *Audit Risk*.

⁴⁵ See, e.g., FASB Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers*, and IFRS 15, *Revenue from Contracts with Customers*.

risk of material misstatement due to fraud relating to revenue recognition.”⁴⁶ Some commenters on the 2010 Proposal indicated that the expanded requirement was not sufficiently clear with respect to “other transactions.” Other commenters expressed concern about expanding the scope of the confirmation procedures from accounts receivable as described in existing AS 2310 to all types of receivables and questioned the effectiveness of that change. In contrast, two commenters supported expanding the scope on the grounds that external evidence from confirmation procedures would be more relevant and reliable than evidence from other procedures. Having considered the comments, we have determined to focus the requirements in the new proposed standard on accounts receivable arising from revenue-generating transactions, as discussed above.

Questions:

14. Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?
15. Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?
16. Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?
17. Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?
18. Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?
19. Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor’s determination sufficiently clear and appropriate? Why or why not?

⁴⁶

PCAOB Rel. No. 2010-003, at 12.

3. Confirming Terms of Certain Transactions

The new proposed standard would update a provision in existing AS 2310.08 that the auditor should consider confirming the terms of certain transactions that are associated with high levels of risk. The new proposed standard would use the terminology “significant risk” and “significant unusual transactions,” but the new proposed provision is intended to be similar to that in existing AS 2310.

As discussed in Section III.C above, the 2010 Proposal would have required the auditor to send confirmation requests in response to significant risks that related to assertions that could be adequately addressed through confirmation. To be consistent with PCAOB risk assessment standards and allow for the exercise of professional judgment by the auditor, the new proposed standard does not include this provision from the 2010 Proposal.

Questions:

20. Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?
21. Is the new proposed standard sufficiently clear that an auditor’s use of confirmation is not limited to the circumstances discussed in paragraphs .09 through .15 of the new proposed standard? If not, how should it be clarified?

E. Designing Confirmation Requests

See paragraphs .16 - .21 and .B1 of the new proposed standard in Appendix 1

As noted above, a properly designed and executed confirmation process may provide relevant and reliable audit evidence. Auditor responsibilities regarding designing a confirmation request are described in paragraphs .16 - .21 and .B1, as follows:

- Paragraphs .16 and .17 discuss identifying information to confirm;
- Paragraphs .18 through .20 discuss identifying the confirming parties for confirmation requests; and
- Paragraphs .21 and .B1 discuss using negative confirmation requests.

The new proposed standard would not prescribe a particular format for a confirmation request. For example, requests could be paper-based or electronic, specifying the information to be confirmed or providing a blank response form, or sent with or without the help of an intermediary that facilitates electronic transmission. As a practical matter, the auditor would determine the format of a confirmation request, taking into consideration, among other things,

the facts and circumstances of the company and the confirming party, to increase the likelihood that the request is received and clearly understood by the confirming party.

1. Identifying Information to Confirm

Under the new proposed standard, the auditor should, as part of designing confirmation requests, identify information related to the relevant assertions that the auditor plans to verify with confirming parties or (when using a blank form) obtain from confirming parties. Such information could include transaction amounts, transaction dates, significant terms of transactions, and balances due from the confirming party or due to the confirming party as of a specific date. The 2010 Proposal would have included a similar requirement in addition to a requirement for the auditor to determine the timing of confirmation procedures.

To improve the reliability of audit evidence obtained through the confirmation process, the new proposed standard would include a reminder of an existing requirement in AS 1105.10, pursuant to which the auditor should test the accuracy and completeness of information produced by the company that the auditor uses as audit evidence. The new proposed standard would emphasize that, in the confirmation process, the requirement in AS 1105.10 applies to the information produced by the company (e.g., populations from which items are selected for confirmation, such as detailed account listings, vendor listings, and contractual agreements) that the auditor uses in selecting the items to confirm. Additionally, the new proposed standard does not include a specific requirement for the auditor to determine the timing of confirmation procedures as timing of substantive procedures is addressed by AS 2301.⁴⁷

Existing AS 2310 includes details regarding the form of confirmation requests, which includes general information on blank-form positive confirmation requests.⁴⁸ This information has been substantially retained in the new proposed standard in a note to paragraph .16. Using a blank confirmation request generally provides more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., customer account balance). In the latter scenario, it is possible that a confirming party could agree to the information without verifying it against the confirming party's records.

Question:

22. Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

⁴⁷ See AS 2301.43-.46.

⁴⁸ See AS 2310.17-.22.

2. Identifying Confirming Parties for Confirmation Requests

Under the new proposed standard, identifying the confirming party is part of the auditor's responsibilities when designing a confirmation request. To obtain reliable audit evidence from the confirmation process, the auditor should direct the confirmation requests to third parties who are knowledgeable about the information to be confirmed. A confirmation request can be addressed to an individual or an organization. This approach is similar to the approach in existing AS 2310.⁴⁹ In contrast, the 2010 Proposal stated that even if the company provides the auditor with the name of an appropriate confirming party, the auditor should select the confirming party. Additionally, the 2010 Proposal included an example in which the auditor should direct the confirmation to an individual as opposed to an organization.

Some commenters on the 2010 Proposal stated that, because auditors often have no or limited interaction with the personnel of confirming organizations, auditors may not be able to select an appropriate addressee for the confirmation request. Having considered the comments, we have made revisions to clearly indicate that the confirming party can be either an individual or an organization.

We note, however, that under the Board's risk assessment standards, which were adopted after the 2010 Proposal, it is the auditor's responsibility to obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁵⁰ For example, identifying a knowledgeable individual within a confirming party's organization and sending the confirmation request directly to that individual could increase the reliability of audit evidence obtained through the confirmation process. To emphasize this point, the new proposed standard includes a note reminding auditors that, under existing PCAOB standards, sending confirmation requests to a specific party within an organization is an example of an audit response to the risk of fraud.

The auditor is responsible for maintaining control over the confirmation process, as discussed below. When designing confirmation requests, an auditor may become aware of information about a potential confirming party's motivation, ability, or willingness to respond, or about the potential confirming party's objectivity and freedom from bias with respect to the audited entity. Similar to the requirements in existing AS 2310,⁵¹ because this type of information can affect the reliability of audit evidence provided by the confirming party to the auditor, under the new proposed standard the auditor should consider any such information that comes to the auditor's attention when selecting the confirming parties. The auditor should also consider the source of any such information. For example, if management indicates to the auditor that a potential confirming party is unlikely to respond to a confirmation request,

⁴⁹ See AS 2310.26.

⁵⁰ See AS 2301.09.

⁵¹ See AS 2310.27.

management may have other reasons to avoid a confirmation request being sent (e.g., concealing management's fraudulent understatement of the amount the company owes to that party).

In addition, the new proposed standard would provide more specific direction than existing AS 2310 for situations in which the auditor is unable to identify a confirming party who, in response to a confirmation request, would provide relevant and reliable audit evidence about a selected item. As noted above, the auditor's objective under the new proposed standard is to obtain relevant and reliable audit evidence from confirming parties. An auditor who is unable to select a confirming party that is likely to provide such evidence should perform alternative procedures.

The 2010 Proposal would have provided that the auditor should perform procedures to determine the validity of addresses of the potential confirming parties, including substantive procedures or test of controls. Several commenters on the 2010 Proposal stated that the characterization of procedures as "substantive procedures" or "test of controls" was not clear in the context of validating addresses. In addition, some commenters noted that the requirements did not appropriately consider the use of electronic confirmation.

Having considered the comments, we have retained a requirement regarding determining that confirmation requests are properly addressed (thus increasing the likelihood that they are received by the confirming party). However, the new proposed standard would not prescribe the nature or extent of procedures to be performed by the auditor when making the determination, thereby allowing the auditor to tailor the procedures to the facts and circumstances of the audit. For example, in practice, some auditors compare some or all confirming party addresses, which are typically provided by the company, to physical addresses or e-mail domains included on the confirming party's website.

Alternatively, when using an intermediary to facilitate direct electronic transmission of confirmation requests and responses (as discussed in Section III.F), Appendix B of the new proposed standard would require the auditor to obtain an understanding of the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses and determine that the relevant controls used by the intermediary are designed and operating effectively. Where an auditor determines that controls that address the risk of interception and alteration also include controls related to validating the addresses of confirming parties, the auditor may be able to determine that audit procedures performed in accordance with proposed Appendix B are sufficient to determine that confirmation requests are properly addressed. In situations where the auditor determines that the intermediary's controls that address the risk of interception and alteration do not also include controls related

to validating the addresses of confirming parties, the auditor would need to perform other procedures to comply with the requirements in paragraph .18 of the new proposed standard.

Questions:

23. Are the provisions of the new proposed standard related to identifying confirming parties sufficiently clear and appropriate?
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?

3. Using Negative Confirmation Requests

When designing a confirmation, the auditor may send a “positive” or a “negative” confirmation request (or both). A positive confirmation request is a confirmation request in which the auditor requests a confirmation response. With a negative confirmation request, the auditor requests a confirmation response only if the confirming party disagrees with the information provided in the request. The auditor generally obtains significantly less audit evidence when using negative confirmation requests than when using positive confirmation requests. A confirming party might not respond to a negative confirmation request because it did not receive or open the request, or alternatively the confirming party might have read the request and agreed with the information included therein.

Because of the limited evidence provided when using negative confirmation requests, the new proposed standard would not allow the auditor to use negative confirmation requests as the sole substantive procedure for addressing the risk of material misstatement to a financial statement assertion. Under the new proposed standard, the auditor may use negative confirmation requests only to supplement audit evidence provided by other substantive procedures (e.g., examining subsequent cash receipts, including comparing the receipts with the amounts of respective invoices being paid, examining shipping documents, examining subsequent cash disbursements, or sending positive confirmation requests). In contrast, under existing AS 2310, the auditor may use negative confirmation requests where certain criteria are present and should consider performing other substantive procedures to supplement their use. Similar to the new proposed standard, the 2010 Proposal would have disallowed using negative confirmation requests as the sole substantive procedure and would have allowed for the use of negative confirmation requests as the only form of confirmation request only if certain factors were present and the auditor also performed other substantive procedures.

Several commenters on the 2010 Proposal expressed concern with the requirement to supplement the use of negative confirmation requests with other substantive audit procedures in all circumstances and instead suggested a risk-based approach to determining whether the

auditor should perform supplementary substantive procedures. In developing the new proposed standard, we have considered both the comments received and the developments in practice that have occurred since the issuance of the 2010 Proposal. The new proposed standard carries forward the approach in the 2010 Proposal with some modifications, including the removal of the requirement for certain factors to be present in order to use negative confirmation requests as the only form of confirmation request in conjunction with other substantive procedures.

As noted above, since the auditing standard on confirmation was promulgated by the AICPA in 1992, the amount of correspondence, especially electronic correspondence, has increased dramatically. This trend has continued since the 2010 Proposal was issued. Accordingly, the likelihood that a negative confirmation request would not be considered by the recipient, either because the recipient would treat the request with suspicion (e.g., as a phishing attempt) or not receive it at all (e.g., if an e-mailed request were caught in a spam filter) has continued to increase. We therefore believe that negative confirmation requests should not be used as the sole substantive procedure for addressing the risk of material misstatement to a financial statement assertion.

The 2010 Proposal described certain factors, all of which would have needed to have been present, to allow the use of negative confirmation requests, without positive confirmation requests but in combination with other substantive procedures, to address the assessed risk to a relevant assertion. Except for one factor, the new proposed standard would reframe these factors as examples of situations in which the auditor may use negative confirmation requests in combination with other substantive procedures. We believe that reframing the factors as examples would allow for a more flexible audit approach (e.g., by allowing for the use of negative confirmation requests, provided that the auditor performs other substantive procedures), reflecting the variety of situations that may exist in practice.

The factor that the new proposed standard does not carry forward from the 2010 Proposal would have limited the use of negative confirmation requests to situations where the auditor “reasonably believes that recipients of negative confirmation requests will give such requests consideration.” Several commenters expressed concern with this factor and stated that it was not an appropriate condition in all circumstances, given that the auditor may not have an existing relationship with the confirming party. Having considered the comments, we have determined not to include this factor as an example in the new proposed standard. As discussed above, however, under the new proposed standard any negative confirmation request should be directed by the auditor to confirming parties who the auditor believes are knowledgeable about the information to be confirmed in accordance with paragraph .18 of the new proposed standard.

Question:

25. Are the provisions of the new proposed standard related to the auditor's use of negative confirmation requests sufficiently clear and appropriate?

F. Maintaining Control over the Confirmation Process

See paragraphs .22 - .24 and .B2 - .B3 of the new proposed standard in Appendix 1

1. The Requirement for the Auditor to Maintain Control over the Confirmation Process

The reliability of audit evidence provided by confirmation depends in large part on the auditor's ability to control the integrity of confirmation requests and responses. The new proposed standard would carry forward the provision in existing AS 2310 that the auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted and altered. Under the new proposed standard, as part of maintaining control, the auditor should send confirmation requests directly to the confirming party and receive confirmation responses directly from the confirming party. It would not be appropriate for company personnel, including internal auditors, to be involved in either sending confirmation requests or receiving confirmation responses.

The 2010 Proposal would have included an analogous requirement regarding maintaining control over the confirmation process. In addition, in the 2010 Proposal, the section on maintaining control would have addressed the auditor's responsibilities for selecting the items to confirm, the confirming party, and the type of confirmation request. Although no comments were received on the location of those requirements in the 2010 Proposal,⁵² we determined, upon further consideration, that they would be more appropriately placed in the section on designing the confirmation request in the new proposed standard.

2. Using an Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses

i. Background and Proposed Requirements

Certain financial institutions and other companies have adopted the policy of responding to electronic confirmation requests from auditors only through another party that they, or the auditor, engage as an intermediary to facilitate the direct transmission of information between the auditor and the confirming party. We understand that such policies

⁵² Comments on the specific requirements are discussed in the relevant sections of this release.

are aimed at managing the timeliness and quality of confirmation responses provided by the confirming party to the auditor.

The involvement of intermediaries is not discussed in existing AS 2310. The 2010 Proposal referred to intermediaries as recipients of confirmation requests and senders of confirmation responses. Upon further consideration of intermediaries' role in the confirmation process, we determined that it would be more appropriate to refer to intermediaries in the new proposed standard as facilitators of the electronic transmission of confirmation requests and responses between the confirming party and the auditor.

The use of an intermediary does not relieve the auditor of the responsibility under PCAOB standards to maintain control over confirmation requests and responses. Because an intermediary's involvement may affect the integrity of information transmitted between the confirming party and the auditor, the new proposed standard would provide that the auditor should evaluate the implications of such involvement for the reliability of confirmation requests and responses.

Under the new proposed standard, the auditor's evaluation should address certain aspects of the intermediary's controls that address the risk of interception and alteration of communications between the auditor and the confirming party. In addition, the auditor's evaluation should assess whether circumstances exist that give the company the ability to override the intermediary's controls (e.g., through financial or other relationships). An intermediary that, based on the auditor's evaluation, does not meet the criteria established by the new proposed standard should not be used in the confirmation process.

The new proposed standard does not specify how the particular procedures should be performed by the auditor, thus allowing auditors to customize their approach based on facts and circumstances of the audit firm as well as of the audit engagement. For example, in obtaining an understanding of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses and determining whether they are designed and operate effectively, the auditor could (i) use, where available, an independent service auditor's report on service organization controls that evaluates the design and operating effectiveness of the relevant controls at the intermediary; or (ii) test the intermediary's controls that address the risk of interception and alteration directly.⁵³

⁵³ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

ii. Interaction of the New Proposed Standard with Proposed QC 1000

In November 2022 the Board issued for public comment a new quality control standard, referred to as proposed QC 1000, *A Firm's System of Quality Control*.⁵⁴ Proposed QC 1000 addresses resources used by a registered public accounting firm that are sourced from third-party providers. An intermediary that facilitates direct electronic transmission of confirmation requests and responses is one example of a "third-party provider" under proposed QC 1000.

Under proposed QC 1000, the firm would consider the nature and extent of resources or services obtained from third-party providers in its risk assessment process and whether the use of third-party providers poses any quality risks to the firm in achieving its quality objectives. One of the required quality objectives relates to obtaining an understanding of how such resources or services are developed and maintained and whether they need to be supplemented and adapted as necessary, such that their use enables the performance of the firm's engagements.⁵⁵

As noted above, the new proposed standard on the auditor's use of confirmation would require specific procedures related to the use of an intermediary, which includes obtaining an understanding of the intermediary's controls that address the risk of interception and alteration of a confirmation request or response and determining whether they are designed and operate effectively. The auditor's evaluation of the intermediary's controls could be performed by an engagement team, an audit firm's national office, or a combination of both. Therefore, a firm would be able to perform some of these controls evaluations in conjunction with its QC activities under proposed QC 1000. Further, as part of its QC activities, a firm could determine it would be appropriate to include additional guidance as part of its methodology, for example, on how to use the services of the intermediary or to specify circumstances in which an engagement team should or should not use the service.

Questions:

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 account when using an intermediary in the confirmation process?

⁵⁴ See *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Rel. No. 2022-006 (Nov. 18, 2022).

⁵⁵ See paragraph .44.j of proposed QC 1000.

27. Is the potential interaction between using an intermediary in the new proposed standard and the proposed requirements in QC 1000 related to third-party providers sufficiently clear?

G. Evaluating Confirmation Responses and Confirmation Exceptions, and Addressing Nonresponses and Incomplete Responses

See paragraphs .25 - .30 of the new proposed standard in Appendix 1

1. Overall Approach

Under the new proposed standard, the auditor's responsibilities related to the confirmation process include evaluating the information received in confirmation responses and addressing nonresponses and incomplete responses. If the auditor is unable to determine whether the confirmation response is reliable, or in the case of a nonresponse or an incomplete response (i.e., a confirmation response that does not provide the auditor with all of the audit evidence the auditor seeks to obtain), the auditor should perform other audit procedures as an alternative to confirmation.⁵⁶ The new proposed standard would build on and improve the requirements in existing AS 2310 that discuss addressing information obtained from the performance of confirmation procedures.

The new proposed standard would not carry forward a requirement, included in both existing AS 2310 and the 2010 Proposal, for the auditor to evaluate in the aggregate audit evidence obtained from performing confirmation procedures and any alternative procedures. Excluding this requirement from the new proposed standard would avoid the unnecessary duplication of certain requirements of AS 2810, *Evaluating Audit Results*, that discuss the auditor's responsibilities for evaluating audit results and determining whether the auditor has obtained sufficient appropriate audit evidence.

2. Evaluating the Reliability of Confirmation Responses

The new proposed standard would provide additional direction beyond what is currently set forth in AS 2310 to assist the auditor's evaluation of the reliability of confirmation responses. Specifically, the new proposed standard would (i) describe information that the auditor should take into account when performing the evaluation, and (ii) provide examples of indicators that a confirmation response may have been intercepted or altered. A similar approach was used in the 2010 Proposal, which included factors that the auditor should take into account in assessing the reliability of confirmation responses.

⁵⁶ Alternative procedures, including the relevant exception described in a note to paragraph .31 of the new proposed standard, are discussed in Section III.H of this release.

Certain commenters on the 2010 Proposal suggested that the auditor should be required to perform further audit procedures only when the auditor identifies concerns as to the reliability of a confirmation response. Other commenters indicated that the factors included in the 2010 proposal should be described as factors that the auditor may consider in assessing the reliability of a confirmation response.

Taking into consideration these comments, the new proposed standard specifies that the auditor should take into account any information about events, conditions, or other information the auditor becomes aware of in assessing the reliability of the confirmation response. The new proposed standard also includes examples of indicators that a confirmation response may have been intercepted or altered and thus not be reliable. Under existing PCAOB standards, the auditor is not expected to be an expert in document authentication, but, if conditions indicate that a confirmation response may not be authentic or may have been altered, the auditor should modify the planned audit procedures or perform additional audit procedures to respond to those conditions and should evaluate the effect, if any, on the other aspects of the audit.⁵⁷ The new proposed standard would not modify these requirements. It would specify that, if the auditor is unable to determine that the confirmation response is reliable, the auditor's response should include performing alternative procedures as discussed in paragraph .31.

The 2010 Proposal included additional procedures regarding the reliability of electronic confirmation responses. Several commenters indicated that the 2010 Proposal, in general, included adequate requirements regarding electronic confirmation procedures. However, one commenter stated that specific procedures related to electronic media should not be promulgated and that the standard should instead focus on the auditor's responsibility to obtain and evaluate evidence that meets both the sufficiency and appropriateness criteria. Considering that the use of electronic means of confirmation has become routine since the 2010 Proposal was issued, we have designed the new proposed standard so that its principles apply to all methods of confirmation, including electronic confirmation. The new proposed standard therefore would not provide a separate set of provisions specifically for electronic confirmation.

Considering that confirming parties may qualify their responses, we have included in the new proposed standard a reminder about the auditor's responsibilities under PCAOB standards to evaluate third-party evidence that is subject to restrictions, limitations, or disclaimers.⁵⁸

⁵⁷ See AS 1105.09.

⁵⁸ See footnote 8 of the new proposed standard, which references a note to AS 1105.08.

Question:

28. Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?

3. Evaluating Confirmation Exceptions and Addressing Nonresponses

For various reasons, information in a confirmation response received by the auditor could differ from other information in the company's records obtained by the auditor. The new proposed standard would provide that the auditor should evaluate the confirmation exceptions and determine their implications for certain aspects of the audit, as discussed below. The direction in the new proposed standard is more detailed than in existing AS 2310.

The 2010 Proposal would have provided that the auditor should investigate all confirmation exceptions to determine why each confirmation exception occurred. Several commenters on the 2010 Proposal asked the Board to clarify whether the auditor would be required to investigate immaterial differences. Having considered the comments, we continue to believe that it is important to accumulate all potential misstatements from individual confirmation exceptions and evaluate whether the confirmation exceptions in combination represent a material misstatement, as discussed in AS 2810. Accordingly, the new proposed standard would provide that the auditor should evaluate whether the confirmation exceptions individually or in the aggregate indicate a misstatement that should be evaluated in accordance with AS 2810. The new proposed standard would not require, however, investigating all confirmation exceptions to determine why every confirmation exception occurred.

Further, several commenters on the 2010 Proposal suggested that evaluating confirmation exceptions should include considering potential deficiencies in the company's internal control over financial reporting ("ICFR"). In response to these comments, the new proposed standard includes a provision that the auditor should evaluate whether the confirmation exceptions individually or in the aggregate indicate a deficiency in the company's ICFR.

In the case of a nonresponse to a positive confirmation request, the 2010 Proposal would have provided that the auditor should send a second positive confirmation request. A number of commenters expressed concern with this requirement, indicating, for example, that in some instances the auditor may have no or a low expectation of receiving a response to a second or third confirmation request. Many of these commenters suggested a risk-based approach whereby the auditor would be allowed to exercise professional judgment when determining whether to send follow-up confirmation requests. Having considered these comments, we propose that the auditor send a second positive confirmation request to the confirming party (e.g., which, in the case of an electronic confirmation request, could be in the form of a reminder or automated reminder) unless the auditor has become aware of information that indicates that the confirming party would be unlikely to respond to the auditor.

Similar to the 2010 Proposal, the new proposed standard specifies that if a confirmation response is returned by the confirming party to anyone other than the auditor, the auditor should contact the confirming party and request that the response be re-sent directly to the auditor. The new proposed standard also specifies that if the auditor does not subsequently receive a confirmation response from the intended confirming party, the auditor should treat the situation as a nonresponse. One commenter on the 2010 Proposal indicated that an oral verification of the confirmation response by the confirming party should also be permitted as oral verification would reduce audit risk to an acceptable level; in another commenter's view an oral confirmation response is a form of audit evidence. Having considered these comments, we continue to believe that obtaining direct written communication (in paper or electronic form) from the confirming party is necessary for a confirmation response to provide reliable audit evidence.

As noted above, the new proposed standard would provide that the auditor should perform alternative procedures if a confirmation response is not received or is incomplete. Neither existing AS 2310 nor the 2010 Proposal specifies the auditor's responsibilities regarding incomplete responses. We believe that if the auditor did not obtain audit evidence that the auditor planned to obtain through confirmation (e.g., because information was not included in the confirmation response), it is necessary to obtain sufficient audit evidence through the performance of alternative procedures.

Questions:

29. Are the provisions of the new proposed standard related to confirmation exceptions and nonresponses sufficiently clear and appropriate?
30. Are the provisions about when the auditor should send a second positive confirmation request sufficiently clear and appropriate? Would this provision be a change from current practice?

H. Performing Alternative Procedures

See paragraph .31 of the new proposed standard in Appendix 1

Under the new proposed standard, the auditor should perform alternative procedures in certain scenarios involving identifying confirming parties or evaluating the reliability of confirmation responses, as well as in scenarios involving nonresponses and incomplete responses.⁵⁹ This range of scenarios would be broader than under existing AS 2310, which provides that, with certain exceptions, the auditor should apply alternative procedures where the auditor has not received replies to positive confirmation requests. The scenarios discussed

⁵⁹ See paragraphs .20 (inability to identify a confirming party), .26 (unreliable response), and .30 (nonresponse or incomplete response) of the new proposed standard.

in the new proposed standard are similar to those in the 2010 Proposal. In addition, existing AS 2310 requires, and the 2010 Proposal would have provided, that the auditor should evaluate the combined evidence provided by confirmation and any alternative procedures and send additional confirmation requests or perform other audit tests, as needed, to obtain sufficient appropriate audit evidence.

The new proposed standard provides examples of alternative procedures that may provide relevant and reliable audit evidence regarding accounts receivable, accounts payable, and the terms of a transaction or agreement. These provisions expand upon the examples of alternative procedures discussed in existing AS 2310 and the 2010 Proposal.

The new proposed standard does not specify whether performing alternative procedures for the items the auditor was unable to confirm, alone or in combination with other audit procedures, would be necessary to obtain sufficient appropriate audit evidence. The auditor would make that determination based on the facts and circumstances of the audit. Further, an auditor might determine that, without obtaining a reliable confirmation response, the auditor is unable to obtain sufficient appropriate audit evidence for a relevant assertion through performing alternative procedures for the items the auditor could not confirm, other audit procedures, or both (e.g., if the auditor observes conditions during the confirmation process that indicate a heightened fraud risk). In such scenarios, the auditor would consider the impact on the audit opinion in accordance with AS 3105.

A number of commenters on the 2010 Proposal suggested clarifying whether alternative procedures described in the 2010 Proposal were examples or required procedures, as the 2010 Proposal used the term “should include” when describing the procedures. Having considered the comments, we have removed this term to clarify that the procedures described in the new proposed standard are examples. Further, the new proposed standard uses the term “alternative procedures” consistently when discussing situations in which the auditor should perform other audit procedures as an alternative to confirmation.⁶⁰

Under the new proposed standard, performing alternative procedures may not be necessary where items selected for confirmation for which the auditor was not able to complete audit procedures would not – if misstated – change the outcome of the auditor’s evaluation of the effect of uncorrected misstatements performed in accordance with AS 2810.17.⁶¹ For example, following the direction in AS 2810.17, an auditor may determine that an item that the auditor was unable to confirm would not be material individually or in combination with other misstatements. In such situations, under the new proposed standard,

⁶⁰ Depending on the scenario, the 2010 Proposal referred to such procedures as “other audit procedures” or “alternative procedures.” See, e.g., paragraphs 20 and 28 of the 2010 Proposal.

⁶¹ The auditor’s evaluation of materiality under AS 2810.17 takes into account both relevant quantitative and qualitative factors.

the auditor would not be required to perform alternative procedures.⁶² Existing AS 2310 includes an analogous exception. The exception was not retained in the 2010 Proposal.

Some commenters on the 2010 Proposal suggested that alternative procedures should be required for nonresponses. Other commenters recommended retaining the exception discussed in existing AS 2310 and asserted that alternative procedures for nonresponses may not be necessary if, for example, an auditor chose a larger sample anticipating a certain rate of nonresponses. Having considered the comments, we believe that alternative procedures should generally be performed in the case of a nonresponse as a nonresponse could indicate, among other things, the existence of a previously unidentified risk of material misstatement that could be identified through the performance of alternative procedures. However, determining whether alternative procedures are necessary should also take into account the effect of any potential misstatements resulting from items selected for confirmation but not confirmed. The proposed exception, discussed above, reflects this approach.

Questions:

31. Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?
32. Are there any additional examples of alternative procedures that we should consider for inclusion as examples in the new proposed standard?

I. Using Internal Audit in the Confirmation Process

See paragraph .32 of the new proposed standard in Appendix 1

The new proposed standard identifies certain activities in the confirmation process where the auditor may not use the assistance of the company's internal audit function. Specifically, the auditor would not be permitted to use internal auditors for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses.

In contrast, existing AS 2310 does not address the use of internal audit in the confirmation process other than to provide in a footnote that the auditor's need to maintain control does not preclude the use of internal auditors and that AS 2605, *Consideration of the Internal Audit Function*, provides guidance on considering the work of internal auditors and on

⁶² In certain circumstances, auditors may have obligations independent of the Board's auditing standards to perform either confirmation procedures or other auditing procedures. *See, e.g.*, Section 30(g) of the Investment Company Act of 1940, 15 U.S.C. § 80a-29(g) (providing that the auditor's report on the financial statements of a registered investment company "shall state that such independent public accountants have verified securities owned, either by actual examination, or by receipt of a certificate from the custodian, as the Commission may prescribe by rules and regulations").

using internal auditors to provide direct assistance to the auditor.⁶³ In comparison, the release accompanying the 2010 Proposal provided, in discussing a proposed requirement to maintain control over the confirmation process, that the auditor would not have been permitted to use internal auditors to send confirmation requests, receive confirmation responses, or evaluate audit evidence obtained from performing confirmation procedures.

Several commenters on the 2010 Proposal suggested moving the discussion of auditor responsibilities regarding the use of internal auditors from the release to the standard for clarity. In response to these comments, we have placed the relevant requirements in the text of the new proposed standard. Further, several commenters either expressly agreed with or did not object to the proposed approach regarding the use of internal audit. At the same time, other commenters expressed concern about the proposed approach. Some of these commenters, for example, suggested that the proposed approach would be inconsistent with the direction in AS 2605, which does not establish a similar restriction on the use of internal auditors. Some commenters stated that they did not understand the Board's rationale for restricting the use of internal auditors in the confirmation process.

Having considered the comments, we believe that using internal auditors for selecting items to be confirmed, or for sending or receiving responses, would not be consistent with the auditor's responsibility to maintain control over the confirmation process. Involving internal auditors or other company employees in these activities would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered. Accordingly, under the new proposed standard, using direct assistance from internal auditors for these activities would not be allowed.⁶⁴

We are not carrying forward the 2010 Proposal's restriction on using internal auditors for evaluating the audit evidence obtained from performing confirmation procedures. We believe that is not necessary as the overall responsibility for determining whether sufficient appropriate audit evidence has been obtained is the auditor's obligation under AS 2810.33. The new proposed standard would allow using internal auditors to assist with administrative aspects of the confirmation process, such as preparing the confirmation request and researching differences in confirmation responses. When using internal auditors to provide direct assistance to the auditor, the auditor should comply with the relevant requirements of AS 2605.

⁶³ See footnote 3 of AS 2310.

⁶⁴ Consistent with the requirement in the new proposed standard for the auditor to confirm cash, we have proposed to amend AS 2605.22 to delete the reference to cash in the example of an assertion "that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence." See Appendix 2 – Proposed Amendments to Related PCAOB Auditing Standards.

Questions:

33. Are the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses sufficiently clear and appropriate? If not, what changes should be considered?
34. Based upon information available, we understand auditors' use of internal audit in a direct assistance capacity to send confirmation requests or receive confirmation responses to be infrequent. Are commenters aware of information to the contrary?

J. Other Matters

As noted above, certain matters that were discussed in the 2010 Proposal have not been retained in the new proposed standard. This section discusses additional matters that were included in the 2010 Proposal but not in the new proposed standard. In addition, this section covers definitions included in the new proposed standard and other proposed amendments to related PCAOB auditing standards as included in Appendix 2.

1. Management Requests Not to Confirm

Existing AS 2310 does not address situations in which management requests that the auditor not confirm one or more items. The 2010 Proposal would have provided that, in such situations, the auditor should perform certain audit procedures, including communicating the management request to the audit committee, obtaining additional audit evidence through the performance of alternative procedures if the auditor agreed to the management request, and evaluating the implications of the management request for the audit report.

Some commenters on the 2010 Proposal supported or did not object to the proposed approach. Other commenters, however, raised concerns about various aspects of the proposed requirements. For example, several commenters questioned the usefulness of communicating to the audit committee all management requests, even those without a significant impact on the audit. In addition, some commenters asked the Board to clarify the rationale for requiring the auditor to obtain more persuasive audit evidence when management requests that the auditor not confirm an item and inquired about the auditor's responsibilities if such evidence did not exist. Further, some commenters asked about applying the proposed requirements in the context of other PCAOB standards (e.g., standards addressing the consideration of fraud risks and scope limitations).

Having considered these comments, we have determined not to carry forward the proposed requirements related to management requests to avoid potential confusion with, or unnecessary duplication of, other requirements under PCAOB standards. For example, in 2012, after the issuance of the 2010 Proposal, the Board adopted AS 1301. Among other things, AS 1301 requires that the auditor communicate to the audit committee disagreements with

management⁶⁵ and difficulties encountered in performing the audit, including unreasonable management restrictions encountered by the auditor on the conduct of the audit.⁶⁶ In addition, AS 3105 sets forth requirements regarding limitations on the scope of an audit,⁶⁷ including scope limitations relating to confirmation.⁶⁸

We also considered that PCAOB standards, including AS 2110 and AS 2401, *Consideration of Fraud in a Financial Statement Audit*, describe auditor responsibilities regarding identifying, assessing, and responding to fraud risks. For example, AS 2401.09 states that fraud may be concealed by withholding evidence. A management request to limit audit testing by not obtaining external audit evidence could be relevant to the auditor's consideration of fraud risk factors, including the consideration of management incentives, opportunities, and rationalization for perpetrating fraud.

Questions:

35. In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?
36. Based upon information available, we understand management requests not to confirm certain items or accounts to be infrequent. Are commenters aware of information to the contrary? If so, in what circumstances do management requests not to confirm commonly arise in practice?

2. Restrictions and Disclaimers

The 2010 Proposal acknowledged that a response to a confirmation request might contain restrictions or disclaimers. Under the 2010 Proposal, the auditor should evaluate the effect of such restrictions or disclaimers on the reliability of the confirmation response and perform appropriate alternative procedures to obtain relevant and reliable audit evidence.

Several commenters on the 2010 Proposal supported the proposed requirements while other commenters indicated that the Board should clarify the requirements by providing guidance and examples on how an auditor can assess the effect of disclaimers and restrictive language on the reliability of a confirmation response.

Having considered these comments, we have determined not to carry forward the proposed requirements related to restrictions and disclaimers as they may be viewed as

⁶⁵ AS 1301.22.

⁶⁶ AS 1301.23.

⁶⁷ AS 3105.05-.17.

⁶⁸ AS 3105.07.

duplicative of the requirement in AS 1105, with which auditors are already familiar, according to which the auditor should evaluate the effect of restrictions, limitations, or disclaimers on the reliability of audit evidence.⁶⁹ However, as discussed in Section III.G, we have included a reminder in the new proposed standard about the auditor's responsibilities under AS 1105.

3. Direct Access

The 2010 Proposal addressed situations in which a third party grants an auditor access to information in the third party's information system concerning the third party's transactions or balances with the company under audit (e.g., the company's balance at a bank). Under the 2010 Proposal, such direct access could be considered a confirmation procedure in certain circumstances. Some commenters on the 2010 Proposal expressed concerns regarding the practicability or clarity of the proposed provisions, including the definition "direct access." Having considered the comments, we decided not to describe direct access as a confirmation procedure in the new proposed standard because it does not involve sending a confirmation request and receiving a confirmation response.

4. Definitions

To operationalize the requirements included in the new proposed standard, Appendix A of the new proposed standard includes definitions for "confirmation exception," "confirmation process," "confirmation request," "confirmation response," "confirming party," "negative confirmation request," "nonresponse," and "positive confirmation request." One commenter on the 2010 Proposal indicated that the definition of "nonresponse" should include situations where the auditor receives no response, not just an incomplete response, from the confirming party. Other commenters asked for clarification on what is meant by the term "other medium" as included in the definitions of "confirmation," "confirmation request," and "confirmation response." Considering these comments, we have made modifications to definitions included in the new proposed standard.

Question:

37. Are the definitions included in the new proposed standard sufficiently clear and appropriate? If not, what changes should be made to the definitions?

5. Proposed Amendments to Related PCAOB Auditing Standards

We are proposing conforming amendments to AS 1105, AS 1301, AS 2401, AS 2510, *Auditing Inventories*, and AS 2605, as described in Appendix 2 to this release.

⁶⁹ See AS 1105.08.

Question:

38. Are there other amendments that should be made to the PCAOB's existing standards to conform them with the new proposed standard?

IV. ECONOMIC ANALYSIS

The Board is mindful of the economic impacts of its standard setting. This section describes the economic baseline, need, and expected economic impacts of the new proposed standard, as well as alternative approaches considered by the Board. Because there are limited data and research findings available to estimate quantitatively the economic impacts of the new proposed standard, the economic analysis is largely qualitative in nature.

A. Baseline

Section II describes important components of the baseline against which the economic impact of the new proposed standard can be considered, including the Board's existing standard governing the audit confirmation process, firms' current practices when performing confirmation procedures, and observations from the Board's inspections program and enforcement cases. We discuss below two additional components that inform our understanding of the economic baseline: (i) the staff's analysis of audit firm methodologies and the use of technology-based tools in the confirmation process, and (ii) a summary of academic and other literature on the confirmation process.

1. Auditing Practices Related to the Confirmation Process

Through its inspection and other oversight activities, the PCAOB has access to sources of information that help inform our understanding of how firms currently engage in the confirmation process. As part of this standard-setting project, the staff has reviewed a selection of firms' audit methodologies, as well as other information about firms' use of technology-based tools when performing confirmation procedures. While this information is not a random sample that can be extrapolated accurately across all registered public accounting firms, we are able to make some general inferences that help inform development of the economic baseline.

i. PCAOB Staff Analysis of Audit Methodologies

PCAOB staff has reviewed the methodologies of selected registered public accounting firms to determine how they currently address the confirmation process and the extent to which changes to those methodologies would be necessary to implement the new proposed standard. Specifically, the staff compared methodologies of selected global network firms

(“GNFs”)⁷⁰ and some methodologies commonly used by U.S. non-affiliate firms (“NAFs”),⁷¹ which are smaller than GNFs, to existing AS 2310 as well as to the new proposed standard. The review focused on the following aspects of the new proposed standard:

- Substantive procedures for confirming cash and cash equivalents (paragraphs .09-.11);
- Substantive procedures for confirming accounts receivable (paragraphs .12-.14);
- The auditor’s use of negative confirmation requests (paragraphs .21 and .B1);
- Maintaining control over the confirmation process, including when an intermediary is used (paragraphs .22-.24 and .B2-.B3); and
- Other areas addressed in the new proposed standard, including the use of internal audit, the evaluation of the reliability of confirmation responses, and the performance of alternative procedures.

For the GNF methodologies reviewed, we observed that the methodologies generally reflect requirements in existing AS 2310 and other auditing standards on external confirmation, such as ISA 505 and AU-C 505. In addition, some of the methodologies already incorporate certain concepts included in the new proposed standard, although amendments would nonetheless be needed if the new proposed standard were adopted.

Specifically, some GNF methodologies, but not all, include requirements for confirmation of cash and cash equivalents held by third parties similar to the requirements described in the new proposed standard. Other GNF methodologies suggest, but do not require, that engagement teams consider specific confirmation procedures for cash and cash equivalents held by third parties. GNF methodologies for confirmation of accounts receivable are generally consistent with existing AS 2310. Some also include guidance that is similar to the new requirements in the new proposed standard when the auditor is unable to obtain relevant and reliable audit evidence through confirmation procedures. With respect to negative confirmation requests, GNF methodologies acknowledge that negative confirmation requests provide less persuasive evidence than positive confirmation requests. However, some GNF

⁷⁰ GNFs are the member firms of the six global accounting firm networks (BDO International Ltd., Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Ltd., and PricewaterhouseCoopers International Ltd.).

⁷¹ NAFs are both U.S. and non-U.S. accounting firms registered with the Board that are not GNFs. Some of the NAFs belong to international networks.

methodologies still allow the use of negative confirmation requests as the sole substantive procedure under certain conditions.⁷²

The staff also observed that GNF methodologies generally include guidance on maintaining control and the use of intermediaries in the confirmation process. The firms' guidance in this area focuses on the performance of audit procedures to ensure that the electronic confirmation process occurs in a secure and controlled environment and that confirmation responses received are reliable. For example, the methodologies of some firms provide that an auditor may obtain a SOC report that would assist the engagement team in assessing the design and operating effectiveness of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses. Finally, although current GNF methodologies include guidance on the other areas to be modernized or clarified in the new proposed standard, firms may be required to make certain modifications to their methodologies to conform to the new proposed standard, such as where it would not be permissible to use internal audit in the confirmation process and whether to perform alternative procedures.

For the NAF methodologies reviewed, the staff observed that the methodologies generally align with existing AS 2310 across each of the areas studied, but include some guidance related to the requirements in the new proposed standard. For example, in some of the NAF methodologies, the confirmation of cash and cash equivalents held by third parties is a consideration but not a requirement. In other NAF methodologies, the confirmation of cash and cash equivalents held by third parties and negative confirmation requests are not discussed at all. NAF methodologies for confirmation of accounts receivable are generally consistent with existing AS 2310. Some include guidance that is similar to the new requirements described in the new proposed standard when the auditor is unable to obtain relevant and reliable audit evidence through confirmation procedures.

The NAF methodologies also generally include guidance on maintaining control and the use of intermediaries in the confirmation process. Similar to GNF methodologies, NAF guidance in this area focuses on the performance of audit procedures to ensure that the electronic confirmation process occurs in a secure and controlled environment and that confirmation responses received are reliable. For example, a firm's methodology may provide that an auditor may obtain a SOC report that would assist the engagement team in assessing the design and operating effectiveness of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses.

In general, the staff's review indicates that all firms would likely need to revise their methodologies to some extent to implement the new proposed standard, if adopted. For example, all firms would need to update their methodologies to ensure that negative confirmation requests are not used as the sole source of audit evidence. NAF methodologies

⁷² See AS 2310.20 for these conditions.

would likely require more revisions than the GNF methodologies which have incorporated certain concepts included in the new proposed standard.

ii. Use of Technology-Based Tools

The PCAOB staff has also reviewed information collected through PCAOB oversight activities on firms' use of technology-based tools in the confirmation process. The staff's review focused primarily on the use of technology-based tools by GNFs, but also encompassed certain technology-based tools used by some NAFs. In addition, the review encompassed information on both proprietary technology-based tools that firms have developed internally and third-party or "off-the-shelf" tools that firms purchase and use (in certain cases, with further customizations) to assist in performing confirmation procedures as part of the audit process. The staff found that the number of technology-based tools used in the confirmation process varies across firms, and also varies based on the facts and circumstances of specific engagements. Generally speaking, firms allow engagement teams to select a tool but do not provide that the use of one or more tools is required.

Both GNFs and NAFs within the scope of the staff's review use third-party tools to automate certain confirmation procedures, or to independently verify balances, terms of arrangements, or other information under audit. GNFs appear to be more likely to invest in customizing off-the-shelf tools they have purchased to their particular environment. For example, such modifications may permit a firm to automate the reconciliation of confirmed balances to client records. In comparison, NAFs tend to use the off-the-shelf tools without customization.

The staff's review also found that GNFs have developed proprietary applications to facilitate various aspects of the confirmation process, whether conducted manually or electronically. These applications may facilitate the preparation of confirmation requests, their dissemination to recipients (including the preparation of logs to track confirmation requests and receipts), and the analysis of confirmation responses to determine their completeness and accuracy. GNFs have also developed tools used when auditing specific accounts, other than cash and accounts receivable, where confirmation may provide audit evidence. For example, tools are used to prepare, log, and track confirmation requests and responses for various deposit, loan, and liability accounts.

As discussed in Section II, auditors or confirming parties may engage an intermediary to facilitate the direct electronic transmission of confirmation requests and responses between the auditor and the confirming party.⁷³ In one area, market forces have influenced firms' willingness to use an intermediary: a majority of financial institutions will only respond to confirmation requests through a centralized process and with a specified intermediary. As a

⁷³ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

result, all firms' methodologies required, and in practice firms did use, the specified intermediary in these circumstances.

The PCAOB staff has observed diverse practices related to the procedures auditors perform to support their reliance on an intermediary's controls when establishing direct communication between the auditor and the confirming party.⁷⁴ In some situations where the procedures performed included obtaining a SOC report, the staff has observed insufficient evaluation of SOC reports, lack of consideration of the period covered and complementary user entity controls, and insufficient coordination of procedures performed centrally by the audit firm and by the engagement team.⁷⁵

These observations suggest that there may be a need for uniform guidance for situations involving the use of intermediaries. For example, enhanced procedures to be performed when auditors place reliance on an intermediary's controls could help address the risk of interception and alteration of communications between the auditor and the company and address the risk of override of the intermediary's controls by the company.

2. Literature on the Confirmation Process

There is limited data on auditor confirmation decisions and research findings on the confirmation process.⁷⁶ The literature documents that confirmation is "extensively used" and that confirmation responses received directly from a third party are often perceived by practitioners to be among "the most persuasive forms of audit evidence."⁷⁷ Consistent with the staff's observations from PCAOB oversight activities,⁷⁸ studies find that the use of electronic confirmation has become prevalent.⁷⁹ One study also observes that current U.S. auditing standards do not fully address how auditors should authenticate confirmations sent or received electronically, and it asserts that there is a need for audit guidance related to electronic forms

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 254 (2008).

⁷⁷ See *id.* at 253.

⁷⁸ See *Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>. See also *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

⁷⁹ See, e.g., Paul Caster, Randal J. Elder, and Diane J. Janvrin, *An Exploration of Bank Confirmation Process Automation: A Longitudinal Study*, 35 *Journal of Information Systems* 1, 5 (2021).

of evidence.⁸⁰ Further, an earlier study reviews enforcement actions described in the SEC's Accounting and Auditing Enforcement Releases and concludes that additional direction regarding when cash and accounts receivable confirmation requests are required or recommended may be needed.⁸¹ Additionally, the literature suggests that more guidance may be necessary to identify when the risk is sufficiently low to justify the use of negative confirmation requests in certain areas.⁸² Moreover, a recent article on bank confirmation advocates a risk-based approach to the determination of confirmation procedures.⁸³ Finally, a study finds that "anecdotal evidence and some research suggest confirmation response rates are declining."⁸⁴

Accordingly, the academic literature is consistent with the conclusion that the Board's auditing requirements for the confirmation process should (i) accommodate electronic communications, and evaluate the implications of using an intermediary, (ii) address the confirmation of cash and accounts receivable, (iii) limit the use of negative confirmation requests, and (iv) align with the PCAOB's risk assessment standards.

Question:

39. We request comment generally on the baseline for evaluating the economic impacts of the new proposed standard. Are there additional data (e.g., data on the use of electronic confirmation, types of accounts confirmed, or confirmation response rates) or academic studies that we should consider?

B. Need

Several attributes of the audit market support a need for the PCAOB to establish effective audit performance standards. First, the company under audit, investors, and other financial statement users cannot easily observe the services performed by the auditor or the

⁸⁰ See *id.* at 2.

⁸¹ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 261-62 (2008).

⁸² See *id.* at 266.

⁸³ See L. Ralph Piercy and Howard B. Levy, *To Confirm or Not to Confirm-Risk Assessment is the Answer*, 91(12) *The CPA Journal* 54, 54 (2021).

⁸⁴ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 254 (2008). The staff has also observed that the use of electronic confirmation may affect the confirmation response rate. See *Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>.

quality of the audit. This leads to a risk that, unbeknownst to the company under audit, investors, or other financial statement users, the auditor may perform a low-quality audit.⁸⁵

Second, the auditor is retained, dismissed, and compensated by the company under audit. This leads to a risk that the auditor may aim to satisfy the interests of management of the company under audit rather than the interests of investors and other financial statement users.⁸⁶ The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) requires that the audit committee be responsible for the appointment, compensation, and retention of the auditor,⁸⁷ which attenuates the incentives for the auditor to seek to please management. However, in practice, management may exert influence over the audit committee, resulting in a *de facto* principal-agent relationship between the company’s management and the auditor.⁸⁸ Effective auditing standards address these risks by explicitly assigning responsibilities to the auditor that, if implemented properly, are expected to lead to high-quality audits that protect the interests of investors and other users of a company’s audited financial statements.

This section discusses the specific problem that the new proposed standard is intended to address and explains how the new proposed standard is expected to address it.

⁸⁵ See, e.g., Monika Causholli and Robert W. Knechel, *An Examination of the Credence Attributes of an Audit*, 26 *Accounting Horizons* 631, 632 (2012):

During the audit process, the auditor is responsible for making decisions concerning risk assessment, total effort, labor allocation, and the timing and extent of audit procedures that will be implemented to reduce the residual risk of material misstatements. As a non-expert, the auditee may not be able to judge the appropriateness of such decisions. Moreover, the auditee may not be able to ascertain the extent to which the risk of material misstatement has been reduced even after the audit is completed. Thus, information asymmetry exists between the auditee and the auditor, the benefit of which accrues to the auditor. If such is the case, the auditor may have incentives to: Under-audit, or expend less audit effort than is required to reduce the uncertainty about misstatements in the auditee’s financial statements to the level that is appropriate for the auditee.

⁸⁶ See, e.g., Joshua Ronen, *Corporate Audits and How to Fix Them*, 24 *Journal of Economic Perspectives* 189, 192 (2010).

⁸⁷ See Section 301 of Sarbanes-Oxley, 15 U.S.C § 78j-1(m).

⁸⁸ See, e.g., Liesbeth Bruynseels and Eddy Cardinaels, *The audit committee: Management watchdog or personal friend of the CEO?*, 89 *The Accounting Review* 113, 114 (2014) (finding that social ties between management and the audit committee are present in 39% of the companies in their sample and “may reduce the quality of the audit committee’s oversight”).

1. Problem to be Addressed

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

In situations where audit evidence can be obtained through confirmation with a knowledgeable external source, the resulting audit evidence is likely to be more reliable than audit evidence obtained from internal company sources. For evidence obtained through confirmation to be reliable, however, the confirmation process must be properly executed. Proper execution involves assessing the reliability of a confirmation response and performing robust, additional alternative procedures when the auditor is unable to determine that a confirmation response is reliable. Similarly, proper execution may entail the performance of alternative procedures when the auditor is unable to identify a confirming party, the auditor does not receive a confirmation response from the intended confirming party, or the confirmation response is incomplete.

As discussed in Section II, the PCAOB staff has observed situations where auditors did not perform procedures to assess the reliability of confirmation responses or, where applicable, perform sufficient alternative procedures.⁸⁹ In addition, the staff has noted that, in the case of some financial reporting frauds, the company's misconduct possibly could have been detected at an earlier point in time had the auditor made an appropriate assessment of the reliability of confirmation responses received, or performed additional procedures needed to obtain reliable audit evidence.⁹⁰ These observations suggest a need for enhancements to auditing standards to more clearly address those situations where confirmation can be expected to provide more reliable audit evidence, including the requirements for evaluating the reliability of confirmation responses and, if appropriate, performing alternative procedures.

ii. Developments in Practice

There are areas of the confirmation process where developments in practice have outpaced existing requirements in the Board's auditing standards. In particular, existing AS 2310 does not reflect significant changes in technology and the methods by which auditors perform the confirmation process, including the use of electronic communication and the involvement of third-party intermediaries.

Regulatory standards that do not reflect changes in practice may lead to inconsistency in their application, potential misinterpretation, and ineffective regulatory intervention. For

⁸⁹ See Section II.B for observations from the PCAOB's audit inspections and from SEC enforcement cases.

⁹⁰ See also Diane Janvrin, Paul Caster, and Randy Elder, *Enforcement Release Evidence on The Audit Confirmation Process: Implications for Standard Setters*, 22 *Research in Accounting Regulation* 1, 10 (2010).

example, the PCAOB staff has observed diverse practices and audit deficiencies related to the procedures performed by auditors to support their use of an intermediary to facilitate the electronic transmission of confirmation requests and confirmation responses with confirming parties.⁹¹

In addition, the presumption to confirm accounts receivable in existing AS 2310 may discourage the use of new technologies that could improve the efficiency and effectiveness of the audit. For example, an auditor may have access to newer audit tools that can provide audit evidence that is at least as persuasive as the evidence the auditor might expect to obtain through confirmation of accounts receivable. Absent further clarification as to the circumstances when the presumption to confirm accounts receivable may be appropriately overcome, the auditor may decide not to use other audit tools available, or to perform redundant procedures when audit effort would have been better directed elsewhere.

2. How the New Proposed Standard Would Address the Need

The new proposed standard would help address the need by (i) strengthening requirements in certain areas to focus on the need to obtain reliable audit evidence from the confirmation process; and (ii) modernizing AS 2310 to accommodate certain developments in practice, including the use of electronic communications, intermediaries, and new audit tools. The new proposed standard is expected to promote consistent and effective practice relating to the confirmation process in audits subject to PCAOB standards, reducing the risk of low-quality audits caused by (i) the lack of observability of audit quality and (ii) the influence of the auditor-client relationship discussed above.

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new proposed standard would strengthen the Board's requirements in certain areas to focus on the need to obtain reliable audit evidence when executing the confirmation process. Specifically, the new proposed standard would require the auditor to confirm certain cash and cash equivalents held by third parties. In addition, the new proposed standard would strengthen the requirements for evaluating the reliability of confirmation responses. It also continues to emphasize the importance of maintaining control over the confirmation process and provides additional examples of indicators that a confirmation response may have been intercepted and altered. When confirmation responses are deemed to be unreliable, the auditor would be directed to perform alternative procedures to obtain audit evidence.

Moreover, as discussed in Section III.E, electronic communications likely have reduced the efficacy of negative confirmation requests. Under the new proposed standard, the auditor

⁹¹ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

would not be able to use negative confirmation requests as the sole substantive procedure for addressing the risk of material misstatement for a financial statement assertion.

ii. Developments in Practice

Under the new proposed standard, the requirement to maintain control over the confirmation process would address both traditional and newer, more prevalent forms of communication between the auditor and confirming parties, including e-mailed confirmation requests and responses and intermediaries facilitating electronic communication of confirmation requests and responses. The new proposed standard is intended to apply to methods of confirmation currently in use and to be flexible enough to apply to new methods that may arise from technological changes in auditing in the future.

Additionally, under the new proposed standard, the auditor would be able to overcome the presumption to confirm accounts receivable, and instead perform other substantive audit procedures where the auditor has determined those other procedures would provide audit evidence that is at least as persuasive as evidence the auditor would expect to obtain through confirmation. To the extent that there are newer tools available to auditors that can provide such audit evidence (for example, certain tools that also make use of information from sources independent of the company), the new proposed standard is not intended to disincentivize the use of those tools.

Question:

40. We request comment generally on the analysis provided above regarding the need for the new proposed standard. Should we consider any additional arguments, academic studies, or data related to the need for standard setting?

C. Economic Impacts

This section discusses the expected benefits and costs of the new proposed standard and potential unintended consequences. Overall, we expect that the economic impact of the new proposed standard, including both benefits and costs, would be relatively modest, especially for those firms that have already incorporated in practice some of the new requirements. We also expect that the benefits of the new proposed standard would justify the costs and any unintended negative effects.

1. Benefits

We expect the new proposed standard to improve the consistency and effectiveness of the confirmation process, reducing the risk of low-quality audits caused by (i) the lack of observability of audit quality and (ii) the influence of the auditor-client relationship discussed in Section IV.B above. Specifically, there exists a risk that, unbeknownst to the company under audit, investors, or other financial statement users, the auditor may perform a low-quality audit

since audit quality is difficult to observe. In addition, some auditors may aim to satisfy the interests of the company under audit or their own financial interests rather than the interests of investors and other financial statement users — interests that may lead them to perform insufficiently rigorous confirmation procedures to minimize the burden on clients and their counterparties to respond to confirmations, or to minimize audit costs.

The new proposed standard would help to mitigate these risks in the confirmation process by strengthening and modernizing the requirements for the auditor regarding the design and execution of the audit confirmation process. Specifically, an audit confirmation process designed and executed under the new proposed standard should benefit investors and other users of a company's financial statements by reducing the likelihood that the financial statements are materially misstated, whether due to error or fraud.

The enhanced quality of audits and financial information available to financial markets should also increase investor confidence in financial statements. In general, investors may use the more reliable financial information to improve the efficiency of their capital allocation decisions (e.g., investors may reallocate capital from less profitable companies to more profitable companies). Investors may also perceive less risk in capital markets generally, leading to an increase in the supply of capital. An increase in the supply of capital could increase capital formation while also reducing the cost of capital to companies.⁹²

Auditors also are expected to benefit from the new proposed standard, because the additional clarity provided by the new proposed standard would reduce regulatory uncertainty and the associated compliance costs. Specifically, the new proposed standard would provide auditors with a better understanding of their responsibilities and our expectations, as well as reduce the risk that auditors would perform unnecessary or ineffective confirmation procedures.

The following discussion describes the benefits of key changes to existing confirmation requirements that are expected to impact auditor behavior. As discussed in Section IV.B above, the changes aim to (1) enhance the auditor's focus on obtaining reliable audit evidence from the confirmation process, and (2) accommodate certain developments in practice. As further discussed below, the changes that enhance the auditor's focus on obtaining reliable audit evidence are expected to strengthen confirmation procedures for cash held by third parties, promote consistency in practice, improve the reliability of confirmation responses, improve the quality of audit evidence, and increase the auditor's likelihood of identifying potential financial statement fraud. The changes that accommodate developments in practice are expected to

⁹² See, e.g., Hanwen Chen, Jeff Zeyun Chen, Gerald J. Lobo, and Yanyan Wang, *Effects of audit quality on earnings management and cost of equity capital: Evidence from China*, 28 *Contemporary Accounting Research* 892, 921 (2011); Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research* 385 (2007).

clarify the auditor's responsibilities regarding the use of electronic communications in the confirmation process, standardize the procedures that auditors perform to support their use of intermediaries, and allow for the use or development of more sophisticated and effective technology-based auditing tools. To the extent that a firm has already implemented certain of the provisions of the new proposed standard into its firm methodology, the benefits described below would be reduced.

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new proposed standard should benefit investors and other users of a company's financial statements by placing additional emphasis on the auditor's need to obtain reliable audit evidence when undertaking to perform confirmation procedures. In this regard, the new proposed standard: (1) identifies certain accounts for which the auditor should perform confirmation procedures, (2) enhances the requirements for assessing the reliability of confirmation responses, (3) addresses the performance of alternative procedures when the auditor is unable to obtain relevant and reliable audit evidence through confirmation, (4) strengthens requirements regarding the use of negative confirmation requests, and (5) specifies which activities in the confirmation process may not be performed using the assistance of internal auditors.

Specifically, the proposed requirement to confirm certain cash and cash equivalents held by third parties may reduce the risk of material errors in financial statements and strengthen investor protection to the extent that auditors are not already confirming cash pursuant to their existing audit methodologies.⁹³ This requirement also specifies that the extent of audit evidence to obtain through cash confirmation procedures should be based on the auditor's understanding of the company's cash management and treasury function.

The new proposed standard does not require that all cash accounts or all accounts receivable should be selected for confirmation. The auditor's assessment of the risk of material misstatement is an important consideration when designing audit procedures, including the use of confirmation. For both cash and accounts receivable, the new proposed standard specifies that the auditor should take into account the auditor's understanding of the substance of a company's arrangements and transactions with third parties when selecting the individual items to confirm.

⁹³ As discussed above, the staff's review of firm methodologies indicated that some firms are already confirming cash balances, while other firms' methodologies do not require auditors to perform procedures beyond those required by AS 2310. The growth in corporate cash holdings also highlights the need to confirm cash and cash equivalents. See, e.g., Kevin Amess, Sanjay Banerji, and Athanasios Lampousis, *Corporate Cash Holdings: Causes and Consequences*, 42 *International Review of Financial Analysis* 421, 422 (2015).

The additional clarity in the new proposed standard should reduce uncertainty in auditor responsibilities and promote consistency in practice with respect to the confirmation of cash accounts and accounts receivable. In addition, the specificity in the new proposed standard should encourage the auditor to determine the extent of confirmation procedures with regard to an assessment of material misstatement risk and avoid more work than necessary to obtain sufficient appropriate audit evidence.

The new proposed standard strengthens requirements addressing the reliability of confirmation responses by describing information that the auditor should take into account when evaluating the reliability of confirmation responses and providing examples of indicators that a confirmation response may have been intercepted or altered. These requirements are expected to improve the reliability of confirmation responses and therefore increase the quality of the audit evidence obtained by the auditor.

The new proposed standard also expands on the existing requirement to address the auditor's potential need to apply alternative procedures. The enhanced requirements for alternative procedures would provide a greater level of detail and clarity to auditors for situations that are not currently addressed explicitly in existing AS 2310, potentially raising the quality of evidence obtained by auditors.

Under the new proposed standard, the auditor may only use negative confirmation requests to supplement other substantive audit procedures; they may not be used as the sole substantive audit procedure. As discussed in Section III.E, the amount of electronic correspondence has increased dramatically over the years, leading to an increased likelihood that a negative confirmation request would not be appropriately considered by the confirming party and, therefore, would provide less persuasive audit evidence. The new proposed standard addresses this issue by providing examples of situations in which negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence. As negative confirmation requests could not be the sole source of audit evidence obtained, insofar as the new proposed standard would affect practice, the overall quality of audit evidence obtained by the auditor likely would increase.⁹⁴

Further, existing AS 2310 does not specify which activities within the confirmation process may or may not be performed using the assistance of internal auditors. As a result, some auditors may involve internal auditors in the confirmation process in a manner that is inconsistent with the auditor's responsibility to maintain control over the confirmation process, which is essential to obtaining reliable audit evidence. The new proposed standard would

⁹⁴ The Board understands through its oversight activities that few, if any, GNFs use negative confirmation requests as the sole substantive procedure in practice. As discussed in Section IV.A, however, the staff's firm methodology review suggests that all the GNFs and NAFs reviewed would need to update their methodologies to ensure that negative confirmation requests are not used as the sole source of audit evidence.

specify that the auditor may not use the assistance of the company's internal audit function for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses, while otherwise allowing auditors to use internal auditors in accordance with AS 2605.⁹⁵ The specificity provided by the new proposed standard should strengthen the reliability of evidence obtained through the confirmation process.

Overall, the additional requirements and examples discussed above are expected to improve the reliability of confirmation responses, and therefore increase the quality of the audit evidence obtained by the auditor. By introducing a new requirement to confirm certain cash balances and enhancing the requirements for evaluating the reliability of confirmation responses, the new proposed standard may also increase the auditor's likelihood of identifying potential financial statement fraud. Early detection of accounting fraud is an important aspect of investor protection, because such fraud can cause significant harm to investors in the companies engaged in fraud, as well as indirect harm to investors in other companies.⁹⁶ In addition, by clarifying and strengthening the auditor's responsibilities, including by specifying additional situations where alternative procedures may be necessary and providing additional examples of indicators that a confirmation response may have been intercepted and altered, the new proposed standard takes into account past inspection findings by the Board that auditors did not obtain sufficient appropriate audit evidence when using confirmation.

ii. Developments in Practice

The new proposed standard would modernize AS 2310 to accommodate certain developments in practice, including the use of electronic communications, intermediaries, and new audit tools.

Specifically, the new proposed standard would accommodate changes in how communications occur between the auditor and confirming parties. It would clarify the auditor's responsibilities by taking into account current confirmation practices among auditors and acknowledging differing methods of confirmation. These methods include not only longstanding methods such as the use of paper-based confirmation requests and responses sent via regular mail, but also increasingly common methods such as e-mailed confirmation requests and responses and the use of intermediaries to facilitate the direct electronic transmission of confirmation requests and responses. This additional clarity may enhance the reliability of audit evidence by decreasing the risk that a confirmation request or response is

⁹⁵ Research shows that the objectivity of internal audit functions has an impact on financial reporting quality. *See, e.g.,* Lawrence J. Abbott, Brian Daugherty, Susan Parker, and Gary F. Peters, *Internal Audit Quality and Financial Reporting Quality: The Joint Importance of Independence and Competence*, 54 *Journal of Accounting Research* 3, 6 (2015).

⁹⁶ *See* Yang Bao, Bin Ke, Bin Li, Y. Julia Yu, and Jie Zhang, *Detecting Accounting Fraud in Publicly Traded US Firms Using a Machine Learning Approach*, 58 *Journal of Accounting Research* 199, 200 (2020).

intercepted and altered. In addition, the new proposed standard includes requirements specific to an intermediary's controls that mitigate the risk of interception and alteration. The requirements are expected to standardize the procedures auditors perform to support their use of intermediaries and reduce audit deficiencies in this area.

With regards to accounts receivable, the new proposed standard would retain the requirement to confirm accounts receivable and, therefore, would not decrease or remove the auditor's responsibility to obtain relevant and reliable audit evidence from confirmation. The auditor would be able to overcome the presumption to confirm accounts receivable and instead perform other substantive audit procedures, however, when the auditor has determined that those procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures. This change would allow for the use or development of more sophisticated and effective audit procedures, which might include the use of technology-based auditing tools, subject to the requirement that they provide the same or increased level of audit evidence about the relevant financial statement assertion. Accordingly, this change could potentially improve the efficiency and effectiveness of the audit. 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.

Question:

41. Are there additional potential benefits that should be considered?

2. Costs

We expect the costs associated with the new proposed standard to be relatively modest. The staff's review of audit firm methodologies related to the confirmation process indicates that some firms have already incorporated in practice some of the new proposed requirements. For example, the methodologies of some GNFs and NAFs include requirements for confirmation of cash that are similar to the requirements described in the new proposed standard. Similarly, both the GNF and NAF methodologies reviewed generally include guidance on maintaining control over the confirmation process and the use of intermediaries to facilitate the electronic transmission of confirmation requests and responses.

To the extent that audit firms would need to make changes to meet the new proposed requirements, they may incur certain fixed costs (i.e., costs that are generally independent of the number of audits performed) to implement the new proposed standard. These include costs to update audit methodologies and tools, and costs to prepare training materials and conduct internal training. GNFs are likely to update methodologies using internal resources, whereas NAFs are more likely to purchase updated methodologies from external vendors. The costs to update these methodologies likely depend on the extent to which the new

requirements have already been incorporated in the firms' current methodologies. For firms that have implemented confirmation procedures like those required by the new proposed standard, the costs of updating methodologies may be lower than for firms that currently do not have such procedures. In this regard, large firms may also benefit from economies of scale.

In addition, audit firms may incur certain engagement-level variable costs related to implementing the new proposed standard. For example, the requirement to confirm certain cash balances could impose engagement-level costs on some auditors if additional procedures need to be performed. Similarly, limiting the use of negative confirmation requests to situations where the auditor is also performing other substantive audit procedures could lead to additional time and effort by the auditor to perform the other audit procedures.

The magnitude of the variable costs likely depends on the extent to which existing practice differs from the new requirements. As discussed above, the staff's review of firm methodologies, which included the methodologies of certain NAFs, suggests that the new proposed standard likely would lead to a greater impact on confirmation procedures performed by smaller firms. Because the new proposed standard generally applies a risk-based approach (i.e., by providing that the use of confirmation may be part of the auditor's response to the assessed risks of material misstatement), the costs of performing the additional procedures are unlikely to be disproportionate to the benefits.

To the extent that auditors incur higher costs to implement the new proposed standard and are able to pass on at least part of the increased costs through an increase in audit fees, companies being audited could incur an indirect cost. Moreover, confirming parties could incur additional costs from supporting the confirmation process as a result of the enhanced requirements of the new proposed standard, although the additional costs are expected to be limited.

Some requirements under the new proposed standard may result in more costs than others. The following discussion describes the potential costs associated with specific changes to existing confirmation requirements.

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new proposed standard: (1) identifies certain accounts for which the auditor should perform confirmation procedures, (2) enhances the requirements for assessing the reliability of confirmation responses, (3) addresses the performance of alternative procedures when the auditor is unable to obtain relevant and reliable audit evidence through confirmation, (4) strengthens requirements regarding the use of negative confirmation requests, and (5) specifies which activities in the confirmation process may not be performed using the assistance of internal auditors.

For some firms, the requirement in the new proposed standard to confirm certain cash balances could be expected to result in the revision of firm methodologies and the performance of additional audit procedures. As discussed in Section IV.A, the methodologies of some GNFs already include requirements for cash confirmation that are similar to the new requirement described in the new proposed standard. In addition, the risk-based approach in the new requirement should encourage the auditor to determine the extent of confirmation with regard to an assessment of the risks of material misstatement and avoid more work than is necessary to obtain sufficient audit evidence.

The new proposed standard would also require the auditor to evaluate the reliability of confirmation responses and provides examples of indicators that a confirmation response may have been intercepted and altered. The costs associated with this requirement, however, are expected to be limited. First, the Board's auditing standards already require the auditor to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor's report, and to evaluate the combined evidence provided by confirmation and other auditing procedures performed when the auditor has not received replies to confirmation requests (i.e., nonresponses) to determine whether sufficient evidence has been obtained about all the applicable financial statement assertions.⁹⁷ Second, the methodologies of some firms reflect application material in ISA 505 regarding factors (similar to indicators in the new proposed standard) that may indicate doubts about the reliability of a confirmation response. One of these factors is analogous to the requirement in the new proposed standard (i.e., the confirmation response appears not to come from the originally intended confirming party), which may further limit the potential costs for firms that have incorporated this factor in their methodologies.

Insofar as the new proposed standard identifies additional situations in which the auditor generally would be required to perform alternative procedures, firms may incur additional costs. Specifically, the new proposed standard would extend the requirement in existing AS 2310 to perform alternative procedures in relation to nonresponses to positive confirmation requests to other situations, including the auditor's inability to identify a confirming party and the receipt of an unreliable response.

In contrast with existing AS 2310, negative confirmation requests may not be used as the sole substantive audit procedure under the new proposed standard. This limitation reflects, among other things, the increase in the volume of electronic correspondence since existing AS 2310 was issued and the increasing likelihood that a recipient of a negative confirmation request would not consider the request. As a result, auditors may have to perform other substantive audit procedures for certain financial statement assertions. Although the Board understands through its oversight activities that few, if any, GNFs use negative confirmation requests as the sole substantive procedure in practice, as discussed in Section IV.A, the staff's firm methodology review suggests that all the GNFs and NAFs reviewed would need to review

⁹⁷ See AS 1105.04; AS 2310.33.

their methodologies to ensure that negative confirmation requests are not allowed to be used as the sole source of audit evidence.

The new proposed standard explicitly restricts the auditor from using internal auditors to select the items to be confirmed, send confirmation requests, and receive confirmation responses. In comparison, existing AS 2310 provides that the auditor should maintain control over confirmation requests and responses (i.e., establish direct communication between the intended recipient of a confirmation request and the auditor), but states that the auditor is not precluded from using internal auditors in the confirmation process pursuant to AS 2605. While the new proposed standard is intended to clarify the existing requirement to maintain control over the confirmation process, and still allow for other situations where internal auditors may provide direct assistance to the auditor in accordance with AS 2605, audit firms that have been using internal auditors to perform tasks that would be expressly prohibited under the new proposed standard could incur additional costs.

ii. Developments in Practice

As discussed in Section III.F, the new proposed standard includes requirements that seek to clarify the procedures auditors should perform to support their use of intermediaries to facilitate the direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. These requirements may lead to modifications to firm methodologies. Further, the required procedures may involve additional auditor time and effort. The resulting costs likely depend on the extent to which the new requirements have already been incorporated in a firm's current methodologies. As discussed in Section IV.A, both the GNF and NAF methodologies reviewed generally already include guidance on maintaining control over the confirmation process and the use of intermediaries, which may limit the costs.

In addition, the new proposed standard would specify that the auditor may overcome the presumption to confirm accounts receivable when the auditor determines that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence the auditor might expect to obtain through performing confirmation procedures. This provision is intended to highlight the flexibility of the new proposed standard and is not expected to impose new costs on firms. To the extent that the auditor is able to replace confirmation with other substantive audit procedures and chooses to do so, consistent with the requirement in the new proposed standard that the other procedures provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures, the new proposed standard could reduce costs for firms. The requirement for the auditor to communicate to the audit committee when the presumption to confirm accounts receivable has been overcome could impose a modest incremental cost.

Questions:

42. Are there additional potential costs that should be considered? If so, what are they?

43. Are there additional academic studies or data related to the potential benefits and costs of the proposed requirements? If so, please provide citations and other reference information for such studies and data.

3. Potential Unintended Consequences

In addition to the benefits and costs discussed above, the new proposed standard could have unintended economic impacts. The following discussion describes potential unintended consequences we have considered and, where applicable, factors that mitigate the negative consequences, such as steps we have taken or the existence of other countervailing forces.

i. Potential Decline in Auditors' Usage of Confirmation

An unintended consequence of the new proposed standard would occur if, contrary to the Board's expectation, there were a significant reduction in the use of confirmation procedures by auditors in circumstances where confirmation would provide relevant and reliable audit evidence.

Under the new proposed standard, auditors would retain the ability to use confirmation as one procedure, among others, to audit one or more financial statement accounts or disclosures. At the same time, the new proposed standard would strengthen the requirements for an auditor regarding evaluating the reliability of confirmation responses, and addressing confirmation exceptions and incomplete responses, including performing alternative procedures to obtain audit evidence. Further, the new proposed standard would describe the types of procedures the auditor should perform in evaluating the effect of using an intermediary on the reliability of confirmation requests and responses, including determining whether relevant controls of the intermediary are designed and operating effectively. In addition, the new proposed standard would not allow the auditor to use negative confirmation requests as the sole substantive procedure. As a result, when not required to use confirmation, auditors might decline to use confirmation and use other audit procedures instead if they perceive there could be more time or cost involved in the confirmation process than in the performance of other procedures.

This potential unintended consequence is mitigated, however, by the requirements that the auditor should perform confirmation procedures for cash and accounts receivable (including specifying situations where the auditor may overcome the presumption to confirm accounts receivable). In addition, the Board's standards already provide that the auditor should evaluate whether the combined evidence provided by confirmation and other auditing procedures provide sufficient evidence about the applicable financial statement assertions. Several of the changes to existing requirements in the new proposed standard would align with our understanding of current practice (for example, many audit firms' methodologies include guidance on maintaining control and the use of intermediaries). Additionally, the potential unintended consequence may be mitigated to the extent that a firm has experienced efficiencies from using newer audit tools for confirmation through reduced time or costs.

Further, we do not anticipate that the requirements of the new proposed standard would cause a significant change in the timing or extent of confirmation procedures for auditors, as we have not proposed to amend the requirements of AS 2301 that address those matters. Accordingly, we do not believe that the new proposed standard, if adopted, would lead to a significant decline in the use of confirmation.

ii. Potential Performance of Confirmation Procedures That Do Not Result in Obtaining Relevant and Reliable Audit Evidence

An unintended consequence of the presumed requirement in the new proposed standard to confirm accounts receivable would arise if auditors misinterpreted the language in the new proposed standard as requiring the confirmation of accounts receivable in all situations. In particular, the new proposed standard would not carry forward a provision (included in existing AS 2310) that an auditor could overcome the presumption to confirm accounts receivable if, among other things, “[t]he use of confirmations would be ineffective.” It is possible that some auditors might misinterpret the elimination of this language as precluding the exercise of auditor judgment with respect to the confirmation of accounts receivable.

We do not intend, however, that an auditor send confirmation requests for accounts receivable when such procedures do not provide relevant and reliable audit evidence. To mitigate the unintended consequence described above, the new proposed standard provides that the auditor may overcome the presumption to confirm accounts receivable when the auditor determines that other substantive audit procedures would provide evidence that is “at least as persuasive as the evidence that the auditor might expect to obtain through confirmation.” Notably, this provision does not require the auditor to determine that the evidence that the auditor would obtain through other substantive auditing procedures is “more persuasive” than the evidence that might be obtained through confirmation. In our view, the language is sufficiently clear to allow for the continued exercise of professional judgment in circumstances where auditors might face particular challenges in obtaining audit evidence by confirming accounts receivable.

Question:

44. We request comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that we should consider? If so, what responses should be considered?

D. Alternatives Considered

The development of the new proposed standard involved considering a number of alternative approaches to address the problems described above. This section explains: (i) why standard setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (ii) other standard-setting

approaches that were considered; and (iii) key policy choices made by the Board in determining the details of the new proposed standard-setting approach.

1. Why Standard Setting is Preferable to Other Policy-Making Approaches

The Board's policy tools include alternatives to standard setting, such as issuing additional interpretive guidance or an increased focus on inspections or enforcement of existing standards. We considered whether providing guidance or increasing inspection or enforcement efforts would be effective mechanisms to address concerns with the auditor's use of confirmation.

Interpretive guidance inherently provides additional information about existing standards. Inspection and enforcement actions take place after insufficient audit performance (and potential investor harm) has occurred. Devoting additional resources to interpretive guidance, inspections, or enforcement activities, without improving the relevant performance requirements for auditors, would at best focus auditors' performance on existing standards and would not provide the benefits discussed in Section IV.C associated with improving the standards. The new proposed standard, on the other hand, is designed to improve existing requirements for the auditor's use of confirmation. For example, the new proposed standard, unlike existing AS 2310, includes requirements relating to the confirmation of cash accounts, imposes additional limitations on the use of negative confirmation requests, clarifies the circumstances in which auditors would be expected to perform alternative procedures, and includes explicit restrictions on the use of internal auditors in the confirmation process.

2. Other Standard-Setting Alternatives Considered

Several alternative standard-setting approaches were also considered, including: (i) making amendments to the existing standard; and (ii) adopting an approach based on ISA 505 with certain modifications to reflect the PCAOB's statutory responsibilities with respect to audits of public companies and registered broker-dealers.

i. Amendments to Existing Standard

We considered, but are not proposing, limiting the amendments to AS 2310 solely to modifications relating to changes in technology that have affected the confirmation process. While this approach could result in fewer changes to firms' audit methodologies, we believe there are a number of other areas discussed throughout this release, beyond amending AS 2310 to reflect the increasing use of technology in the confirmation process, where the existing standard should be improved.

ii. Standard Based on ISA 505

Some commenters on the 2009 Concept Release and the 2010 Proposal suggested that the Board should consider adopting ISA 505, the IAASB's standard on audit confirmation, which

was issued in 2008. We have taken the requirements and application material of ISA 505 into account in developing the new proposed standard (e.g., the ISA 505 application material relating to the use of a third party to coordinate and provide responses to confirmation requests).

We concluded, however, that the new proposed standard should also establish certain requirements that are not included in ISA 505 (e.g., requirements to confirm cash and accounts receivable) or should not include certain provisions that are described in ISA 505 (e.g., regarding management's refusal to allow the auditor to send a confirmation request). In addition, audit practices have continued to evolve since ISA 505 was issued in 2008, and we believe that the new proposed standard should reflect these developments (e.g., by addressing electronic communication and the use of intermediaries in the requirements of the standard rather than in application materials).

3. Key Policy Choices

Given a preference for replacing existing AS 2310 in its entirety, we considered different approaches to addressing key policy issues.

i. Use of Confirmation Procedures for Specific Accounts

The new proposed standard provides that the auditor should perform confirmation procedures for cash and cash equivalents held by third parties, as well as for accounts receivable that arise from the transfer of goods or services to a customer or a financial institution's loans. In addition, under the new proposed standard, when confirming cash, the auditor should consider sending confirmation requests about other financial relationships with the confirming party. The auditor also should consider, for significant risks of material misstatement associated with either a complex or significant unusual transaction, confirming terms of the transaction with the counterparty. The new proposed standard does not specify other significant accounts or disclosures that the auditor should confirm or consider confirming. We considered several alternatives to this approach, as discussed below.

First, we considered an approach that would have no requirement for the auditor to confirm specified accounts or transactions. In our view, this approach might result in the selection by some auditors of audit procedures that provide less relevant and reliable audit evidence than confirmation with respect to cash and accounts receivable (e.g., if an auditor mistakenly assessed the risk of material misstatement too low for cash or accounts receivable). Further, confirmation of cash and accounts receivable is already a standard practice for many auditors and is consistent with the concept that audit evidence obtained from an external knowledgeable source, including through the confirmation process, is more reliable than evidence obtained only from internal company sources. Accordingly, we have decided against an approach that does not require the confirmation of any accounts and disclosures in the new proposed standard.

In addition, we considered including a requirement that the auditor should confirm other accounts in addition to cash and accounts receivable, such as investments, in the new proposed standard. We have decided against this approach, as it would limit auditor judgment in circumstances where the performance of other auditing procedures might provide relevant and reliable audit evidence, could be viewed as unduly prescriptive, and would not allow the auditor to take company-specific facts and circumstances into account. Instead, under the new proposed standard, the auditor could decide to perform confirmation procedures with respect to financial statement assertions relating to other accounts and disclosures but would not be required to do so.

We also considered adding an additional requirement that the auditor should perform confirmation procedures in response to significant risks that relate to relevant assertions, when such assertions can be adequately addressed by confirmation procedures. A similar requirement was included in the 2010 Proposal. Several commenters on the 2010 Proposal asserted, however, that the requirement was too broad and was inconsistent with the Board's risk assessment standards, which allow for auditor judgment in determining the audit response to significant risks identified by the auditor. In response to these comments, we have not included this requirement in the new proposed standard.

ii. Management Requests Not to Confirm

We considered addressing situations where management requests that the auditor not confirm one or more items in the new proposed standard. Specifically, we considered requiring the auditor to obtain an understanding of the reasons for management's request, perform alternative procedures as discussed in paragraph .31 of the new proposed standard, and communicate the request to the audit committee. In addition, we considered a requirement that the auditor should evaluate the implications for the auditor's report if the auditor determines that management's request impairs the auditor's ability to obtain sufficient appropriate audit evidence or indicates that one or more fraud risk factors are present. The 2010 Proposal includes similar requirements. For the reasons discussed in Section III.J, we have decided not to include such provisions in the new proposed standard.

Questions:

45. We request comment generally on the alternative approaches described in this release that we considered but are not proposing. Are any of these approaches, or any other approaches, preferable to the approaches that are being proposed? What reasons support those approaches over the approaches proposed?
46. Are there additional economic impacts or considerations associated with this proposal that should be considered? If so, what are those considerations?

V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

Pursuant to Section 104 of the Jumpstart Our Business Startups Act (“JOBS Act”), rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of emerging growth companies (“EGCs”), as defined in Section 3(a)(80) of the Securities Exchange Act of 1934 (“Exchange Act”), unless the SEC “determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.”⁹⁸ As a result of the JOBS Act, the rules and related amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about characteristics of EGCs.⁹⁹ As of the November 15, 2020 measurement date, PCAOB staff identified 1,940 companies that self-identified with the SEC as EGCs and filed audited financial statements in the 18 months preceding the measurement date.

Confirmation is a longstanding audit procedure used in nearly all audits, including audits of EGCs. The discussion of benefits, costs, and unintended consequences in Section IV is generally applicable to audits of EGCs. The economic impacts of the new proposed standard on an EGC audit depend on factors such as the audit firm’s current methodologies, the audit firm’s ability to distribute implementation costs across engagements, and the auditor’s assessed level of material misstatement risk.

EGCs are likely to be newer companies, which may increase the importance to investors of the external audit to enhance the credibility of management disclosures.¹⁰⁰ Further,

⁹⁸ See Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as added by Section 104 of the JOBS Act also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The new proposed standard does not fall within either of these two categories.

⁹⁹ See *White Paper on Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2020* (Jan. 24, 2022), available at <https://pcaobus.org/resources/other-research-projects>.

¹⁰⁰ Researchers have developed a number of proxies that are thought to be correlated with information asymmetry, including small issuer size, lower analyst coverage, larger insider holdings, and higher research and development costs. To the extent that EGCs exhibit one or more of these properties, there may be a greater degree of information asymmetry for EGCs than for the broader population of companies, which increases the importance to investors of the external audit to enhance

compared to non-EGCs, EGCs are more likely to be audited by NAFs.¹⁰¹ As discussed in Section IV.A, NAFs are expected to make more changes to their methodologies and practice to comply with the new proposed standard. Therefore, all else equal, the benefits of the higher audit quality resulting from the new proposed standard may be larger for EGCs than for non-EGCs, including improved efficiency of market capital allocation, lower cost of capital, and enhanced capital formation. In particular, because investors who face uncertainty about the reliability of a company's financial statements may require a larger risk premium that increases the cost of capital to companies, the improved audit quality resulting from applying the new proposed standard to EGC audits could reduce the cost of capital to those EGCs.¹⁰²

Moreover, because of the scalability of the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures. Conversely, if any of the new proposed amendments were determined not to apply to the audits of EGCs, auditors would need to address differing audit requirements in their methodologies, or policies and procedures, with respect to audits of EGCs and non-EGCs, which would create the potential for confusion. The new proposed standard could impact competition in an EGC product market if the indirect costs to audited companies disproportionately impact EGCs relative to their competitors. However, as discussed in Section IV.C above, the costs associated with the new proposed standard are expected to be relatively modest. Therefore, the impact of the new proposed standard on competition, if any, is expected to be limited. Overall, the new proposed standard is expected to enhance audit quality and contribute to an increase in the credibility of financial reporting by EGCs.

Accordingly, and for the reasons explained above, the Board anticipates that, if it adopts the new proposed standard, it will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether

the credibility of management disclosures. *See, e.g.,* Steven A. Dennis and Ian G. Sharpe, *Firm Size Dependence in the Determinants of Bank Term Loan Maturity*, 32 *Journal of Business Finance and Accounting* 31, 59 (2005); Michael J. Brennan and Avanidhar Subrahmanyam, *Investment Analysis and Price Formation in Securities Markets*, 38 *Journal of Financial Economics* 361, 363 (1995); David Aboody and Baruch Lev, *Information Asymmetry, R&D, and Insider Gains*, 55 *Journal of Finance* 2747, 2755 (2000); Raymond Chiang and P. C. Venkatesh, *Insider Holdings and Perceptions of Information Asymmetry: A Note*, 43 *Journal of Finance* 1041, 1047 (1988); Molly Mercer, *How Do Investors Assess the Credibility of Management Disclosures?*, 18 *Accounting Horizons* 185, 194 (2004).

¹⁰¹ This statement is based on staff analysis of SEC filings and data from Audit Analytics and Standard & Poor's as of the Nov. 15, 2021 measurement date. The non-EGC-population is limited to exchange-listed companies that are not registered investment companies or EGCs and have filed audited financial statements with the SEC, including an audit report signed by a firm in the 18 months preceding the measurement date.

¹⁰² For a discussion of how increasing reliable public information about a company can reduce risk premium, *see* David Easley and Maureen O'Hara, *Information and the Cost of Capital*, 59 *The Journal of Finance* 1553, 1578 (2004).

the action will promote efficiency, competition, and capital formation, to apply the new proposed standard to audits of EGCs.

Question:

47. We request comment generally on the analysis of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?

VI. EFFECTIVE DATE

The Board seeks comment on the amount of time auditors would need before the new proposed standard and related amendments would become effective, if adopted by the Board and approved by the SEC. Specifically, the Board is considering whether compliance with adopted amendments and a new auditing standard should be required for audits of fiscal years beginning in the year after approval by the SEC (or for audits of fiscal years beginning two years after the year of SEC approval if SEC approval occurs in the fourth quarter of a calendar year).

Questions:

48. How much time following SEC approval would audit firms need to implement the proposed requirements?
49. Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?

VII. APPENDICES

This proposal includes this release and its appendices:

- Appendix 1 – New Proposed Auditing Standard
- Appendix 2 – Proposed Amendments to Related PCAOB Auditing Standards

VIII. OPPORTUNITY FOR PUBLIC COMMENT

The Board is seeking comments on all aspects of its proposal, as well as specific comments on the new proposed standard and amendments. Among other things, the Board is seeking comment on the economic analysis relating to its proposal, including potential costs. To assist the Board in evaluating such matters, the Board is requesting relevant information and empirical data regarding the new proposed standard and amendments.

Comments should be sent by e-mail to comments@pcaobus.org or through the Board's website at www.pcaobus.org. Comments may also be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 028 in the subject or reference line and should be received by the Board by February 20, 2023.

The Board will consider all comments received. After the close of the comment period, the Board will determine whether to adopt final rules, with or without changes from the proposal. Any final rules adopted will be submitted to the SEC for approval. Pursuant to Section 107 of the Sarbanes-Oxley Act, proposed rules of the Board do not take effect unless approved by the SEC. Standards are rules of the Board under the Sarbanes-Oxley Act.

* * *

On the 20th day of December, in the year 2022, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

December 20, 2022

* * *

APPENDIX 1 – NEW PROPOSED AUDITING STANDARD

[AS 2310 is amended in its entirety with the following:]

AS 2310: The Auditor’s Use of Confirmation

Introduction

.01 This standard establishes requirements for the auditor’s use of confirmation.

Objective

.02 The objective of the auditor in designing and executing the **confirmation process** is to obtain relevant and reliable audit evidence about one or more relevant financial statement assertions of a significant account or disclosure.¹

Relationship of the Confirmation Process to the Auditor’s Identification and Assessment of and Response to the Risks of Material Misstatement

.03 AS 2110, *Identifying and Assessing Risks of Material Misstatement*, establishes requirements regarding the process of identifying and assessing risks of material misstatement of the financial statements and provides that the auditor’s assessment of risks of material misstatement, including fraud risks, should continue throughout the audit. When the auditor obtains audit evidence during the course of the audit (including through the confirmation process) that contradicts the audit evidence on which the auditor originally based the risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in respect to the revised risk assessments.²

.04 AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*, requires the auditor to design and implement appropriate responses that address risks of material misstatement. This may include using confirmation to address the assessed risks of material misstatement for certain relevant assertions of significant accounts and disclosures.

Note: If different components in a significant account or disclosure are subject to significantly differing risks of material misstatement, the auditor’s responses should include procedures that are responsive to the differing risks of material misstatement.

.05 AS 2301 provides that as the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The

¹ Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

² See AS 2110.74; see also paragraphs .02 and .29 of AS 1105, *Audit Evidence*.

evidence provided by substantive procedures depends upon the mix of the nature, timing, and extent of those procedures.

Note: AS 2110.68 provides that the auditor should presume that there is a fraud risk involving improper revenue recognition. According to paragraph .54 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, examples of audit procedures that might be performed in response to this risk include confirming with customers certain relevant contract terms and the absence of side agreements.

.06 Audit evidence obtained through the confirmation process from an external knowledgeable source is generally more reliable than evidence obtained only from internal company sources.³ The following are examples of financial statement assertions for which the confirmation process, when properly designed and executed, can provide relevant and reliable audit evidence:

- Existence (e.g., cash, accounts receivable, investments)
- Occurrence (e.g., revenue transactions)
- Completeness (e.g., accounts payable, debt)
- Rights and obligations (e.g., cash, assets pledged as collateral)

.07 In situations involving fraud risks and significant unusual transactions, audit evidence obtained through the confirmation process generally is more persuasive than audit evidence obtained solely through other procedures.

.08 This standard describes the auditor's responsibilities related to the confirmation process, as follows:

- Paragraphs .09-.15 discuss confirming certain accounts and terms of transactions.
- Paragraphs .16-.21 discuss designing the **confirmation request**.
- Paragraphs .22-.24 discuss maintaining control over the confirmation process.
- Paragraphs .25-.30 discuss **confirmation responses, confirmation exceptions and nonresponses**.

³ See AS 1105.08.

- Paragraph .31 discusses alternative procedures.
- Paragraph .32 discusses using internal audit in the confirmation process.

Other PCAOB standards also address auditor responsibilities relevant to the auditor's use of confirmation.⁴ This standard does not address matters described in AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

Confirming Certain Accounts and Terms of Transactions

.09 For cash and cash equivalents held by third parties ("cash"), the auditor should perform confirmation procedures.

.10 In selecting the individual items of cash to confirm, the auditor should take into account the auditor's understanding of the company's cash management and treasury function, and the substance of the company's arrangements and transactions with third parties.

.11 When confirming cash, the auditor should consider sending confirmation requests about other financial relationships with the **confirming party**. Examples of other financial relationships are lines of credit, other indebtedness, compensating balance arrangements, or contingent liabilities, including guarantees.

.12 For accounts receivable that arise from the transfer of goods or services to a customer or a financial institution's loans ("accounts receivable"), the auditor should perform confirmation procedures.

.13 In selecting the individual accounts receivable to confirm, the auditor should take into account the auditor's understanding of the substance of the company's arrangements and transactions with third parties and the nature of items that make up account balances.

.14 The presumption to confirm accounts receivable in paragraph .12 may be overcome when the auditor determines that performing other substantive procedures (without using confirmation) would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures. The auditor should communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination. The communications to the audit committee should be made and

⁴ See, e.g., AS 2301 (regarding the nature, timing, and extent of audit procedures); and AS 2315, *Audit Sampling* (regarding planning, performing, and evaluating audit samples).

documented in accordance with paragraphs .25 and .26 of AS 1301, *Communications with Audit Committees*.⁵

.15 For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction.

Designing Confirmation Requests

Identifying Information to Confirm

.16 The auditor should identify the information related to the relevant assertions that the auditor plans to verify with confirming parties or (when using a blank form) obtain from confirming parties.

Note: Some forms of **positive confirmation requests** ask the confirming party to indicate whether the confirming party agrees with the information stated on the request. Other forms of positive confirmation requests, referred to as blank forms, do not state the amount (or other information) to be confirmed, but request the confirming party to fill in the balance or furnish other information. Using a blank form confirmation request may provide more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., customer account balance).

.17 The auditor should test the accuracy and completeness of information produced by the company that the auditor uses in selecting the items to confirm.⁶

Identifying Confirming Parties for Confirmation Requests

.18 The auditor should direct confirmation requests to confirming parties (individuals or organizations) who are knowledgeable about the information to be confirmed and determine that the confirmation requests are properly addressed.

Note: AS 2401.53 provides that when the auditor has assessed a fraud risk, sending confirmation requests to a specific party within an organization is an example of an audit response to the risk.

⁵ The term "audit committee," as used in this standard, has the same meaning as defined in Appendix A of AS 1301.

⁶ See AS 1105.10.

.19 If the auditor is aware of information about a potential confirming party's (i) motivation, ability, or willingness to respond, or (ii) objectivity and freedom from bias with respect to the audited entity,⁷ the auditor should consider this information, including its source, in selecting the confirming parties.

Note: Such information may indicate that the potential confirming party has incentives or pressures to provide responses that are inaccurate or otherwise misleading.

.20 If the auditor is unable to identify a confirming party who, in response to a confirmation request, would provide relevant and reliable audit evidence about the selected item, the auditor should perform alternative procedures as discussed in paragraph .31.

Using Negative Confirmation Requests

.21 Generally, the auditor obtains significantly less audit evidence when using **negative confirmation requests** than when using positive confirmation requests because the auditor typically does not receive from the confirming party a confirmation response to a negative confirmation request unless the confirming party disagrees with the information provided in the request. Therefore, the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence for addressing the risk of material misstatement to a financial statement assertion.

Note: Appendix B discusses examples of situations where the use of negative confirmation requests in combination with the performance of other substantive audit procedures may provide sufficient appropriate audit evidence.

Maintaining Control over the Confirmation Process

.22 The auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted or altered.

.23 The auditor should send the confirmation request directly to the confirming party and obtain the confirmation response directly from the confirming party.

.24 The auditor or the confirming party can engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. When using an intermediary for this purpose, the auditor

⁷ AS 2410, *Related Parties*, requires the auditor to perform procedures to obtain an understanding of the company's relationships and transactions with related parties.

should evaluate the implications on the reliability of confirmation requests and responses as discussed in Appendix B.

Evaluating Confirmation Responses and Confirmation Exceptions, and Addressing Nonresponses and Incomplete Responses

Evaluating Reliability of Confirmation Responses

.25 The auditor should evaluate the reliability of confirmation responses, taking into account any information about events, conditions, or other information that the auditor becomes aware of that (i) contradicts the information used when selecting the confirming party pursuant to paragraphs .18 and .19 or (ii) indicates that the confirmation request or confirmation response may have been intercepted and altered.⁸

Note: The following are examples of indicators that a confirmation response may have been intercepted or altered:

- a. The confirmation response comes from a physical or electronic address other than the address on the confirmation request.
- b. The confirmation response does not include a signature of the confirming party or otherwise identify the confirming party.
- c. The confirmation response does not include a copy of the original confirmation request, e-mail chain, or any other information indicating that the confirming party is responding to the auditor's confirmation request.

.26 If the auditor is unable to determine that the confirmation response is reliable, the auditor should perform alternative procedures as discussed in paragraph .31.

Evaluating Confirmation Exceptions

.27 The auditor should evaluate confirmation exceptions and determine whether the confirmation exceptions individually or in the aggregate indicate (i) a deficiency in the

⁸ A note to AS 1105.08 also describes the auditor's responsibilities to evaluate third-party evidence provided to the auditor subject to restrictions, limitations, or disclaimers.

company's internal control over financial reporting,⁹ (ii) a misstatement that should be evaluated in accordance with AS 2810, *Evaluating Audit Results*, or both.

Addressing Nonresponses and Incomplete Responses

.28 If the auditor does not receive a confirmation response to a positive confirmation request, the auditor should send a second positive confirmation request to the confirming party unless the auditor has become aware of information that indicates that the confirming party would be unlikely to respond to the auditor. The auditor should evaluate any response to a second confirmation request according to paragraphs .25-.27.

.29 If a confirmation response is returned by the confirming party to anyone other than the auditor, the auditor should contact the confirming party and request that the response be re-sent directly to the auditor. If the auditor does not subsequently receive a confirmation response from the intended confirming party, the auditor should treat the situation as a nonresponse.

.30 In the case of a nonresponse or an incomplete response, the auditor should perform alternative procedures as discussed in paragraph .31.

Performing Alternative Procedures

.31 Performing other audit procedures as an alternative to confirmation may be necessary when the auditor is unable to obtain relevant and reliable audit evidence about the selected item through confirmation. Paragraphs .20 (inability to identify a confirming party), .26 (unreliable response), and .30 (nonresponse or incomplete response) discuss certain situations in which the auditor should perform alternative procedures.¹⁰ The following are examples of alternative procedures that individually or in combination may provide relevant and reliable audit evidence:

- a. For terms of a transaction or agreement, inspecting the original signed contract and amendments thereto, comparing contractual terms to industry norms, and

⁹ In an integrated audit of financial statements and internal control over financial reporting, the auditor should perform the evaluation in accordance with AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. In an audit of financial statements, the auditor should follow the direction of AS 2201.62-.70, as stated in paragraph .03 of AS 1305, *Communications About Control Deficiencies in an Audit of Financial Statements*.

¹⁰ If the auditor is unable to obtain sufficient appropriate audit evidence about a relevant assertion, the auditor considers the impact on the audit opinion in accordance with AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*.

discussing and corroborating significant information with other parties involved in the transaction or agreement.

- b. For accounts receivable, examining one or more of the following: (i) subsequent cash receipts, including comparing the receipts with the amounts of the respective invoices being paid, (ii) shipping documents, or (iii) other supporting documentation (e.g., purchase orders or signed contracts and amendments thereto).
- c. For accounts payable, examining one or more of the following: (i) subsequent cash disbursements, (ii) correspondence from vendors and suppliers, or (iii) other supporting documentation.

Note: Performing alternative procedures may not be necessary if the inclusion of the items for which the auditor was not able to complete the audit procedures in the auditor's evaluation of the effect of uncorrected misstatements,¹¹ would not change the outcome of the evaluation.

Using Internal Audit in the Confirmation Process

.32 The auditor may use internal auditors to provide direct assistance to the auditor in the confirmation process in accordance with AS 2605, *Consideration of the Internal Audit Function*, except that an internal auditor should not (i) select the items to be confirmed, (ii) send confirmation requests, or (iii) receive confirmation responses.¹²

APPENDIX A – Definitions

.A1 For purposes of this standard, the terms listed below are defined as follows:

.A2 Confirmation exception – Information in a confirmation response that differs from information the auditor obtained from the company.

.A3 Confirmation process – The process that involves sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions.

¹¹ AS 2810.17 describes the auditor's responsibility to evaluate the effect of uncorrected misstatements.

¹² AS 2605 establishes requirements for using internal auditors to provide direct assistance to the auditor including supervising, reviewing, evaluating and testing the work performed by internal auditors.

.A4 Confirmation request – A request from the auditor to a confirming party regarding information about one or more particular accounts, balances, transactions, or other items as a means of obtaining audit evidence about one or more financial statement assertions.

.A5 Confirmation response – Information obtained as a direct written communication (in paper or electronic form) to the auditor from a confirming party in response to a confirmation request.

.A6 Confirming party – A third party, whether an individual or an organization, to which the auditor sends a confirmation request.

.A7 Negative confirmation request – A confirmation request in which the auditor requests a confirmation response only if the confirming party disagrees with the information provided in the request.

.A8 Nonresponse – A situation in which (i) after sending a confirmation request(s), the request is returned undelivered; (ii) the auditor does not receive a confirmation response to a positive confirmation request from the intended confirming party; (iii) the auditor receives correspondence from the intended confirming party indicating that the confirming party is unable or unwilling to respond to the confirmation request; or (iv) the auditor receives an oral response only.

.A9 Positive confirmation request – A confirmation request in which the auditor requests a confirmation response.

APPENDIX B – Additional Auditor Responsibilities

Considering Negative Confirmation Requests

.B1 The following are examples of situations in which the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence:

- a. The auditor has (i) assessed the risk of material misstatement for the relevant assertions as low, and (ii) obtained sufficient appropriate audit evidence regarding the design and operating effectiveness of controls.¹³

¹³ See also AS 2301.16-.18 for a discussion of tests of controls.

- b. The population of items within the account balance or class of transactions for which the auditor considers sending negative confirmation requests is composed of many small, homogeneous items.
- c. The auditor expects a low exception rate in response to negative confirmation requests and has a reasonable basis for this expectation.

Evaluating the Implications of Using an Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses

.B2 Paragraph .24 requires that the auditor evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party on the reliability of confirmation requests and responses. In performing the evaluation, the auditor should:

- a. Obtain an understanding of the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses.
- b. Determine that the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively.

Note: If the auditor performs procedures to determine that the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively at an interim date, the auditor should evaluate whether the results of the interim procedures can be used at period end or whether they need to be updated. In performing the evaluation, the auditor should consider the length of time between the date of the interim procedures and period end, and whether the process used by the intermediary has changed during that time.

- c. Assess the relationship of the intermediary with the company - specifically, whether circumstances exist that give the company the ability to override the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses (e.g., through financial, ownership, or other business relationships, contractual rights, or otherwise).

.B3 If information obtained by the auditor indicates that (i) the intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses, (ii) the necessary controls are not designed or operating effectively, or (iii) circumstances exist that give the company the ability to override the intermediary's controls, the auditor should not use the intermediary to send confirmation requests or receive confirmation responses.

APPENDIX 2 – PROPOSED AMENDMENTS TO RELATED PCAOB AUDITING STANDARDS

In connection with the new proposed auditing standard AS 2310, *The Auditor's Use of Confirmation*, the Board is proposing amendments to several of its auditing standards to conform to the requirements of the new proposed auditing standard.

Language that would be deleted by the proposed amendments is ~~struck through~~. Language that would be added by the proposed amendments is underlined. The presentation of proposed amendments to PCAOB standards by showing deletions and additions to existing sentences, paragraphs, and footnotes is intended to assist the reader in easily comprehending the Board's proposed changes to the auditing standards. The Board's proposed amendments consist of only the deleted or added language. This presentation does not constitute or represent a proposal of all or of any other part of the auditing standard as amended by this proposal.

The Board is requesting comments on all aspects of the proposed amendments.

AS 1105, *Audit Evidence*

Confirmation

.18 A confirmation response is information ~~represents a particular form of audit evidence~~ obtained as a direct written communication (in paper or electronic form) to by the auditor from a confirming third party in response to a confirmation request in accordance with PCAOB standards.¹⁰

¹⁰ See AS 2310, *The Auditor's Use of Confirmation Process*. The terms "confirmation response," "confirmation request," and "confirming party," as used in this standard, have the same meaning as defined in Appendix A of AS 2310.

AS 1301, *Communications with Audit Committees*

Appendix B – Communications with Audit Committees Required by Other PCAOB Rules and Standards

- AS 2310, *The Auditor's Use of Confirmation*, paragraph .14.

AS 2401, *Consideration of Fraud in a Financial Statement Audit*

Additional Examples of Audit Procedures Performed to Respond to Assessed Fraud Risks Relating to Fraudulent Financial Reporting

- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements.²¹ For example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances

²¹ AS 2310, *The Auditor's Use of Confirmation-Process*, establishes requirements regarding the use of confirmation process in audits of financial statements.

AS 2510, *Auditing Inventories*

Inventories Held in Public Warehouses

.14 If inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian.¹ If such inventories represent a significant proportion of current or total assets, to obtain reasonable

assurance with respect to their existence, the auditor should apply one or more of the following procedures as he considers necessary in the circumstances.

- a. Test the owner's procedures for investigating the warehouseman and evaluating the warehouseman's performance.
- b. Obtain an independent accountant's report on the warehouseman's control procedures relevant to custody of goods and, if applicable, pledging of receipts, or apply alternative procedures at the warehouse to gain reasonable assurance that information received from the warehouseman is reliable.
- c. Observe physical counts of the goods, if practicable and reasonable.
- d. If warehouse receipts have been pledged as collateral, confirm with lenders pertinent details of the pledged receipts (on a test basis, if appropriate).

¹ See AS 2310, *The Auditor's Use of Confirmation*, which establishes requirements for the auditor's use of confirmation.

AS 2605, *Consideration of the Internal Audit Function*

Extent of the Effect of the Internal Auditors' Work

.22 On the other hand, for certain assertions related to less material financial statement amounts where the risk of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is low, the auditor may decide, after considering the circumstances and the results of work (either tests of controls or substantive tests) performed by internal auditors on those particular assertions, that audit risk has been reduced to an acceptable level and that testing of the assertions directly by the auditor may not be necessary. Assertions about the existence of ~~cash~~, prepaid assets, and fixed-asset additions are examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence.

Using Internal Auditors to Provide Direct Assistance to the Auditor

.27 In performing the audit, the auditor may, unless prohibited by PCAOB standards,^{7A} request direct assistance from the internal auditors. This direct assistance relates to work the auditor specifically requests the internal auditors to perform to complete some aspect of the auditor's work. For example, internal auditors may assist the auditor in obtaining an understanding of internal control or in performing tests of controls or substantive tests, consistent with the guidance about the auditor's responsibility in paragraphs .18 through .22. When direct assistance is provided, the auditor should assess the internal auditors' competence and objectivity (see paragraphs .09 through .11) and supervise,⁸ review, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances. The auditor should inform the internal auditors of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible accounting and auditing issues. The auditor should also inform the internal auditors that all significant accounting and auditing issues identified during the audit should be brought to the auditor's attention.

^{7A} See, e.g., paragraph .32 of AS 2310, *The Auditor's Use of Confirmation*, which prohibits the use of internal auditors in the confirmation process for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses.



1666 K Street, NW
Washington, D.C. 20006
Telephone: (202) 207-9100
Facsimile: (202)862-8430
www.pcaobus.org

)
)
)
)
CONCEPT RELEASE ON POSSIBLE REVISIONS) PCAOB Release No. 2009-002
TO THE PCAOB'S STANDARD ON AUDIT) April 14, 2009
CONFIRMATIONS)
) PCAOB Rulemaking
) Docket Matter No. 028
)
)
)
)
)
)
)
)

Summary: The Public Company Accounting Oversight Board ("PCAOB" or "Board") is issuing a concept release to solicit public comment on the potential direction of a proposed standards-setting project on audit confirmations.

Public Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted via email to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 028 in the subject or reference line. Comments should be received by the Board no later than 5:00 PM EDT on May 29, 2009.

Board Contacts: Dee Mirando-Gould, Associate Chief Auditor (202/207-9264, mirando-gouldd@pcaobus.org) and Christopher David, Assistant Chief Auditor (202/207-9231, davidc@pcaobus.org)

* * *



CONCEPT RELEASE

I. Introduction

The Board is evaluating the PCAOB's auditing standard on audit confirmations, AU sec. 330, *The Confirmation Process*. The Board is issuing this concept release to seek public comment on the potential direction of a standards-setting project that could result in an amendment to AU sec. 330 or a new auditing standard that would supersede the Board's current standard on audit confirmations.^{1/}

Confirmation is an audit process by which an auditor obtains and evaluates a direct communication from a knowledgeable third party in response to a request for information regarding account balances, transactions or other items that comprise a company's financial statements. For example, an auditor might request a company's customers to confirm balances due to the company at the financial statement date, or a company's bank to confirm balances of the company's accounts or loans payable to the bank.

Confirmations may be an important source of the evidence auditors obtain as part of an audit of a company's financial statements.^{2/} Confirmation requests, if properly designed by the auditor, may address one or more financial statement assertions,^{3/}

^{1/} Audit confirmation is hereafter referred to as "confirmation."

^{2/} Paragraph .21a of the Board's auditing standard on audit evidence, AU sec. 326, *Evidential Matter*, states 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."

^{3/} Paragraph .12 of AU sec. 330, *The Confirmation Process*. Assertions are representations by management that are embodied in the financial statement components. They can be either explicit or implicit and can be classified according to the following broad categories: existence or occurrence, completeness, rights and obligations, valuation or allocation, and presentation and disclosure. See AU sec. 326.03 and PCAOB Release 2008-006, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*, Proposed Auditing Standard, *Audit Evidence* (October 21, 2008), paragraph 11.



CONCEPT RELEASE

although, confirmations do not address all assertions equally well.^{4/} "Thus, when obtaining evidence for assertions not adequately addressed by confirmations, auditors should consider other audit procedures to complement confirmation procedures or to be used instead of confirmation procedures."^{5/}

AU sec. 330 was written over 15 years ago, and there have been significant advances in technology since then. Email, facsimiles, and other electronic communications have become accepted methods of communication in addition to traditional mail. While adding efficiency, some of these electronic methods of communication also add opportunities, unforeseen by the drafters of AU sec. 330, for skilled individuals to intercept and change responses before they reach the auditor. Also as a result of advances in technology, auditors, in many cases, now may obtain a direct website link into the electronic records of an audit client's customer, bank, or other confirming party and directly check the existence and amount of the audit client's balance without the need for interaction with an employee of that customer, bank, or other party.^{6/} Further, due to the expansion in the number and international reach of transactions since the confirmation standard was issued, among other reasons, some banks and other businesses have decided to no longer dedicate the resources required to handle responses to confirmations and, thus, have hired third parties to respond on their behalf. Academic literature also provides insights into the use of confirmations. A publication that summarizes academic research and U.S. Securities and Exchange Commission enforcement actions states that "[g]enerally, confirmations are relatively

^{4/} AU sec. 330.12. For example, "[c]onfirmation of goods held on consignment with the consignee would likely be more effective for the existence and the rights-and-obligations assertions than for the valuation assertion. Accounts receivable confirmations are likely to be more effective for the existence assertion than for the completeness and valuation assertions."

^{5/} AU sec. 330.12.

^{6/} The auditor may obtain a username and password separate from the client's to gain access to the client's account information. Although an auditor may be able to review electronic records with little or no interaction with client personnel, the auditor may need to interact with the confirming party to ascertain that the direct website link to the confirming party's records is secure and that the link provides the auditor access to the information that is requested.

CONCEPT RELEASE

effective in testing the existence assertion for accounts receivable."^{7/} The authors also noted that "[l]ow response rates, as well as respondent errors and directional bias in detecting errors, are key barriers to confirmation effectiveness."^{8/} All of these changes in practice have motivated the Board to examine the confirmation standard to determine whether it continues to be appropriate in the current business environment.

There are additional reasons for the Board to review the current standard. Although AU sec. 330 provides direction on designing and using confirmations, the Board wishes to explore whether improvements to such direction and to the confirmation process itself could result in more consistent and effective application of the standard. For example, auditors may use a variety of approaches in the confirmation process. The Board may consider which approaches are most effective in differing situations.^{9/} Opportunities also may exist to make the confirmation process more meaningful by having auditors confirm, on a routine basis, not only accounts receivable, as required by the current standard, but also other significant accounts and the significant terms of material, complex revenue transactions and unusual

^{7/} Paul Caster, Randal J. Elder, and Diane J. Janvrin, "A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory* (November 2008). The authors had additional findings, including that "[a]necdotal evidence and some research suggest confirmation responses rates are declining," and that "[r]esearch has identified several methods to improve response rates." They also note that "[c]onsiderable evidence exists that electronic confirmations and other forms of electronic database queries (i.e., defined views of supplier and/or customer databases) are becoming more prevalent. Technology offers alternatives to standard paper confirmations that may provide for authentication and improve confirmation effectiveness..."

^{8/} Ibid.

^{9/} See, for example, Public Oversight Board, *The Panel on Audit Effectiveness, "Report and Recommendations"* (August 31, 2000), paragraph 2.98, which states in part, "The Panel is aware from the focus groups and other input that some auditors believe that confirmation is not a particularly effective audit procedure in many situations." The Panel noted additional examples of differences in the application of the standard as discussed in paragraphs 2.99 through 2.100. See Panel recommendations at <http://www.pobauditpanel.org/index.html>.

CONCEPT RELEASE

agreements. Expanding the presumption to request confirmation of accounts receivable to also include confirmation of other significant accounts and significant terms in certain transactions and agreements may enhance audit quality and investor protection.

The rationale noted above is based, in part, on advice the Board received from the PCAOB's Standing Advisory Group ("SAG"). At a recent meeting with the Board, SAG members provided their views in the following areas –

- Definition of confirmation, including whether the definition of confirmation contained in AU sec. 330 should be expanded to include direct access to information held by a third party.
- Requirement to confirm, including whether the presumption to request confirmation of accounts receivable should be expanded to request confirmation of terms of unusual agreements or transactions as well as complex or unusual revenue transactions. The SAG also discussed whether the standard should include a requirement that the auditor should consider requesting confirmation of other items, such as cash, investments, credit facilities, and debt agreements.
- Reliability of confirmation responses, including factors the auditor should consider when evaluating the reliability of confirmation responses in paper, electronic, or other forms.
- Management requests not to confirm, including procedures the auditor should perform when management makes such requests.
- Disclaimers and restrictive language, including whether auditors should perform procedures to evaluate the effect of such disclaimers and restrictive language on confirmation responses.^{10/}

^{10/} The Board discussed audit confirmations with the Standing Advisory Group ("SAG") on April 2, 2009. See the related agenda item at: [http://www.pcaobus.org/News and Events/Events/2009/04-02.aspx](http://www.pcaobus.org/News%20and%20Events/Events/2009/04-02.aspx). The Board also discussed audit confirmations with the SAG in September 2004. Topics discussed in 2004 included the role confirmations play in the audit process, confirmation of revenue transactions and terms, the presumption to request confirmation of accounts receivable, confirmation of other matters, such as cash and accounts payable, types of confirmation



CONCEPT RELEASE

In addition, the International Auditing and Assurance Standards Board recently updated its auditing standard on confirmations, International Standard on Auditing 505 ("ISA 505"), *External Confirmations*.^{11/} The Board has considered the information in ISA 505 in developing this concept release. Specifically, the Board considered whether the objective, requirements, and application and other explanatory material of ISA 505 are appropriate for audits of public companies and consistent with the Board's statutory mandate "to oversee the audit of public companies that are subject to the securities laws...in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports."^{12/}

As discussed in more detail in the Appendix, there are areas in which the Board may diverge from the requirements in ISA 505 as it considers the changes it might make to AU sec. 330. For example, the Board notes that ISA 505 does not require confirmation of any particular accounts or transactions. ISA 505 describes other procedures, and the Board is considering whether certain of those procedures should be expressly required in a standard of the PCAOB.^{13/}

requests, and management requests not to confirm. See the related agenda item at: http://www.pcaobus.org/News_and_Events/Events/2004/09-08-09.aspx.

^{11/} International Standard on Auditing 505 ("ISA 505"), *External Confirmations*, can be found at: <http://www.ifac.org/Store/Details.tml?SID=1229365477610684&Cart=12348970672001520>.

^{12/} Section 101 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7211.

^{13/} The Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants has undertaken a project to converge U.S. generally accepted auditing standards ("GAAS") with the ISAs, while avoiding unnecessary conflict with PCAOB auditing standards. See the ASB project, *Clarification and Convergence* (July 2008), at: <http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Att+est+Standards/Improving+the+Clarity+of+ASB+Standards/default.htm>.

The convergence document states that "[t]he ASB expects that nearly all ISA requirements will also be requirements of U.S. GAAS. However, there may be additional GAAS requirements that address issues specific to the U.S. or the retention of current



CONCEPT RELEASE

In contrast to ISA 505, confirmation of accounts receivable has been a presumptively mandatory procedure in the United States since 1939. Confirmation was first required in response to the McKesson & Robbins case, which involved a fraud that independent auditors failed to detect. The fraud was carried out through collusion among members of top management of the company. Of reported consolidated assets in excess of \$87 million, approximately \$19 million, primarily accounts receivable and inventories, were fictitious. The auditing standard developed in response to that fraud required confirmation of accounts receivable by direct communication with customers in all independent audits of financial statements.^{14/}

The Board believes that it is important to retain the presumption to request confirmation of accounts receivable and to consider whether additional, similar presumptions to request confirmation of certain other accounts may be appropriate. In addition, the Board is considering whether and how improvements to the standard on confirmations could enhance the quality of audits. The Board will consider comments received on this concept release as it develops possible changes to the standard on confirmations.

II. Summary of AU Sec. 330 Requirements

AU sec. 330 includes, among other things, the following –

- A presumption that the auditor will request confirmation of accounts receivable.^{15/}

practices." In December 2008, "[t]he ASB confirmed its belief (as was decided at the October 2007 ASB meeting) that inclusion of the presumptive requirement to confirm accounts receivable is appropriate." See the ASB meeting summary (December 11-12, 2008), at: http://www.aicpa.org/download/auditstd/2008_12_ASB_Highlights.pdf.

^{14/} See U.S. Securities and Exchange Commission Accounting Series Release No. 19, *In the Matter of McKesson & Robbins, Inc., Summary of Findings and Conclusions* (1940). AU sec. 330, which was written in the early 1990s, superseded the previous auditing standard that addressed confirmations.

^{15/} AU secs. 330.34-.35.

CONCEPT RELEASE

- 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.^{16/}
- Procedures to consider when the auditor does not receive a written confirmation response via return mail, including how the auditor should evaluate the reliability of oral and facsimile responses to written confirmation requests.^{17/}
- Alternative auditing procedures when the auditor has not received a response to a positive confirmation request.^{18/}
- Requirements for evaluating the results of confirmation procedures, which include the auditor's consideration of "...(a) the reliability of the confirmations and alternative procedures; (b) the nature of any exceptions,^{19/} including the implications, both quantitative and qualitative, of those exceptions; (c) the evidence provided by other procedures; and (d) whether additional evidence is needed."^{20/}

III. Summary of Possible Changes to AU Sec. 330

The following are summaries of the possible changes to the PCAOB's standard on confirmations that the Board is considering. For additional detail regarding each of

^{16/} AU secs. 330.16-.27.

^{17/} AU sec. 330.29.

^{18/} AU secs. 330.31-.32.

^{19/} AU sec. 330 does not define an exception. Paragraph 6(e) of ISA 505 defines an exception as "[a] response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party." Changes to the confirmation standard may define an exception that is similar to the definition in ISA 505.

^{20/} AU sec. 330.33.

CONCEPT RELEASE

these areas, refer to the Appendix. The Board is seeking commenters' views on these matters to assist it in developing possible changes to its standard.

- *Definition of confirmation* – The Board is considering expanding the definition of confirmation contained in AU sec. 330 to include direct access to information held by a third party.^{21/} Under an expanded definition, confirmation could be defined as "the process of obtaining and evaluating a direct communication from a third party or direct access to information held by a third party in response to a request for information about a particular item affecting financial statement assertions." Also, under this definition, communications via email and confirmation responses processed through third-party service providers would be acceptable forms of confirmation.

Expanding the definition may create more opportunities for auditors to use confirmations and improve response rates. For example, providing direct on-line access to the auditor may take less effort on the part of the confirming party than responding to the confirmation request in written form.

- *Requirement to confirm* – AU sec. 330 establishes the presumption "that the auditor will request the confirmation of accounts receivable."^{22/} The

^{21/} As discussed previously in this concept release, forms of communication include those via traditional mail, email, facsimile and other electronic communications. As a result of advances in technology, auditors may obtain a direct website link into electronic records of an audit client's customer, bank, or other confirming party. "Direct access to information held by a third party," as used in this concept release, refers to an auditor obtaining a read-only direct website link into electronic records of an audit client held by a third party. It is also referred to elsewhere in this concept release as "direct on-line access." The auditor would have to be given a separate password by the third party to enable the auditor to independently confirm information held by the third party. If the auditor were to use the client's password, it would not serve as a confirmation for the auditor but, rather, would be considered to be an alternative procedure.

^{22/} AU sec. 330.34. The auditor can overcome the presumption to request confirmation of accounts receivable when, among other reasons, in the auditor's judgment, the use of confirmations would be ineffective based on prior audit experience.

CONCEPT RELEASE

standard further provides that "[t]he auditor should consider requesting confirmation of the terms of unusual agreements or transactions, such as bill and hold sales, in addition to the amounts."^{23/} If a Board standard provides that the auditor "should consider" an action or procedure, consideration of an action or procedure is presumptively mandatory, while the action or procedures is not.^{24/} The Board is considering whether

^{23/} AU sec. 330.25. Also, other PCAOB standards include confirmation requirements. For example, pursuant to paragraph .06 of AU sec. 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, "[t]he auditor should request a company's management to send a letter of inquiry to those lawyers with whom management consulted concerning litigation, claims, and assessments." Additionally, paragraph .14 of AU sec. 331, *Inventories*, states that "[i]f inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian." Also, paragraph .10 of AU sec. 334, *Related Parties*, states that "[w]hen necessary to fully understand a particular transaction, the following procedures, which might not otherwise be deemed necessary to comply with generally accepted auditing standards, should be considered" –

- "Confirm transaction amount and terms, including guarantees and other significant data, with the other party or parties to the transaction."
- "Confirm or discuss significant information with intermediaries, such as banks, guarantors, agents, or attorneys, to obtain a better understanding of the transaction."

Changes to the standard on confirmations would not change these requirements or otherwise affect the auditor's responsibilities under AU secs. 331, 334, or 337.

^{24/} The Board's Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*, states that the Board's auditing and related professional practice standards use certain terms set forth in this rule to describe the degree of responsibility that the standards impose on auditors. Under this rule, words like "must," "shall," and "is required" indicate unconditional responsibilities; the word "should" indicates responsibilities that are presumptively mandatory; words such as "may," "might," "could" and other terms and phrases describe actions and procedures that auditors have a responsibility to consider; and "should consider" indicates that

CONCEPT RELEASE

requirements of the standard should be elevated to establish the presumption to request confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions.^{25/} The Board also is considering whether to include a requirement that the auditor should consider confirming other items, such as cash, investments, credit facilities, and debt agreements.

- *Designing confirmation requests* – AU sec. 330 discusses factors to consider in designing confirmation requests, including the form of the confirmation request, the auditor's prior experience on the audit or similar engagements, the nature of the information being confirmed, and the intended respondent,^{26/} including directing a confirmation request to a third party who the auditor believes is knowledgeable about the information being confirmed.^{27/} The Board is considering including a requirement to determine whether the confirming party's address directs the confirmation to the intended recipient.^{28/} This requirement would apply to traditional communication using mail as well as electronic communication via email,

consideration of an action or procedure is presumptively mandatory, while the action or procedure is not.

^{25/} AU sec. 330.08 states that, "[u]nusual or complex transactions may be associated with high levels of inherent risk and control risk. If the entity has entered into an unusual or complex transaction and the combined assessed level of inherent and control risk is high, the auditor should consider confirming the terms of the transaction with the other parties in addition to examining documentation held by the entity. For example, if the combined assessed level of inherent and control risk over the occurrence of revenue related to an unusual, year-end sale is high, the auditor should consider confirming the terms of that sale."

^{26/} AU sec. 330.16.

^{27/} AU sec. 330.26.

^{28/} Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent.

CONCEPT RELEASE

facsimile, use of third-party service providers or direct on-line access to third-party databases.

- *Maintaining control over confirmation requests and responses* – AU sec. 330 requires the auditor to maintain control over confirmation requests and responses.^{29/} This requirement may need to be updated to address advances in technology that were not anticipated when AU sec. 330 was written, since such technology provides additional opportunities for skilled individuals to intercept and revise confirmation responses.
- *Reliability of confirmation responses* – The Board is considering whether additional direction may be needed beyond that which is currently contained in AU sec. 330 requiring the auditor to evaluate the reliability of confirmation responses. Similar to the discussion in the section, "Maintaining control over confirmation requests and responses," technological developments may create concerns about the reliability of confirmation responses that were not foreseen when the current standard was drafted, and changes to the standard may need to address such reliability issues.
- *Exceptions and non-responses* – The Board is considering whether the standard should eliminate the ability for the auditor to omit performing alternative procedures for non-responses to positive confirmation requests^{30/} and explicitly require the auditor to investigate exceptions in confirmation responses to determine whether or not they are indicative of

^{29/} AU sec. 330.28.

^{30/} Positive confirmations provide audit evidence only when responses are received from the recipients. See AU sec. 330.18. AU sec. 330.31 permits the omission of alternative procedures "... (a) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (b) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated."

CONCEPT RELEASE

misstatements. Performing alternative procedures for non-responses and investigating exceptions to confirmation requests may result in the identification of previously unidentified risks of material misstatements, including previously unidentified fraud risk factors that require evaluation.

- *Management requests not to confirm* – AU sec. 330 does not specifically address what actions the auditor should consider when management requests that the auditor not confirm selected accounts, transactions, agreements, or other items. However, although such a situation is not specifically addressed in the standard, depending on the circumstances, it could be a scope limitation, which is addressed in the auditor's reporting standard.^{31/} As a result of discussions with SAG members, the Board is considering whether the standard should include requirements to evaluate circumstances in which management requests the auditor not to confirm certain accounts, transactions, agreements, or other items.
- *Disclaimers and restrictive language* – Some respondents to confirmation requests include disclaimers or restrictive language in their responses. Such disclaimers sometimes indicate, among other things, that the respondent takes no responsibility for the accuracy of the response. Restrictive language may indicate the response is not appropriate for use in the audit of financial statements. As a result of discussions with SAG members, the Board is considering whether the standard should require auditors to evaluate disclaimers and restrictive language and determine whether alternative procedures are necessary to obtain sufficient, competent audit evidence.^{32/}

^{31/} Paragraphs .22-.34 of AU sec. 508, *Reports on Audited Financial Statements*.

^{32/} AU sec. 326 refers to sufficient, competent evidential matter. *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*, Proposed Auditing Standard, *Audit Evidence* (October 21, 2008), would supersede AU sec. 326 and indicates that "[t]he objective of the auditor is to obtain appropriate audit evidence that is sufficient to support the opinion expressed in the auditor's report."

CONCEPT RELEASE

- *Negative confirmations* – The Board is considering whether the confirmation standard should continue to allow the use of negative confirmations. If the use of negative confirmations is allowed, the Board is considering whether the auditor should be required to perform other substantive procedures to supplement the use of negative confirmations.^{33/}

IV. Opportunity for Public Comment

The Board is interested in the views of commenters on the potential direction of the proposed standards-setting project and whether there are other approaches that the Board should consider. While the Appendix includes a number of specific questions for which the Board would like to obtain feedback, the Board welcomes comments on any concerns commenters may have related to these issues. The questions posed in the Appendix are applicable to both an integrated audit and an audit of financial statements only.

The Board will seek comment on this concept release for a 45-day period. Interested persons are encouraged to submit their views to the Board. Written comments should be sent to Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 028 in the subject or reference line and should be received by the Board no later than 5:00 PM EDT on May 29, 2009.

^{33/} According to AU sec. 330.20, auditors are permitted, in certain circumstances, to use "negative" confirmations, in which the respondent is asked to respond only if he or she disagrees with the information provided on the confirmation request. AU sec. 330.22 indicates that returned negative confirmations may provide evidence about financial statement assertions. "However, unreturned negative confirmations do not provide explicit evidence that the intended third parties received the confirmation requests and verified that the information contained on them is correct."



PCAOB Release No. 2009-002
April 14, 2009
Page 15

CONCEPT RELEASE

* * *

On the 14th day of April, in the year 2009, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Secretary

April 14, 2009

Appendix – Additional Background and Discussion on Possible Changes to AU Sec. 330



PCAOB Release No. 2009-002
April 14, 2009
Page A – 1– Concept Release

Appendix – Additional Background and Discussion on Possible Changes to AU Sec. 330

AU sec. 330, *The Confirmation Process*, provides direction on the use of confirmations and the confirmation process. The following discussion provides a description of the existing standard and describes possible changes the Board is considering making to that standard.

The Proposed Auditing Standard, *Audit Evidence*, indicates that "in general, evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources."^{1/} AU sec. 330, states that "[c]onfirmation requests, if properly designed by the auditor, may address any one or more of those [financial statement] assertions. However, confirmations do not address all assertions equally well."^{2/} For example, "[c]onfirmation of goods held on consignment with the consignee would likely be more effective for the existence and the rights-and-obligations assertions than for the valuation assertion. Accounts receivable confirmations are likely to be more effective for the existence assertion than for the completeness and valuation assertions. Thus, when obtaining evidence for assertions not adequately addressed by confirmations, auditors should consider other audit procedures to complement confirmation procedures or to be used instead of confirmation procedures."^{3/}

Consistent with other proposed PCAOB standards, the Board is considering including in the standard the objective of the auditor when using confirmations.^{4/} Preliminarily, such an objective may focus on designing and performing confirmation

^{1/} See PCAOB Release No. 2008-006, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*, Proposed Auditing Standard, *Audit Evidence* (October 21, 2008), paragraph 8. Paragraph .21a of AU sec. 326, *Evidential Matter*, indicates 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."

^{2/} Paragraph .12 of AU sec. 330, *The Confirmation Process*.

^{3/} Ibid.

^{4/} PCAOB Release No. 2008-006, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (October 21, 2008).



procedures to obtain sufficient, competent audit evidence^{5/} from knowledgeable third parties outside the company in response to identified risks. The Board would be interested in comments on a potential objective for the confirmation standard.

Question

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

Definition of confirmation

Currently, the PCAOB's standard defines confirmation as "... the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions."^{6/} The standard permits oral confirmations, but requires that they be documented in the auditor's work papers and, if significant, "...the auditor should request the parties involved to submit written confirmation of the specific information directly to the auditor."^{7/}

International Standard on Auditing 505 ("ISA 505"), *External Confirmations*, defines an external confirmation as "[a]udit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium."^{8/} The Application and Other Explanatory Material^{9/} to ISA

^{5/} AU sec. 326.01. *See Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*, Proposed Auditing Standard, *Audit Evidence* (October 21, 2008), which would supersede AU sec. 326 and indicates that "[t]he objective of the auditor is to obtain appropriate audit evidence that is sufficient to support the opinion expressed in the auditor's report."

^{6/} AU sec. 330.04.

^{7/} AU sec. 330.29.

^{8/} International Standard on Auditing ("ISA") 505, *External Confirmations*, paragraph 6(a).

^{9/} As described in paragraph A59 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International*



PCAOB Release No. 2009-002
April 14, 2009
Page A – 3– Concept Release

505 states that "an oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor."^{10/}

The Board is considering expanding the definition of confirmation to include direct access to information held by a third party in response to a request for information about a particular item affecting financial statement assertions.^{11/} Under the revised definition, communications via email and confirmation responses processed through third-party service providers also would be acceptable forms of confirmation.^{12/} The

Standards on Auditing, Application and Other Explanatory Material does not, in itself, impose a requirement, but is relevant to the proper application of the requirements of an ISA.

^{10/} ISA 505, paragraph A15.

^{11/} As discussed previously in this concept release, forms of communication include those via traditional mail, email, facsimile and other electronic communications. As a result of advances in technology, auditors may obtain a direct website link into electronic records of an audit client's customer, bank, or other confirming party. "Direct access to information held by a third party," as used in this concept release, refers to an auditor obtaining a read-only direct website link into electronic records of an audit client held by a third party. It is also referred to elsewhere in this concept release as "direct on-line access." The auditor would have to be given a separate password, by the third party to enable the auditor to independently confirm the information held by the third party. If the auditor were to use the client's password, it would not serve as a confirmation for the auditor but, rather, would be considered to be an alternative procedure. However, the auditor may need to perform procedures to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised. Although an auditor may be able to review electronic records with little or no interaction with client personnel, the auditor may need to interact with the confirming party to ascertain that the direct website link to the confirming party's records is secure and that the link provides the auditor access to the information that is requested.

^{12/} The Board discussed audit confirmations with the Standing Advisory Group ("SAG") on April 2, 2009. Certain SAG members expressed the view that oral confirmations should not be used for a number of reasons, including that oral communications are less reliable than written communications. Other SAG members said oral confirmation should be permitted in limited circumstances since, in some audits, there may be legitimate reasons why the auditors will not be able to obtain



Board is concerned that limiting the definition of confirmation to written responses, as ISA 505 does, may discourage the use of confirmations by auditors. There may be circumstances in which an auditor prefers direct communication from a respondent instead of direct on-line access to information. For example, a direct communication from a respondent provides an opportunity for the respondent to question the information included in a confirmation request or to provide additional information, such as the existence of a side agreement. Direct communication also may be a more effective confirmation procedure in certain situations, such as when an auditor is confirming revenue transactions.

Questions

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct on-line access to information held by a third party? Why or why not?
3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?
4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

written confirmation responses. In addition, some SAG members supported expanding the definition of a confirmation to include direct access to information held by a third party for various reasons, including that it might improve confirmation response rates. Other SAG members were concerned that the access to the information held by the third party may not be secure and properly controlled. SAG members expressed concern regarding how the auditor knows whether he or she has been given access to the information that is requested. These members also expressed concern with whether the auditor would interpret that information correctly. See the related agenda item at: [http://www.pcaobus.org/News and Events/Events/2009/04-02.aspx](http://www.pcaobus.org/News_and_Events/Events/2009/04-02.aspx).



Requirement to confirm

AU sec. 330 includes "a presumption that the auditor will request the confirmation of accounts receivable during an audit" unless certain criteria are met.^{13/} Accounts receivable is defined in the standard to mean –

- "The entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and
- A financial institution's loans."^{14/}

If confirmation of accounts receivable is not requested, the auditor "should document how he or she overcame this presumption."^{15/} AU sec. 330 requires the auditor to request confirmation of accounts receivable unless, in the auditor's judgment, the use of confirmations would be ineffective based on prior audit experience.^{16/} In addition to accounts receivable, AU sec. 330 indicates that "[t]he auditor should

^{13/} AU sec. 330.34.

^{14/} Ibid.

^{15/} AU sec. 330.35.

^{16/} AU sec. 330.34. Footnote 4 of AU sec. 330.34 indicates that "if, based on prior years' audit experience or on experience with similar engagements, the auditor concludes that response rates to properly designed confirmation requests will be inadequate, or if responses are known or expected to be unreliable, the auditor may determine that the use of confirmations would be ineffective."

AU sec. 330.34 also indicates the auditor can overcome the presumption to request confirmation of accounts receivable if accounts receivable are immaterial to the financial statements or the auditor's combined assessed level of inherent and control risk is low, and the assessed level, 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.



PCAOB Release No. 2009-002
 April 14, 2009
 Page A – 6– Concept Release

consider requesting confirmation of the terms of unusual agreements or transactions, such as bill and hold sales, in addition to the amounts."^{17/}

ISA 505 does not require confirmation of any specific accounts, terms, or transactions.^{18/} The Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants is considering revising its standard on confirmations. In its December 2008 meeting, "[t]he ASB confirmed its belief (as was decided at the October 2007 ASB meeting) that inclusion of the presumptive requirement to confirm accounts receivable is appropriate."^{19/}

Confirmation procedures may provide auditors with sufficient, competent audit evidence regarding the existence assertion for accounts receivable and also may provide some audit evidence regarding the occurrence assertion for revenue.^{20/} The Board is considering whether to expand the presumption to request confirmation of accounts receivable, and the related requirement to document how he or she overcame this presumption when omitting such confirmation requests. Expansion of that presumption could establish the presumption to request confirmation of the significant terms of unusual agreements or transactions, including complex or unusual revenue transactions, because of the risk of fraud. The Board also is considering whether the

^{17/} AU sec. 330.25.

^{18/} The International Auditing and Assurance Board took this position because, in part, "there are many circumstances where external confirmation procedures may not be effective" and "a documentation burden would arise if the auditor were to rebut the presumption." See Staff of the International Auditing and Assurance Standards Board, *Basis for Conclusions: ISA 505, External Confirmations* at: [http://web.ifac.org/download/Basis for Conclusions ISA 505 Revised and Redrafted.pdf](http://web.ifac.org/download/Basis%20for%20Conclusions%20ISA%20505%20Revised%20and%20Redrafted.pdf).

^{19/} See the Auditing Standards Board meeting summary (December 11 -12, 2008) at: http://www.aicpa.org/download/auditstd/2008_12_ASB_Highlights.pdf.

^{20/} Paragraph .41 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, states that "[m]aterial misstatements due to fraudulent financial reporting often result from an overstatement of revenues...or an understatement of revenues....Therefore, the auditor should ordinarily presume that there is a risk of material misstatement due to fraud relating to revenue recognition."



standard should include the requirement that the auditor should consider confirmation of other items when confirmations may provide the auditor sufficient, competent audit evidence for other financial statements assertions.^{21/} Such items could include cash, investments, credit facilities, and debt agreements.^{22/}

Questions

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?
6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?
7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

^{21/} The Board's Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*, states that the Board's auditing and related professional practice standards use certain terms set forth in this rule to describe the degree of responsibility that the standards impose on auditors. Under this rule, words like "must," "shall," and "is required" indicate unconditional responsibilities; the word "should" indicates responsibilities that are presumptively mandatory; words such as "may," "might," "could" and other terms and phrases describe actions and procedures that auditors have a responsibility to consider; and "should consider" indicates that consideration of an action or procedure is presumptively mandatory, while the action or procedure is not.

^{22/} During the April 2, 2009 SAG meeting, certain SAG members expressed their views that the presumption to request confirmation of accounts receivable should be expanded to certain items, such as investments and cash. Another member indicated the standard should encourage, but not require, confirmations for material revenue transactions near year end because of the risk of fraud. Other members, who were not supportive of expanding the requirement to confirm accounts or other items, indicated that auditors should determine which procedures to perform based on the assessed level of risk for the relevant assertions for each account.



8. Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?

Designing confirmation requests

The PCAOB's standard requires that "[c]onfirmation requests should be tailored to the specific audit objectives."^{23/} In addition, the standard provides the following direction in designing confirmation requests –

- "[t]he auditor should consider the assertion(s) being addressed and the factors that are likely to affect the reliability of the confirmations. Factors such as the form of the confirmation request, prior experience on the audit or similar engagements, the nature of the information being confirmed, and the intended respondent should affect the design of the requests because these factors have a direct effect on the reliability of the evidence obtained through confirmation procedures."^{24/}
- "[t]he auditor should consider the types of information respondents will be readily able to confirm, since the nature of the information being confirmed may directly affect the competence of the evidence obtained as well as the response rate."^{25/}
- "The auditor's understanding of the client's arrangements and transactions with third parties is key to determining the information to be confirmed. The auditor should obtain an understanding of the substance of such arrangements and transactions to determine the appropriate information to include on the confirmation request."^{26/}

^{23/} AU sec. 330.16.

^{24/} Ibid.

^{25/} AU sec. 330.24.

^{26/} AU sec. 330.25.



PCAOB Release No. 2009-002
 April 14, 2009
 Page A – 9– Concept Release

- "The auditor should direct the confirmation request to a third party who the auditor believes is knowledgeable about the information to be confirmed."^{27/}

The PCAOB's standard provides that, "[i]f information about the respondent's competence, knowledge, motivation, ability, or willingness to respond, or about the respondent's objectivity and freedom from bias with respect to the audited entity comes to the auditor's attention, the auditor should consider the effects of such information on designing the confirmation request and evaluating the results, including determining whether other procedures are necessary."^{28/}

The Board is considering including a requirement for the auditor to determine whether the confirming party's address directs the confirmation to the intended recipient. This requirement may address advances in technology that were not anticipated when AU sec. 330 was written since such technology provides additional opportunities for skilled individuals to intercept confirmation requests if they are not directed to the intended recipient. This requirement also would apply to traditional communication using mail in addition to electronic communication via email, facsimile, use of third-party service providers or direct on-line access to third-party databases.

Questions

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?
10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

Maintaining control over confirmation requests and responses

AU sec. 330 includes the requirement that "the auditor should maintain control over the confirmation requests and responses. Maintaining control means establishing

^{27/} AU sec. 330.26.

^{28/} AU sec. 330.27.



direct communication between the intended recipient and the auditor to minimize the possibility that the results will be biased because of interception and alteration of the confirmation requests or responses."^{29/} Consideration of fraud risk is an important part of maintaining control. "Fraud also may be concealed through collusion among management, employees, or third parties."^{30/} The auditor may receive a false confirmation from a third party that is in collusion with management.^{31/} Maintaining control over the confirmation process may reduce the risk of receiving a fraudulent confirmation response. The standard also states that "[w]hen using confirmation requests other than the negative form, the auditor should generally follow up with a second and sometimes a third request to those parties from whom replies have not been received."^{32/}

The Board is concerned with the risk that unauthorized individuals will obtain access into the confirmation process. For example, company personnel may be able to intercept the confirmation request to forge a signature or otherwise provide the auditor with false confirmations. The Board is considering whether the standard may need to be updated to address advances in technology that were not anticipated when AU sec. 330 was written since such technology may provide opportunities for skilled individuals to intercept and revise confirmation responses.

Questions

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?
12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

^{29/} AU sec. 330.28.

^{30/} AU sec. 316.10.

^{31/} Ibid.

^{32/} AU sec. 330.30.



Reliability of confirmation responses

AU sec. 330 requires the auditor to evaluate the reliability of confirmation responses and alternative procedures as part of the auditor's overall evaluation to determine whether sufficient evidence has been obtained about all the applicable financial statement assertions.^{33/} As discussed above in the section "Designing confirmation requests," "[i]f information about the respondent's competence, knowledge, motivation, ability, or willingness to respond, or about the respondent's objectivity and freedom from bias with respect to the audited entity comes to the auditor's attention, the auditor should consider the effects of such information on designing the confirmation request and evaluating the results, including determining whether other procedures are necessary."^{34/}

In a publication that summarizes research and U.S. Securities and Exchange Commission enforcement actions, the authors note that fictitious responses provided by company management were a problem area in enforcement actions involving accounts receivable and cash balance confirmations. "Current auditing standards do not require auditors to authenticate responses."^{35/}

ISA 505 requires that –

- "If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts."^{36/}
- "If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of

^{33/} AU sec. 330.33.

^{34/} AU sec. 330.27.

^{35/} Paul Caster, Randal J. Elder, and Diane J. Janvrin, "A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory* (November 2008).

^{36/} ISA 505, paragraph 10.



the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures."^{37/}

The Board is considering whether more specific requirements may be needed beyond those currently contained in AU sec. 330 by requiring the auditor to evaluate the reliability of confirmations in a manner that is similar to the guidance in ISA 505. As discussed above in the section, "Maintaining control over confirmation requests and responses," technological developments may create concerns about the reliability of confirmation responses which were not foreseen when the current confirmation standard was drafted. Changes to the standard may include performing procedures to address the reliability of responses when alternative forms of communication are used. Factors that auditors may consider when evaluating the reliability of electronic confirmations include –

- The electronic confirmation process is secure and properly controlled;
- The information is obtained directly by the auditor; and
- The information is obtained from a third party who is the intended recipient.

As discussed previously, banks and other businesses may hire third parties to respond to confirmation requests on their behalf. If a system or process that facilitates confirmation between the auditor and the confirming party is in place, such as a third-party service provider, and if the auditor plans to rely on that system or process, another auditor's report on that system or process may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls that address the reliability of the information being confirmed.

Questions

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?
14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be

^{37/} ISA 505, paragraph 11.



required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

Exceptions and non-responses

AU sec. 330 does not define explicitly an exception or a non-response.^{38/} The standard, however, provides direction for situations in which alternative procedures should be performed for non-responses to positive confirmation requests, as well as the types of alternative procedures that may be performed by the auditor.^{39/} The nature of alternative procedures varies according to the account and assertion in question. In the examination of accounts receivable, for example, alternative procedures may include examination of subsequent cash receipts, shipping documents, or other company documentation to provide evidence of the existence assertion. The standard permits the auditor to omit alternative procedures in limited situations.^{40/}

The Board is considering whether changes to the standard should eliminate the ability for the auditor to omit performing alternative procedures for non-responses to positive confirmation requests. The Board also is considering whether the standard should require the auditor to investigate exceptions in confirmation responses to

^{38/} Paragraph 6(e) of ISA 505 defines an exception as "[a] response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party." Changes to the Board's confirmation standard may define an exception that is similar to the definition in ISA 505.

^{39/} AU secs. 330.31-.32.

^{40/} AU sec. 330.31 indicates the auditor may omit alternative procedures "(a) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (b) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated."



determine whether or not they are indicative of misstatements. Performing alternative procedures for non-responses and investigating exceptions to confirmation requests may result in the identification of previously unidentified risk of material misstatements, including previously unidentified fraud risk factors that require evaluation.

Questions

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?
17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?
18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?
19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

Management requests not to confirm

The PCAOB's standard does not specifically address what actions the auditor should consider when management requests that the auditor not confirm selected accounts, transactions, agreements, or other items. However, such a request could be a scope limitation, which is addressed in the auditor's reporting standard.^{41/}

The Board is considering including procedures for auditors to perform to evaluate situations in which management requests the auditor not to confirm certain accounts, transactions, agreements, or other items. Such procedures could include requiring the auditor to –

^{41/} Paragraphs .22-.34 of AU sec. 508, *Reports on Audited Financial Statements*.



PCAOB Release No. 2009-002
 April 14, 2009
 Page A – 15– Concept Release

- Inquire as to management's reasons for the request and seek audit evidence as to their validity and reasonableness;
- Evaluate the implications of management's request on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing, and extent of other audit procedures; and
- Perform alternative procedures designed to obtain sufficient, competent audit evidence.^{42/}

Question

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Disclaimers and restrictive language

Through the inspection process, the PCAOB has observed instances in which confirmation responses from third parties or counterparties included disclaimers as to their accuracy and appropriateness for use in the preparation of financial statements.^{43/} Examples of such disclaimers and restrictive language include statements that –

- Information is obtained from electronic data sources, which may not contain all information in the bank's possession.

^{42/} ISA 505, paragraph 8, includes similar procedures in situations in which management refuses to allow the auditor to send confirmation requests.

^{43/} See PCAOB Release No. 2008-008, *Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms* (December 5, 2008), page 14.



PCAOB Release No. 2009-002
April 14, 2009
Page A – 16– Concept Release

- Information is not guaranteed to be accurate nor current and may be a matter of opinion.
- The confirming party does not accept any responsibility for errors or omissions.
- Information is furnished as a matter of courtesy without a duty to do so and without responsibility, liability or warranty, express or implied.
- The confirming party has not sought to verify that the information contained in the attached report is true and complete and hereby expressly disclaims any liability.

AU sec. 330 does not specifically address the use of disclaimers and restrictive language by confirming parties, although AU sec. 326 indicates that "sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit."^{44/} Depending on the circumstance, a disclaimer or the use of restrictive language may limit the responsibility the respondent is taking for the accuracy and completeness of the information on the confirmation response, which limits the amount of audit evidence that is provided by the confirmation. Examples of such language include a respondent stating that he or she has not verified whether the information in the response is accurate or that the information in the response may not be appropriate for use in the preparation of financial statements.^{45/} If the auditor concludes that the disclaimer or restrictive language on a confirmation response limits the extent of audit evidence provided by the confirmation, the auditor should perform additional procedures to obtain sufficient, competent audit evidence. For example, in auditing the existence assertion for accounts receivable, alternative procedures may include examining subsequent cash receipts (including matching some receipts with the actual items being paid), shipping documents, or other company documentation.

The Board is considering whether the standard should further clarify the auditor's responsibility to evaluate disclaimers or restrictive language on confirmation responses

^{44/} AU sec. 326.01.

^{45/} PCAOB Release No. 2008-008, *Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms* (December 5, 2008).



and determine whether or not such responses provide sufficient, competent audit evidence. The Board also is considering, when the audit evidence provided by confirmation responses containing such language appears to be limited, alternative procedures auditors should perform to obtain additional audit evidence.

Question

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

Negative confirmations

The PCAOB's standard on confirmations provides for two types of confirmation requests: the positive form and the negative form.^{46/} Positive confirmations provide audit evidence only when responses are received from the recipients.^{47/} With a negative confirmation, the recipient is asked to respond only if he or she disagrees with the information stated on the request.^{48/} The standard states that "...unreturned negative confirmation requests rarely provide significant evidence concerning financial statement assertions other than 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 provide explicit evidence that the intended third parties received the confirmation requests and verified that the information contained on them is correct."^{49/}

The PCAOB's standard provides that "[n]egative confirmation requests may be used to reduce audit risk to an acceptable level when (a) the combined assessed level of inherent and control risk is low, (b) a large number of small balances is involved, and

^{46/} AU sec. 330.17.

^{47/} AU sec. 330.18.

^{48/} AU sec. 330.20.

^{49/} AU sec. 330.22.



PCAOB Release No. 2009-002
April 14, 2009
Page A – 18– Concept Release

(c) the auditor has no reason to believe that the recipients of the requests are unlikely to give them consideration."^{50/} The existing standard further states that "the auditor should consider performing other substantive procedures to supplement the use of negative confirmations."^{51/}

The Board is considering whether the standard should continue to permit the use of negative confirmations and, if so, whether to require the auditor to perform other substantive procedures to supplement the use of negative confirmations.

Questions

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?
23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

^{50/} AU sec. 330.20.

^{51/} Ibid.



1666 K Street, NW
 Washington, D.C. 20006
 Telephone: (202) 207-9100
 Facsimile: (202)862-8430

)
)
 PROPOSED AUDITING STANDARD)
)
 RELATED TO CONFIRMATION) PCAOB Release No. 2010-003
) July 13, 2010
)
 AND RELATED AMENDMENTS TO) PCAOB Rulemaking
 PCAOB STANDARDS) Docket Matter No. 028
)
)
)
)
)
)
)
)

Summary: The Public Company Accounting Oversight Board ("PCAOB" or the "Board") is proposing an auditing standard, *Confirmation*, which would supersede the Board's standard, AU section 330, *The Confirmation Process*, and related amendments to the Board's auditing standards. The proposed auditing standard and the related amendments would be applicable to all registered firms conducting audits in accordance with PCAOB standards.

Public
 Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 028 in the subject or reference line. Comments should be received by the Board no later than September 13, 2010.

Board
 Contacts: Jennifer Rand, Deputy Chief Auditor (202-207-9206; randj@pcaobus.org), Dee Mirando-Gould, Associate Chief Auditor (202-207-9264; mirando-gouldd@pcaobus.org) and Christopher David, Assistant Chief Auditor (202-207-9231; davidc@pcaobus.org).

RELEASE

I. Introduction

The Board is proposing a new confirmation standard to supersede the PCAOB's existing confirmation standard, AU section ("sec.") 330, *The Confirmation Process*. On April 14, 2009, the Board issued *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (the "Concept Release").^{1/} The Board received 24 comment letters^{2/} from a variety of commenters on a broad range of topics, including responses to specific questions the Board raised in the Concept Release. In developing the project, the Board considered comments on the Concept Release, input from the PCAOB's Standing Advisory Group ("SAG"),^{3/} the Board's inspection activities, academic research,^{4/} and the actions of other standard setters.

The Board is proposing a new standard that:

- *Requires confirmation procedures for specific accounts* – The Board is retaining the requirement for the auditor to perform confirmation procedures for receivables because a confirmation response from a confirming party can provide relevant and reliable audit evidence of the existence of receivables, academic research supports the effectiveness of confirmation procedures in testing the existence assertion for receivables, and audit evidence from a third party generally is more reliable than audit evidence generated internally by a company or provided directly by a company. The

^{1/} PCAOB Release No. 2009-002, *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (April 14, 2009).

^{2/} Comments on the Concept Release are available on the Board's Web site at <http://pcaobus.org/Rules/Rulemaking/Pages/Docket028.aspx>.

^{3/} Webcasts of Standing Advisory Group meetings are available on the Board's Web site at <http://pcaobus.org/News/Webcasts/Pages/default.aspx>.

^{4/} Paul Caster, Randal J. Elder, and Diane J. Janvrin, "A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory* 27, no.2 (November 2008). Also, see Diane Janvrin, Paul Caster, and Randy Elder, "Enforcement Release Evidence on the Audit Confirmation Process: Implications for Standard Setters," *Research in Accounting Regulation* 22 (April 2010).

RELEASE

Board also is proposing to expand the requirement to receivables that arise from credit sales, loans, or other transactions, because confirmation procedures can provide audit evidence to address the risk of material misstatement due to fraud. AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, requires the auditor to presume there is a risk of material misstatement due to fraud relating to revenue recognition and receivables often are related to revenue recognition.^{5/} Confirmation procedures also can provide audit evidence regarding the occurrence assertion for revenue. In addition, a company might have a material receivable from the sale of assets or the sale of a business.

The Board is proposing to require the auditor to perform confirmation procedures for cash and other relationships with financial institutions. The Board is including this requirement because confirmation procedures can provide audit evidence to address the risk of material misstatement due to fraud and because of the importance of cash to a company's liquidity and ongoing operations. The Board also is including this requirement because properly designed confirmation procedures can provide audit evidence regarding other relationships with financial institutions, such as lines of credit, other indebtedness, compensating balance arrangements, and contingent liabilities, including guarantees.

- *Incorporates procedures in response to risk of material misstatement* – The proposed confirmation standard incorporates procedures that build upon the Board's Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk (the "proposed risk assessment standards").^{6/} The auditor designs and performs audit procedures to address the risks of material misstatement due to error or fraud. The proposed risk assessment standards require the auditor to determine whether any identified and assessed risks of material misstatement are

^{5/} Paragraph .41 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*.

^{6/} PCAOB Release 2009-007, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards* (December 17, 2009).

RELEASE

significant risks^{7/} and to perform audit procedures in response to significant risks.^{8/} The proposed confirmation standard applies this approach to the confirmation process by requiring the auditor to perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures. In addition, the proposed standard includes other procedures that address the risk of material misstatement, such as in the areas of investigating exceptions reflected on confirmation responses and evaluating non-responses to confirmation requests.

- *Updates the standard to reflect significant advances in technology –* Significant advances in technology, including increased use of electronic communication methods, have occurred since the existing confirmation standard was written more than 15 years ago. While adding efficiency, some of these electronic methods of communication also have added opportunities for skilled individuals to intercept confirmation requests and change confirmation responses before they reach the auditor. The proposed confirmation standard includes requirements related to addressing the risks that are applicable to confirmation in an electronic environment and includes requirements to assess the reliability of electronic confirmation responses.
- *Defines a confirmation response to include electronic or other medium –* The proposed standard defines a confirmation response as "audit evidence obtained as a direct communication to the auditor from a third party, either in paper form or by electronic or other medium." Revising the definition of a confirmation response to provide for a response by electronic or other medium might make the confirmation process more efficient than paper form, although

^{7/} The term "significant risk" is defined in paragraph A5 of PCAOB Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, as "a risk of material misstatement that requires special audit consideration." The Board intends for that definition to apply to the proposed confirmation standard as well.

^{8/} Paragraph 11 of PCAOB Proposed Auditing Standard, *The Auditor's Responses to the Risks of Material Misstatement*.

RELEASE

auditors should take into account the risks associated with electronic confirmation responses.

- *Enhances requirements when confirmation responses include disclaimers and restrictive language* – The proposed confirmation standard requires the auditor to evaluate disclaimers and restrictive language included in confirmation responses to determine whether such disclaimers or restrictive language affect the reliability of those responses. The proposed standard further provides that if such language precludes the auditor from treating the response as a confirmation response, the auditor should perform alternative procedures to obtain relevant and reliable audit evidence or assess the implications, if any, for the audit report.

The proposed standard carries forward some of the requirements in AU sec. 330. In addition, for certain matters, the proposed standard adds to the existing requirements by requiring the auditor to perform additional procedures. For example, the proposed standard requires the auditor to perform confirmation procedures in response to significant risks in certain circumstances and to determine the validity of addresses in confirmation requests. Additionally, in drafting the proposed standard the Board considered International Standard on Auditing ("ISA") 505, *External Confirmations*, issued by the International Auditing and Assurance Standards Board ("IAASB") and the Proposed Statement on Auditing Standards, *External Confirmations* (the "ASB's proposed SAS"), of the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants ("AICPA").^{9/}

This release includes three appendices. Appendix 1 to this release contains the text of the proposed standard, *Confirmation*, which has one appendix, *Definitions*. Appendix 2 to this release contains related proposed amendments to existing PCAOB auditing standards to conform them to the requirements in the proposed standard. Appendix 3 provides a comparison of the proposed standard to ISA 505 and the ASB's proposed SAS.

^{9/} See the ASB's Proposed Statement on Auditing Standards, *External Confirmations*, at http://www.aicpa.org/Research/ExposureDrafts/AccountingandAuditing/DownloadableDocuments/20090528a_ED_External_Confirmations.pdf.

RELEASE

II. General Areas of Comment on the Concept Release

Commenters were supportive of the Board updating the existing confirmation standard given the significance of the changes in the business environment since the adoption of that standard, particularly with respect to advances in technology. To make the confirmation process more effective in the current business environment, the proposed definition of confirmation response addresses the significant advances in technology since the existing standard was issued.

The Board received some general comments related to its standard-setting process, including the use of a concept release. The Board continuously endeavors to improve its standards, including by using a robust standard-setting process, and is considering these comments as it does so.

Several commenters encouraged the Board to more closely align a revised confirmation standard with ISA 505. A number of commenters also suggested that the Board consider the ASB's proposed SAS. As discussed above, Appendix 3 to the release compares the Board's proposed standard to ISA 505 and the ASB's proposed SAS.

III. Overview of the Proposed Standard

The Board's proposed standard is intended to strengthen the existing requirements for confirmation.^{10/} The Board requests comments on the proposed standard and is particularly interested in responses to the specific questions included in this release in the sections below.

The Board's proposed standard establishes the requirement for the auditor to perform confirmation procedures (1) for receivables that arise from credit

^{10/} PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*, states that "[t]he Board's auditing and related professional practice standards use certain terms set forth in this rule to describe the degree of responsibility that the standards impose on auditors." Under this rule, words like "must," "shall," and "is required" indicate unconditional responsibilities; the word "should" indicates responsibilities that are presumptively mandatory; words such as "may," "might," "could" and other terms and phrases describe actions and procedures that auditors have a responsibility to consider; and "should consider" indicates that consideration of the action or procedure is presumptively mandatory, while the action or procedure is not.

RELEASE

sales, loans, or other transactions; (2) for cash and other relationships with financial institutions; and (3) in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures. The proposed standard also establishes requirements regarding the design and performance of confirmation procedures.

For clarity and ease of understanding, the proposed confirmation standard refers to portions of the Board's proposed risk assessment standards. Consequently, the proposed confirmation standard might need to be revised to reflect any changes that are made to the proposed risk assessment standards. Also, because the proposed risk assessment standards were subject to comment during a separate comment process, the Board is not seeking additional comments on the proposed risk assessment standards through proposal of the confirmation standard.

A. Definitions

AU sec. 330 defines confirmation as "the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions."^{11/} That standard permits oral confirmations, but requires that they be documented in the auditor's work papers and, if significant, the auditor should request the parties involved to submit written confirmation of the specific information directly to the auditor.^{12/}

The majority of commenters to the Concept Release supported expanding the definition of a confirmation response to allow for responses other than traditional mailed responses. Several of these commenters stated that a proposed standard should not attempt to include all the various ways in which a confirmation response might be obtained, as technology and processes will continue to evolve. In addition, the majority of commenters recommended that an oral response to a confirmation request not be considered a confirmation response.

The proposed standard defines confirmation as "[t]he process of obtaining and evaluating a direct communication from a third party in response to a request, either in paper form or by electronic or other medium, for information

^{11/} Paragraph .04 of AU sec. 330, *The Confirmation Process*.

^{12/} AU sec. 330.29.

RELEASE

about a particular item affecting financial statement assertions." Further, the proposed standard defines a confirmation response as "[a]udit evidence obtained as a direct communication to the auditor from a third party, either in paper form or by electronic or other medium." The proposed standard also states that "[a]n oral response to a confirmation request is audit evidence, but it does not meet the definition of a confirmation response."

Revising the definition to permit a confirmation response by electronic or other medium might make the confirmation process less burdensome for confirming parties and, therefore, improve confirmation response rates. In addition, the Board considered comments on the Concept Release that an oral communication does not constitute a confirmation response.

The proposed standard permits the use of direct access as a confirmation response if certain conditions are met. Direct access is defined in the proposed standard as "[a]n auditor's electronic access into a confirming party's electronic records of transactions or balances with the company." For example, auditors might obtain electronic access (e.g., using a Web site link) into a confirming party's (e.g., the company's customer, bank, or other party) electronic records of transactions or balances with the company. A brokerage firm, for instance, can set up a web portal and grant the auditor a unique ID and password for limited-time access to the company's detailed account statements or information specifically generated for, or made available to, the auditor. The definition further states that "[i]f access codes or information necessary to access data held by a confirming party are provided to the auditor by management of the company and not by the confirming party, evidence obtained by the auditor from access to such information does not meet the definition of a confirmation response. Rather that information constitutes other audit evidence."

The proposed standard provides that, among other things, the auditor should evaluate whether direct access is an appropriate means to confirm the particular information that is the subject of the confirmation request and provides that direct access is not an appropriate confirmation procedure in all cases. For example, direct access might be appropriate for confirming the existence of certain cash and investment accounts. However, when confirming revenue agreements, the auditor should evaluate whether the revenue agreements could include terms and oral modifications that would make direct access an inappropriate mechanism for confirmation.

RELEASE

The proposed standard also includes definitions of confirmation request, exception, negative confirmation request, non-response, and positive confirmation request.

Question

1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

B. Objective

The Board's existing standard does not include an objective. In the Concept Release, the Board requested comments on a potential objective for a proposed standard and indicated that the objective might be "for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks."

The majority of the commenters supported including an objective in a proposed standard. However, commenters indicated that the objective as stated in the Concept Release might be misunderstood to require confirmation for all relevant identified risks. Other commenters indicated that the objective might imply that confirmation would provide sufficient, competent audit evidence in all cases.

The proposed standard states that "[t]he objective of the auditor in designing and performing confirmation procedures is to obtain relevant and reliable audit evidence." In response to comments received on the Concept Release, the proposed objective focuses the auditor on obtaining relevant and reliable audit evidence from confirmation procedures. It also addresses comments by some commenters to the Concept Release that confirmation responses might not provide sufficient audit evidence in all cases and that there might be a need to supplement the responses with other substantive procedures.

Questions

2. Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?
3. What other matters, if any, should the objective include?

RELEASE

C. Confirmation of Specific Accounts

As described in the Board's proposed risk assessment standards, confirmation procedures frequently are used in relation to account balances and their constituent parts.^{13/} Confirmation procedures also are used to confirm terms of the company's agreements or transactions with third parties, or to confirm the absence of certain conditions, such as undisclosed side agreements. The Board is proposing requirements for auditors to confirm receivables and cash and to perform confirmation procedures in response to certain significant risks.

Receivables That Arise from Credit Sales, Loans, or Other Transactions

AU sec. 330 includes a presumption that the auditor will request confirmation of accounts receivable during an audit unless one of the following is true:

- Accounts receivable are immaterial to the financial statements.
- The use of confirmations would be ineffective.
- The auditor's combined assessed level of inherent and control risk is low, and the assessed level, 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. In many situations, both confirmation of accounts receivable and other substantive tests of details are necessary to reduce audit risk to an acceptably low level for the applicable financial statement assertions.^{14/}

The existing standard defines accounts receivable as:

- a. The entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and

^{13/} Paragraph 18 of PCAOB Proposed Auditing Standard, *Audit Evidence*.

^{14/} AU sec. 330.34.

RELEASE

b. A financial institution's loans.^{15/}

In the Concept Release, the Board acknowledged the importance of retaining the presumption to request confirmation of accounts receivable. The accounting profession in the United States has required confirmation of accounts receivable since 1939, when the American Institute of Accountants^{16/} adopted Statement on Auditing Procedure No. 1 as a direct result of the McKesson & Robbins fraud case.^{17/} In that case, the U.S. Securities and Exchange Commission (the "SEC") concluded that if confirmation of receivables had been accepted practice at that time, such a procedure would have revealed the fictitious nature of the McKesson & Robbins receivables.^{18/}

Although the Board did not specifically request comment on retaining the presumption that the auditor will request confirmation of accounts receivable, a few commenters indicated that they did not support retaining this requirement. One commenter expressed concern that the presumptive requirement supplants auditor judgment and might result in over-reliance on confirmation procedures.

The Board is retaining the requirement to perform confirmation procedures for receivables in the proposed standard because a confirmation response from a confirming party can provide relevant and reliable audit evidence of the existence of a receivable, academic research supports the effectiveness of such procedures in testing the existence of receivables,^{19/} and audit evidence from a third party generally is more reliable than audit evidence generated internally by

^{15/} Ibid.

^{16/} The American Institute of Accountants was the predecessor to the American Institute of Certified Public Accountants ("AICPA").

^{17/} See United States of America before the Securities and Exchange Commission (the "SEC") in the Matter of McKesson & Robbins, Inc., pursuant to Section 21(a) of the Securities Exchange Act of 1934, *Report on Investigation and Testimony of Expert Witnesses* (December 1940), Section 5, Conclusions.

^{18/} Ibid, p. 394.

^{19/} P. Caster, et al., "A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness." Also see D. Janvrin, et al., "Enforcement Release Evidence on the Audit Confirmation Process: Implications for Standard Setters."

RELEASE

a company or provided directly by a company. Also, there is limited evidence regarding the effectiveness of alternative procedures in place of confirmation of receivables.^{20/} The proposed standard includes the requirement for the auditor to perform confirmation procedures for receivables that arise from credit sales, loans, or other transactions and states that "[t]hese receivables may be in the form of loans, notes, and other financial instruments and may be originated by the company or purchased from another entity." The proposed standard further states that "[t]he auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which receivables to confirm." The proposed standard also eliminates the definition of accounts receivable that was included in AU sec. 330.^{21/} The Board is proposing to extend the requirement to perform confirmation procedures to receivables that arise from credit sales, loans, or other transactions. This requirement includes purchased loans, accounts receivable, royalty receivables, lease receivables, notes receivable, and other similar receivables. As discussed above, the Board is proposing this change to the existing standard because confirmation of receivables can provide audit evidence regarding the occurrence assertion for revenue and can potentially address the risk of material misstatement due to fraud relating to revenue recognition.^{22/} In addition, a company might have material receivables that arise from the sale of assets or the sale of a business.

The proposed standard does not carry forward the exceptions for not confirming receivables for several reasons. First, AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*, establishes requirements regarding the auditor's consideration of materiality in planning and performing an audit.^{23/}

^{20/} D. Janvrin, et al., "Enforcement Release Evidence on the Audit Confirmation Process: Implications for Standard Setters."

^{21/} AU sec. 330.34.

^{22/} AU sec. 316.41 states, "[m]aterial misstatements due to fraudulent financial reporting often result from an overstatement of revenues... or an understatement of revenues. Therefore, the auditor should ordinarily presume that there is a risk of material misstatement due to fraud relating to revenue recognition."

^{23/} AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*. PCAOB Proposed Auditing Standard, *Consideration of Materiality in Planning*

RELEASE

Auditors should follow that standard when considering materiality. Second, if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures. For example, it might be ineffective to confirm a particular accounts receivable balance, but it might be effective to confirm individual transactions that make up that accounts receivable balance. In addition, useful information can be obtained from the confirmation responses. Finally, AU sec. 316 requires the auditor to presume there is a risk of material misstatement due to fraud relating to revenue recognition, and receivables often are related to revenue recognition.^{24/}

Under the proposed standard, the auditor may use audit sampling to select receivables to confirm. If the auditor uses audit sampling when selecting receivables to confirm, he or she should follow the requirements in AU sec. 350, *Audit Sampling*.^{25/}

AU sec. 330 requires the auditor to document how he or she overcame the presumption to request confirmation of accounts receivable.^{26/} PCAOB Auditing Standard No. 3, *Audit Documentation*, requires, among other things, that audit documentation demonstrate that the engagement complied with the standards of the PCAOB.^{27/} Accordingly, pursuant to Auditing Standard No. 3, the auditor should document in the audit work papers his or her rationale for not performing confirmation procedures for receivables that arise from credit sales, loans, or other transactions.

and Performing an Audit, would supersede AU sec. 312 after it is adopted by the Board and approved by the SEC.

^{24/} AU sec. 316.41.

^{25/} AU sec. 350, *Audit Sampling*.

^{26/} AU sec. 330.35.

^{27/} Paragraph 5.a. of PCAOB Auditing Standard No. 3, *Audit Documentation*.

RELEASE

Question

4. Is the description of "receivables that arise from credit sales, loans, or other transactions" sufficiently clear and appropriate? If not, what changes should the Board make?

Cash with Financial Institutions

The proposed standard requires the auditor to perform confirmation procedures for cash with financial institutions, such as banks, brokerage firms, trust companies, and other similar entities. It further requires that confirmation procedures with these financial institutions should include confirming (a) other relationships, such as lines of credit, other indebtedness, compensating balance arrangements, and contingent liabilities, including guarantees; and (b) whether, during the process of completing the confirmation response, any additional information about other deposit or loan accounts has come to the attention of the financial institution.

The Board is including these requirements because confirmation procedures can provide audit evidence to address the risk of material misstatement due to fraud and because of the importance of cash to a company's liquidity and ongoing operations. The Board also is including these requirements in the proposed standard because properly designed confirmation requests can provide audit evidence regarding other relationships with financial institutions, such as lines of credit, other indebtedness, compensating balance arrangements, and contingent liabilities, including guarantees.

The AICPA *Standard Form to Confirm Account Balance Information with Financial Institutions*^{28/} includes a request that the confirming party represent that "[t]he information presented above by the customer is in agreement with our records. Although we have not conducted a comprehensive, detailed search of our records, no other deposit or loan accounts have come to our attention except as noted [in the confirmation response]." In the proposed standard's requirement to confirm cash and other relationships with financial institutions, the auditor is required to request a similar representation from the financial institution.

^{28/} The AICPA, the American Bankers Association, and the Bank Administration Institute agreed on a standard form designed specifically to inquire about deposit balances and loans. This standard form is available from the AICPA at <http://www.cpa2biz.com>.

RELEASE

The proposed standard also requires the auditor to obtain an understanding of the company's cash management and treasury function to determine which cash accounts and other relationships with financial institutions to confirm. In addition, the proposed standard provides that the auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which cash accounts and other relationships to confirm. The auditor should not base his or her selection of cash accounts to confirm only on the reported balances of the cash accounts. There might be significant activity in, and risks associated with, a cash account that has an immaterial or zero balance. In addition, there might be other relationships with the financial institution, such as a significant unused line of credit.

The AICPA *Standard Form to Confirm Account Balance Information with Financial Institutions* provides for confirming cash balances and loan account balances only.^{29/} In addition, some financial institutions do not have the relationship management systems that provide the ability to confirm cash and other relationships using one confirmation request. Accordingly, confirmation requests for other relationships with the financial institutions might need to be sent separately from cash confirmation requests.

Question

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

Significant Risks

The existing standard states, "[i]f the entity has entered into an unusual or complex transaction and the combined assessed level of inherent and control risk is high, the auditor should consider confirming the terms of the transaction with the other parties in addition to examining documentation held by the entity."^{30/} In addition, the existing standard states, "[t]he auditor should consider

^{29/} See AU sec. 330.14 which states that "the AICPA *Standard Form to Confirm Account Balance Information with Financial Institutions* is designed to substantiate information that is stated on the confirmation request; the form is not designed to provide assurance that information about accounts not listed on the form will be reported."

^{30/} AU sec. 330.08.

RELEASE

requesting confirmation of the terms of unusual agreements or transactions, such as bill and hold sales, in addition to the amounts."^{31/}

In the Concept Release, the Board asked whether the presumptively mandatory requirement to request confirmation of accounts receivable should be expanded to include the requirement for the auditor to request confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. Numerous commenters were not supportive of expanding the presumptively mandatory requirement to request confirmation beyond accounts receivable. A number of these commenters recommended that determining whether to use confirmation to obtain audit evidence should be a function of the auditor's risk assessment and judgment regarding the nature and extent of procedures necessary to obtain sufficient appropriate audit evidence. A few commenters indicated that if the Board decides to expand the requirement to request confirmation of significant complex or unusual agreements or transactions, it would be helpful for the Board to include an explanation of what constitutes significant complex or unusual agreements or transactions.

Many commenters also did not support requiring confirmation procedures for other accounts, transactions, or agreements; however, most commenters suggested that a new standard focus on risks. Accordingly, the Board incorporated procedures to address the risk of material misstatement by requiring the auditor to perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures.^{32/} The proposed requirement should enhance the auditor's application of the standard because (1) the proposed risk assessment standards include factors that should be evaluated in determining which risks are significant risks^{33/} and (2) the requirement to perform confirmation procedures

^{31/} AU sec. 330.25.

^{32/} This requirement is applicable to significant risks associated with accounts other than receivables and cash, which are addressed in paragraphs 8 and 9, respectively, of the proposed standard.

^{33/} Paragraph 71 of PCAOB Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement* states, "[f]actors that should be evaluated in determining which risks are significant risks include:

- a. Whether the risk is a fraud risk;

RELEASE

has been expanded to apply to all significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures.

The proposed standard also acknowledges that confirmation procedures might not be specifically responsive to every significant risk. Confirmation procedures might not adequately address the relevant assertions for a particular account, balance, or other item associated with a significant risk. For example, in the audit of a utility or telecommunications company, the auditor might identify additions to property, plant, and equipment ("fixed assets") as a significant risk. However, confirming these fixed asset additions might not be an appropriate substantive procedure to perform. A confirmation response might not provide any evidence as to (1) whether the asset has been placed into service, is still in use, or exists at the balance sheet date; (2) the cost of the asset, since additional costs might have been incurred to get the asset ready for use; or (3) the value of the asset at the balance sheet date, because the asset might have been depreciated or impaired.

AU sec. 330 states that "[t]he auditor also should consider whether there may be oral modifications to agreements, such as unusual payment terms or liberal rights of return. When the auditor believes there is a moderate or high degree of risk that there may be significant oral modifications, he or she should

Note: A fraud risk is a significant risk.

- b. Whether the risk is related to recent significant economic, accounting, or other developments;
- c. The complexity of transactions;
- d. Whether the risk involves significant transactions with related parties;
- e. The degree of complexity or judgment in the recognition or measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- f. Whether the risk involves significant transactions that are outside the normal course of business for the company, or that otherwise appear to be unusual due to their timing, size or nature."

RELEASE

inquire about the existence and details of any such modifications to written agreements. One method of doing so is to confirm both the terms of the agreements and whether any oral modifications exist.^{34/} The proposed standard carries forward and enhances the requirements in the existing standard. The proposed standard states that "[f]or example, for significant risks related to agreements or transactions for which confirmation procedures adequately address the relevant assertions, the auditor should confirm the amounts and terms of such agreements or transactions, including whether there are any undisclosed oral or undisclosed written modifications to those agreements, such as undisclosed side agreements."

Questions

6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?
7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

Other Risks

The proposed standard acknowledges that performing confirmation procedures might be an appropriate response to other risks of material misstatement. The proposed standard states, "[e]ven when a significant risk does not exist for a particular account, balance, transaction, agreement, or other item, the performance of confirmation procedures still might be an appropriate response to obtain audit evidence for certain relevant assertions regarding that particular account, balance, transaction, agreement, or other item." For example, a company might have an accounts payable account that does not represent a significant risk. In this situation, however, confirming account balances might be the most effective procedure to obtain relevant and reliable audit evidence.

^{34/} AU sec. 330.25.

RELEASE

Question

8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

D. Confirmation Procedures

The existing standard states, "[c]onfirmation requests should be tailored to the specific audit objectives. Thus, when designing the confirmation requests, the auditor should consider the assertion(s) being addressed and the factors that are likely to affect the reliability of the confirmations."^{35/} The existing standard requires the auditor to maintain control over confirmation requests and responses.^{36/} The existing standard also states that "[m]aintaining control means establishing direct communication between the intended recipient and the auditor to minimize the possibility that the results will be biased because of interception and alteration of the confirmation requests or responses."^{37/} A footnote in the existing standard adds that "[t]he need to maintain control does not preclude the use of internal auditors in the confirmation process."^{38/}

Through the Concept Release, the Board asked whether additional requirements were needed in a confirmation standard with regard to maintaining control over confirmation requests and responses and designing confirmation requests. The Board also asked whether additional requirements were needed to address advances in technology that were not anticipated when AU sec. 330 was written.

Several commenters indicated that the proposed standard should include further explanation regarding maintaining control over confirmation requests, such as selecting the appropriate confirming party and determining that confirmation requests are appropriately addressed. In response to these comments, the proposed standard retains the existing requirements and includes additional requirements regarding maintaining control over the confirmation

^{35/} AU sec. 330.16.

^{36/} AU sec 330.28.

^{37/} Ibid.

^{38/} Footnote 3 to AU sec. 330.28.

RELEASE

process. For example, the proposed standard includes the requirements for the auditor to request that the confirming parties or intended intermediaries^{39/} respond directly to the auditor and that if a confirming party sends a confirmation response to anyone other than the auditor, the auditor should contact the confirming party and request that the confirming party re-send the response directly to the auditor.

The Board is not retaining the reference to the use of internal auditors in the proposed standard because the requirements for considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor are included in AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*.

The requirement in the proposed standard to maintain control over the confirmation process, however, limits the auditor's ability to use internal auditors to perform certain procedures in the confirmation process for the auditor. The proposed standard provides that "[t]he auditor should send the confirmation requests directly to the intended confirming parties or intended intermediaries and should not permit the company or any other party to send the confirmation requests" and "[w]hen performing confirmation procedures, the auditor should request that the confirming parties or intended intermediaries respond directly to the auditor and not to the company or any other party." In addition, the proposed standard provides that "[t]he auditor should evaluate the audit evidence obtained from performing confirmation procedures and should not rely on the company or any other party for this evaluation." Therefore, the auditor cannot use internal auditors to send confirmation requests, receive confirmation responses, or evaluate the audit evidence obtained from performing confirmation procedures. An auditor may use internal auditors to perform procedures for the auditor in other ways, however, provided that the auditor has assessed the internal auditors' competence and objectivity^{40/} and that the auditor supervises, reviews, evaluates, and tests the work performed by internal auditors^{41/} pursuant to AU sec. 322. Under this framework, for example, internal auditors may assist in

^{39/} An intermediary is an entity used by the intended confirming party and the auditor to facilitate confirmation between the confirming party and the auditor.

^{40/} Paragraph .11 of AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*.

^{41/} AU sec. 322.27.

RELEASE

testing that confirmation requests are properly addressed and in assembling information necessary for the auditor to resolve exceptions in confirmation responses.

In addition, consistent with AU sec. 322, an auditor may consider work performed by internal auditors in determining the timing and extent of the auditor's procedures,^{42/} provided that the auditor has obtained an understanding of the internal audit function and assessed the internal auditors' competence and objectivity.^{43/} For example, if the internal auditors, as part of their work, confirm certain receivables, the auditor may consider the internal auditors' work and change the timing of his or her confirmation procedures or the number of receivables to confirm.^{44/} AU sec. 322 also states that:

Even though the internal auditors' work may affect the auditor's procedures, the auditor should perform procedures to obtain sufficient, competent, evidential matter to support the auditor's report. The responsibility to report on the financial statements rests solely with the auditor. Unlike the situation in which the auditor uses the work of other independent auditors, this responsibility cannot be shared with the internal auditors. Because the auditor has the ultimate responsibility to express an opinion on the financial statements, judgments about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor's report should always be those of the auditor. As the materiality of the financial statement amounts increases and either the risk of material misstatement or the degree of subjectivity increases, the need for the auditor to perform his or her own tests of the assertions increases.^{45/}

^{42/} AU sec. 322.17.

^{43/} AU secs. 322.04-.11.

^{44/} AU sec. 322.17.

^{45/} AU secs. 322.18-.20.

RELEASE

Questions

9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?
10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

Designing the Confirmation Requests

With regard to designing confirmation requests, several commenters stated that they believed that no significant change is needed from what is in the existing standard. Other commenters recommended that the Board consider including factors for the auditor to consider when designing confirmation requests.

The proposed standard requires the auditor to design confirmation requests to obtain relevant and reliable audit evidence. Factors for the auditor to consider when designing confirmation requests include:

- The assertions being addressed, e.g., selecting balances from the accounts payable subsidiary ledger when addressing the existence assertion and selecting vendor accounts from a vendor list when addressing the completeness assertion.
- The specific risks of material misstatement, including the risk of material misstatement due to fraud ("fraud risk"), e.g., the possible existence of undisclosed side agreements.
- The nature of the information to be confirmed, e.g. the components of a complex mortgage calculation instead of the mortgage balance.
- The layout, presentation, and content of the confirmation request. For example, for a receivable confirmation request, a recipient might be more likely to reply, as well as identify discrepancies, if a copy of the customer's account statement is included with the confirmation request.

RELEASE

- Prior experience on the audit engagement or other similar engagements. For example, based on prior experience on the audit engagement, the auditor might be aware that certain respondents' accounting systems might facilitate confirming single transactions rather than entire account balances.
- The method of communication, whether it is in paper form or by electronic or other medium. For example, a financial institution might not respond to paper confirmation requests and might respond only to confirmation requests submitted electronically via a designated intermediary or that request direct access to the financial institution's electronic records for the information.
- The company's authorization to the confirming parties to respond to the auditor. For example, some confirming parties might be willing to respond only to a confirmation request containing the company's authorization.
- Local customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information. For example, if the local custom is that a confirming party confirms the information contained in the confirmation request without verifying that the information is correct in order to maintain a customer relationship, the auditor could address this issue by using a positive confirmation request that does not state the balance or amount (or certain other information) on the confirmation request.

Question

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

RELEASE

Determining the Type of Confirmation Requests to Send

The existing standard permits the use of negative confirmations^{46/} and provides that "[n]egative confirmation requests may be used to reduce audit risk to an acceptable level when (a) the combined assessed level of inherent and 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 consideration." It further provides that "[t]he auditor should consider performing other substantive procedures to supplement the use of negative confirmations."^{47/}

The Concept Release requested feedback on whether the proposed standard should continue to permit the use of negative confirmations and, if so, whether to require the auditor to perform other substantive procedures to supplement the use of negative confirmations. The majority of commenters responded that negative confirmations should continue to be permitted. However, several of those commenters also indicated that negative confirmations should not be the sole substantive audit procedure, unless certain conditions were present.

In developing the proposed standard, the Board took into account comments that negative confirmation requests may provide audit evidence in limited circumstances. For example, when performing audit procedures for demand deposit accounts in a financial institution audit, it may be appropriate for an auditor to use negative confirmation requests with copies of the customers' regular account statements attached to the confirmation requests when the risk of material misstatement is low, the auditor reasonably expects a low exception rate, and the auditor reasonably believes that recipients of the negative confirmation requests will give such requests consideration. Negative confirmation requests also might provide some evidence of the existence of confirming parties if the requests are not returned with an indication that the addressees are unknown. In addition, negative confirmation requests might be used effectively in conjunction with positive confirmation requests.

^{46/} AU sec. 330.20 defines negative confirmation as a request for the recipient to respond only if he or she disagrees with the information stated on the request.

^{47/} Ibid.

RELEASE

The absence of a response to a negative confirmation request provides significantly less audit evidence than a response to a positive confirmation request. Therefore, unless the auditor receives a response, the auditor does not know whether the intended confirming party received the confirmation request and verified the accuracy of the information contained in the request. Consequently, the proposed standard states, "the auditor should not use negative confirmation requests as the only form of confirmation request to address the assessed risk of material misstatement at the assertion level unless all of the following factors are present:

- The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the design and operating effectiveness of controls relevant to the assertion;^{48/}
- The population of items subject to negative confirmation procedures is made up of a large number of small, homogeneous account balances, transactions, or other items;
- The auditor reasonably expects a low exception rate; and
- The auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration.

Because negative confirmation requests provide limited audit evidence, even when all of the factors above are present, the auditor should perform other substantive procedures to supplement the use of negative confirmation requests."

In designing the confirmation requests, the auditor may use positive confirmation requests, negative confirmation requests, or a combination of both. A response to a positive confirmation request can provide audit evidence. There is a risk, however, that a confirming party will reply to the confirmation request without verifying that the information is correct. The auditor might reduce this risk by using a positive confirmation request that does not state the balance or amount (or certain other information) on the confirmation request (a "blank confirmation request") and, instead, asks the confirming party to fill in the amount

^{48/} Also see paragraphs 16-17 of PCAOB Proposed Auditing Standard, *The Auditor's Responses to the Risks of Material Misstatement*, for a discussion of tests of controls.

RELEASE

or furnish the other information. Thus, the use of blank confirmation requests might provide a greater degree of assurance about the information confirmed. However, blank forms might result in lower response rates because additional effort is required of the confirming parties.

Question

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

Determining That Confirmation Requests Are Properly Addressed

The existing standard does not include a requirement for the auditor to perform procedures to determine the validity of addresses on confirmation requests. In the Concept Release, the Board asked whether the auditor should be required to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients. Some commenters supported including a requirement to test addresses while other commenters thought the standard should include guidance rather than specific requirements.

The proposed standard requires the auditor to perform procedures to determine the validity of addresses on the confirmation requests, including substantive procedures or tests of controls. The proposed standard further states that "[t]he nature and extent of the procedures depend on the associated risks and materiality of the items being confirmed. For example, the auditor should perform substantive procedures to determine the validity of addresses on the confirmation requests for transactions or accounts that involve significant risks or are material to the financial statements."

The proposed standard provides other factors to consider in determining the nature and extent of procedures to perform to validate addresses on confirmation requests, which include the following:

- The company has a new customer base;
- An address is a post office box; or

RELEASE

- An e-mail address is not consistent with the confirming party's Web site address (e.g., situations in which the e-mail address has a domain name that differs from the domain name of the Web site).

The proposed standard also states that "[i]f the auditor identifies an invalid address, the auditor should perform the following procedures:

- a. Investigate the reasons for the invalid address and attempt to obtain a valid address;
- b. Evaluate the implications of the invalid address on the auditor's planned confirmation procedures and the auditor's assessment of the relevant risks of material misstatement, including fraud risk, and on the nature, timing, and extent of other audit procedures; and
- c. Perform other audit procedures designed to obtain relevant and reliable audit evidence with respect to the account, balance, or other item, if a valid address cannot be obtained for the confirmation request."

Questions

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?
14. Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

Management Requests Not to Confirm

AU sec. 508, *Reports on Audited Financial Statements*, provides that restrictions on the scope of the audit, whether imposed by the client or by circumstances, such as the timing of his or her work, the inability to obtain sufficient competent evidential matter, or an inadequacy in the accounting records, may require the auditor to qualify his or her opinion or to disclaim an

RELEASE

opinion.^{49/} Management requests not to confirm certain accounts, transactions, agreements or other items could be a scope limitation, which is addressed in the auditor's reporting standard.^{50/} In the Concept Release, the Board asked whether a proposed confirmation standard should include procedures for the auditor to perform when management requests the auditor not to confirm certain accounts, transactions, agreements, or other items. The majority of commenters believed that a proposed standard should include specific procedures for the auditor to perform when management makes such a request.

In response to comments received on the Concept Release, the proposed standard states that "[i]f management requests the auditor not to confirm certain accounts, balances, or other items, the auditor should:

- a. Obtain an understanding of management's reasons for the request;
- b. Obtain audit evidence as to the appropriateness of management's reasons for the request; and
- c. Determine whether management's request is appropriate."

For example, management might request the auditor not confirm a specific receivable balance because of litigation between the company and the customer. If the auditor agrees to management's request and does not confirm certain accounts, balances, or other items, the proposed standard requires that the auditor perform the following procedures:

- a. Evaluate the implications of management's request on the auditor's assessment of the relevant risks of material misstatement, including fraud risk, and on the nature, timing, and extent of other audit procedures;
- b. Perform other audit procedures designed to obtain relevant and reliable audit evidence with respect to the accounts, balances, or other items not being confirmed;

^{49/} Paragraph .22 of AU sec. 508, *Reports on Audited Financial Statements*.

^{50/} AU secs. 508.22-.34.

RELEASE

- c. Communicate management's request to the audit committee, or equivalent;
- d. Include management's reason for the request in the management representation letter; and
- e. Evaluate the implications for the audit report.

The proposed standard further indicates that "[i]f the auditor does not agree to management's request and management refuses to authorize the confirmation request, the auditor should communicate management's refusal to the audit committee, or equivalent, and evaluate the implications for the audit report."

Question

- 15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

E. Evaluation

The proposed standard requires the auditor to evaluate the audit evidence obtained from performing confirmation procedures and not rely on the company or any other party for this evaluation. Such evaluation includes:

- a. Performing appropriate alternative procedures for each non-response;
- b. Investigating each exception in confirmation responses;
- c. Assessing the reliability of confirmation responses, including performing additional procedures for electronic confirmation responses;
- d. Considering the effect of disclaimers and restrictive language; and
- e. Evaluating results to determine whether relevant and reliable audit evidence has been obtained.

RELEASE

Non-responses

AU sec. 330 indicates that "[w]hen using confirmation requests other than the negative form, the auditor should generally follow up with a second and sometimes a third request to those parties from whom replies have not been received."^{51/} The proposed standard includes a similar requirement and states that "[w]hen using positive confirmation requests and a response from a confirming party has not been received, the auditor should follow up with a second request and should consider following up with a third request."

AU sec. 330 provides requirements for situations in which the auditor should perform alternative procedures for non-responses to positive confirmation requests, as well as examples of the types of alternative procedures that he or she might perform.^{52/} The existing standard also permits the auditor to omit alternative procedures in limited situations.^{53/}

In the Concept Release, the Board requested feedback on whether the auditor should be required to perform alternative procedures for non-responses to positive confirmation requests. The majority of commenters agreed that a proposed standard should include such a requirement. However, several commenters suggested that the Board also retain the provisions in AU sec. 330 that permit auditors to omit alternative procedures for certain non-responses.^{54/}

The proposed standard requires the auditor to perform appropriate alternative procedures for all non-responses to positive confirmation requests. Such alternative procedures should address the risks for the related assertion(s)

^{51/} AU sec. 330.30.

^{52/} AU secs. 330.31-.32.

^{53/} AU sec. 330.31 states that "omission of alternative procedures may be acceptable (a) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (b) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated."

^{54/} Ibid.

RELEASE

intended to be addressed by the confirmation request. The Board is including the requirement to perform appropriate alternative procedures because a non-response to a positive confirmation request might indicate a previously unidentified risk of material misstatement, including a fraud risk. In such situations, the auditor might need to revise the assessed risk of material misstatement at the assertion level and modify planned audit procedures. The proposed standard does not provide for omitting alternative procedures for non-responses to positive confirmation requests.

The proposed standard requires that the item being confirmed, the account, the assertion in question, and the risk of material misstatement affect the nature of the alternative audit procedures that the auditor should perform for non-responses. For example, when performing confirmation procedures for the existence assertion for receivables that arise from credit sales, loans, or other transactions, the auditor's alternative procedures should include examining one or more of the following: (1) subsequent cash receipts (including matching such receipts with the actual invoices being paid), (2) shipping documents, or (3) other supporting documentation. In addition, if the auditor is confirming the account balance for a receivable, and the account balance is made up of numerous invoices, debit memos, credit memos and other adjustments, the auditor's alternative procedures should include (1) testing subsequent cash receipts or other supporting documentation for the invoices, and (2) testing documentation for the debit memos, credit memos, and other adjustments that make up that account balance. When performing confirmation procedures for the completeness assertion for accounts payable, the auditor's alternative procedures should include examining one or more of the following: (1) subsequent cash disbursements, (2) correspondence from vendors and suppliers, or (3) other documentation or records.

Under the proposed standard, when the auditor performs confirmation procedures for the terms of a transaction or agreement and does not receive a response to such a request, he or she should perform appropriate alternative procedures. The proposed standard also provides examples of such procedures, including inspecting the original signed contract and amendments thereto, comparing contractual terms to industry norms, and confirming or discussing significant information with other parties involved in the transaction or agreement. The proposed standard also indicates that in addition to performing alternative procedures, the auditor should, for significant transactions or agreements, include the terms of the transactions or agreements in the management representation letter and communicate the terms of the transactions or agreements to the audit committee, or equivalent. The auditor also should

RELEASE

consider inquiring of and obtaining written representation from the company personnel involved with the significant transaction or agreement.

Questions

16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?
17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

In certain circumstances, a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. AU sec. 326, *Evidential Matter*, states, "[s]ufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit."^{55/}

The proposed standard includes circumstances that make it necessary for the auditor to receive a response to a positive confirmation request to obtain sufficient appropriate audit evidence. In such circumstances, alternative audit procedures will not provide the audit evidence the auditor requires. The proposed standard lists such circumstances to include the following:

- The information to corroborate management's assertion(s) is available only outside the company.
- Specific fraud risk factors, such as the risk of management override of controls or the risk of collusion, which can involve employee(s),

^{55/} Paragraph .01 of AU sec. 326, *Evidential Matter*. PCAOB Proposed Auditing Standard, *Audit Evidence*, would supersede AU sec. 326 after it is adopted by the Board and approved by the SEC.

RELEASE

management, or outside parties, prevent the auditor from relying on evidence from the company.

If the auditor does not obtain a confirmation response in such circumstances, he or she should determine the implications for the audit and the audit report.

Question

18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

Exceptions

The existing standard provides that the auditor should evaluate the combined evidence provided by confirmation procedures and the alternative procedures.^{56/} In that evaluation, the auditor considers the nature of any exceptions, including the implications, both quantitative and qualitative, of those exceptions.^{57/} In the Concept Release, the Board requested feedback on whether the auditor should be required to investigate exceptions included in confirmation responses. The majority of commenters agreed that a proposed standard should include such a requirement.

The proposed standard defines an exception as "[a] confirmation response that indicates a difference between the information about a particular item for which a confirmation response is requested and the information provided by the confirming party." The proposed standard includes a new requirement for the auditor to investigate all exceptions in confirmation responses to determine why each exception occurred and whether any exceptions, individually or in the aggregate, are indicative of a misstatement or of a previously unidentified risk of material misstatement. An exception might indicate, among other things, a previously unidentified risk of material misstatement due to error or fraud, or deficiencies in the company's internal control over financial reporting. In addition, the proposed standard indicates that "[t]he item being confirmed, the account, the assertion in question, and the risk of material misstatement affect the nature of

^{56/} AU sec. 330.33.

^{57/} Ibid.

RELEASE

the procedures that the auditor should perform to investigate exceptions in confirmation responses."

Question

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

Reliability of Confirmation Responses

The existing standard includes requirements addressing the reliability of the responses to confirmation requests. However, as mentioned previously, there have been significant advances in technology since the existing standard was written. While adding efficiency, some of these electronic methods of communication have added opportunities for skilled individuals to intercept and change confirmation responses before they reach the auditor.

Any confirmation response carries some risk of interception, alteration, or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. In the Concept Release, the Board requested comments on how best to evaluate the reliability of confirmation responses, including when the auditor uses electronic confirmation, direct access, or an intermediary to coordinate and process responses to confirmation requests. Most commenters indicated that additional explanation would be helpful for evaluating the reliability of electronic confirmation. Some commenters referred the Board to AICPA Practice Alert 03-1, *Audit Confirmations*,^{58/} and AU

^{58/} AICPA Practice Alert 03-1, *Audit Confirmations*, includes guidance for auditors on improving confirmation response rates, use of negative versus positive confirmations, non-responses to positive confirmations, responses to positive confirmations indicating exceptions, use of electronic confirmation, confirmations received via facsimile or electronically, management requests not to confirm, alternative procedures, confirmation with respect to specific areas, use of client personnel, and evolving alternatives.

RELEASE

sec. 9330, *The Confirmation Process: Auditing Interpretations of AU section 330*^{59/} that discuss the use of electronic confirmation.

With regard to the auditor's responsibility to evaluate confirmation responses, numerous commenters suggested that the Board consider including requirements when the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request. Those commenters recommended that the proposed standard require the auditor to obtain further audit evidence to resolve doubts about the reliability of confirmation responses, and when a confirmation response is not reliable, to evaluate the implications on the assessment of the relevant risks of material misstatement, including fraud risk, and on the related nature, timing, and extent of other audit procedures.

The requirements in the existing standard to evaluate the reliability of confirmation responses are carried forward in the proposed standard with some modifications. The proposed standard also sets forth factors that the auditor should take into account in assessing the reliability of confirmation responses. These factors include, but are not limited to, whether confirmation responses:

- Are returned to the auditor indirectly because the confirming parties forwarded the confirmation responses to the company.
- Appear not to have come from the original intended confirming parties.
- Contradict other information obtained during the audit.
- Come from addresses other than the addresses to which the auditor sent the confirmation requests.
- Are not the original confirmation requests that were sent to the confirming parties.
- Do not include the signatures of or acknowledgements by the confirming parties.

^{59/} AU sec. 9330, *The Confirmation Process: Auditing Interpretations of AU section 330*, was adopted by the ASB after April 16, 2003; therefore, it is not part of the Board's auditing standards.

RELEASE

- Reflect local customs that may affect the confirmation responses, such as customs that create an environment in which confirmation responses are inherently unreliable.

When evaluating the reliability of the response received from a confirming party, the proposed standard requires the auditor to assess any indication that the confirming party:

- Is not competent, or knowledgeable.
- Has questionable motives.
- Is not objective or free from bias with respect to the company.

The proposed standard provides that circumstances might indicate the need for additional audit evidence to conclude whether the confirmation request is being sent to or received from a confirming party from whom the auditor can expect the response to provide relevant and reliable audit evidence. Such circumstances could include significant, unusual period-end transactions that have a material effect on the financial statements; when management of the company has significant influence over the confirming party; when the confirming party has significant influence over management of the company; when the confirming party is the custodian and servicer of a material amount of the company's assets; or when a confirmation response is from an affiliated party.

The proposed standard further states that "[i]f conditions indicate that a confirmation response might not be reliable, the auditor should obtain additional audit evidence."

Question

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

Additional Procedures for Electronic Confirmation Responses

Confirmation responses involve risks relating to reliability because proof of origin might be difficult to establish, and alterations can be difficult to detect. Confirmation responses received electronically (e.g., by facsimile, e-mail, through

RELEASE

an intermediary, or direct access) might involve additional risks relating to reliability. An electronic confirmation process that creates a secure confirmation environment might mitigate the risks of interception or alteration.^{60/} Consequently, the Board is including requirements with regard to electronic confirmation responses in the proposed standard. These requirements focus the auditor on the basic tenets of maintaining control over the confirmation process and on the reliability of the confirmation responses. In assessing the reliability of the electronic confirmation responses, the proposed standard requires the auditor to take into account risks that:

- The confirmation process might not be secure or might not be properly controlled;
- The information obtained might not be from a proper source; and
- The integrity of the transmission might have been compromised.

The proposed standard requires the auditor to perform procedures to address the risks associated with electronic confirmation responses. Such procedures depend on the form of electronic communication and include the following:

- If information is provided via facsimile response, the auditor should verify the source and contents of the facsimile response by directly contacting the intended confirming party (e.g., by a telephone call to the intended confirming party).
- If information is provided via an e-mail response, the auditor should verify the source and contents of the e-mail response, such as verifying the e-mail address of the intended confirming party or contacting the intended confirming party by telephone.
- If an intermediary is engaged to facilitate confirmation, the auditor should obtain an understanding of the controls over the procedures used by the intermediary to process the confirmation requests and

^{60/} Various means can validate the source and prevent interception or alteration of the electronic information. For example, the use of encryption, electronic digital signatures, and procedures to verify Web site authenticity might improve the security of the electronic confirmation process.

RELEASE

responses. The auditor should perform procedures to determine whether the auditor can use the intermediary's process. For example, the auditor could perform procedures to determine whether the controls are designed and operating effectively. Risks to consider in performing these procedures and making this determination include (1) the process might not be secure or might not be properly controlled, (2) the information obtained might not be from a proper source, and (3) the integrity of the transmission might have been compromised. In addition, the auditor should determine whether the intermediary is authorized to respond on behalf of the intended confirming party.

- If information is provided via direct access, the auditor should evaluate whether direct access is an appropriate means to confirm information about the particular item that is the subject of the confirmation request. Direct access is not an appropriate confirmation procedure in all cases. For example, when confirming revenue agreements, the auditor should evaluate whether the revenue agreements could include terms and oral modifications that would make direct access an inappropriate mechanism for confirmation.

The proposed standard also notes that direct access to information held by a confirming party constitutes a confirmation response only if (1) the auditor's access is provided by the confirming party rather than the company, and (2) the confirming party represents to the auditor, in writing, that (a) it is aware of the auditor's request for and intended use of the information, and (b) the files to be accessed contain information responsive to the auditor's request.

Direct access might pose additional risks because the information might not be in a form that is readily understandable or the Web site might contain disclaimers or restrictions as to use. Accordingly, more experienced engagement team members might need to review the responses provided through direct access. AU sec. 230, *Due Professional Care in the Performance of Work*, states that "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining."^{61/}

^{61/} Paragraph .06 of AU sec. 230, *Due Professional Care in the Performance of Work*.

RELEASE

If access codes or information necessary to access data held by a confirming party are provided to the auditor by management of the company and not by the confirming party, evidence obtained by the auditor from access to such information does not meet the definition of a confirmation response. Rather that information constitutes other audit evidence.

Financial institutions often provide account holders with direct access to their accounts on the financial institutions' systems. These account holders frequently use this direct access to verify account balances, pay their obligations, transfer funds to other accounts, and perform similar transactions. Financial institutions are subject to regulatory oversight and they have a fiduciary responsibility to account holders. Similar direct access to account information might not be as commonplace between companies in other industries and their customers, suppliers, and vendors. In addition, other companies do not have the same responsibilities and obligations to their account holders as financial institutions have. Consequently, the Board is considering whether to limit the use of direct access as a confirmation response to responses received from financial institutions, and the Board has posed question 25 to solicit feedback on this topic.

Auditors are reminded of the audit documentation requirements pursuant to Auditing Standard No. 3. That standard provides that the "[a]udit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review."^{62/}

Consequently, when using an electronic environment, such as direct access, the auditor should include sufficient detail in the audit documentation to demonstrate that the auditor complied with the requirements of the proposed confirmation standard. This includes documentation of the information the auditor received through direct access, such as copies of reports, account statements, or a print screen of the information on the Web site.

^{62/} Paragraph 6 of Auditing Standard No. 3.

RELEASE

Questions

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?
22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?
23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.
24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?
25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

Disclaimers and Restrictive Language

Under the existing standards, "[s]ufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit."^{63/} Through the inspection process, the PCAOB has observed instances in which the auditor did not obtain sufficient competent evidential matter from confirmation responses that included disclaimers as to their accuracy and appropriateness for use in the preparation of financial statements.^{64/} Examples of disclaimers and restrictive language include statements that:

^{63/} AU sec. 326.01.

^{64/} Page 14 of PCAOB Release No. 2008-008, *Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms* (December 5, 2008).

RELEASE

- Information is obtained from electronic data sources, which might not contain all information in the bank's possession.
- Information is not guaranteed to be accurate nor current and might be a matter of opinion.
- The confirming party does not accept any responsibility for errors or omissions.
- Information is furnished as a matter of courtesy without a duty to do so and without responsibility, liability, or warranty, express or implied.
- The confirming party has not sought to verify that the information contained in the attached report is true and complete and hereby expressly disclaims any liability.

In the Concept Release, the Board requested comments on whether a proposed standard should require the auditor to evaluate such disclaimers and restrictive language. Several commenters indicated that the auditor should be required to evaluate disclaimers and restrictive language to determine their effect on audit evidence but that the specific procedures for the auditor to perform should be left to the auditor's judgment. In addition, a number of commenters urged the Board to work with others to address the issue of disclaimers and restrictive language in confirmation responses.

The proposed standard includes a requirement for the auditor to evaluate the effect of disclaimers and restrictive language on the reliability of a confirmation response. The Board agrees with commenters that disclaimers or restrictive language do not invalidate the reliability of the confirmation response as audit evidence in all cases. However, the Board acknowledges that the use of disclaimers and restrictive language has become more prevalent and that it raises issues for auditors regarding their reliance on confirmation responses. Accordingly, the proposed standard also states that "[i]f a disclaimer or restrictive language causes doubts about the reliability of a confirmation response, the auditor should obtain additional appropriate audit evidence." The proposed standard requires that, to the extent that a disclaimer or restrictive language precludes the auditor from treating the response as a confirmation response, the auditor should treat such a response as a non-response and perform appropriate alternative audit procedures to obtain relevant and reliable audit evidence or assess the implications, if any, for the audit report.

RELEASE

Question

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

Evaluating Results

The existing standard includes requirements for evaluating the results of confirmation procedures, including evaluating the combined evidence provided by the confirmations and the alternative procedures to determine whether sufficient evidence has been obtained about all the applicable financial statement assertions.^{65/} The existing standard states, "[i]n performing that evaluation, the auditor should consider (a) the reliability of the confirmations and alternative procedures; (b) the nature of any exceptions, including the implications, both quantitative and qualitative, of those exceptions; (c) the evidence provided by other procedures; and (d) whether additional evidence is needed. If the combined evidence provided by the confirmations, alternative procedures, and other procedures is not sufficient, the auditor should request additional confirmations or extend other tests, such as tests of details or analytical procedures."^{66/}

The proposed standard carries forward, with limited changes, the requirements contained in the existing standard. The proposed standard requires the auditor to evaluate whether the results of the confirmation procedures, including alternative procedures, provide the necessary relevant and reliable audit evidence or whether additional audit evidence is necessary. In performing such evaluation, the auditor should take into account:

- The reliability of the audit evidence obtained from confirmation responses and alternative procedures;
- The nature and extent of non-responses to positive confirmation requests, including the implications of those non-responses; and
- The nature and extent of any exceptions, including the implications of those exceptions.

^{65/} AU sec. 330.33.

^{66/} Ibid.

RELEASE

If the confirmation procedures, including alternative procedures, do not provide the necessary relevant and reliable audit evidence, the auditor should send additional confirmation requests or perform additional tests^{67/} and evaluate the implications, if any, for the audit report.^{68/}

Question

27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

F. Related Amendments to PCAOB Standards

The Board is proposing to amend the existing standards, AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, AU sec. 331, *Inventories*, and AU sec. 333, *Management Representations*. Appendix 2 presents the proposed amendments to these standards.

^{67/} The evaluation requirements in the PCAOB Proposed Auditing Standard, *Evaluating Audit Results*, also apply in addition to these considerations, which are specific to the confirmation process.

^{68/} AU secs. 508.22-.34.

RELEASE

AU sec. 322 states that:

For certain assertions related to less material financial statement amounts where the risk of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is low, the auditor may decide, after considering the circumstances and the results of work (either test of controls or substantive tests) performed by internal auditors on those particular assertions, that audit risk has been reduced to an acceptable level and that testing of the assertions directly by the auditor may not be necessary. Assertions about the existence of cash, prepaid assets, and fixed-asset additions are examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence.^{69/}

The Board is proposing to remove the reference to cash in the last sentence because it is inconsistent with the requirement in the proposed confirmation standard that the auditor perform confirmation procedures for cash with financial institutions.

AU sec. 331 states, "[i]f inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian."^{70/} The proposed amendment to AU sec. 331 states that "[i]f inventories are in the hands of public warehouses or other outside custodians, the auditor should confirm such inventories with the custodians." Because AU sec. 331 requires confirmation of inventories held by public warehouses or other outside custodians, the Board is proposing this amendment to directly state the requirements using terms consistent with PCAOB Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*. AU sec. 331 continues to require the auditor to perform other, more extensive procedures, if such inventories are a significant portion of current or total assets.

AU sec. 333 provides that the auditor should obtain written representations from management for all financial statements and periods covered by the audit report.^{71/} That standard also provides a list of specific

^{69/} AU sec. 322.22.

^{70/} Paragraph .14 of AU sec. 331, *Inventories*.

^{71/} Paragraph .05 of AU sec. 333, *Management Representations*.

RELEASE

representations that should be included as written representations from management.^{72/} The Board is proposing to amend the list of specific representations to include the following requirements from the proposed confirmation standard:

- If management requests the auditor not to confirm certain accounts, balances, or other items, and the auditor agrees to management's request, the reason for management's request.
- If the auditor does not receive a response to a positive confirmation request when confirming the terms of a significant transaction or agreement, the terms of the transaction or agreement.

AU sec. 333 also provides examples of circumstances when an auditor might want to obtain written representation from other individuals. The Board is proposing to add a requirement that when the auditor performs confirmation procedures for the terms of a significant transaction or agreement and the auditor does not receive a response to the confirmation request, the auditor should consider inquiring of, and obtaining written representation from, the company personnel involved with the transaction or agreement.

IV. **Effective Date**

The Board anticipates that the proposed standard would be effective, subject to approval by the SEC, for audits for fiscal years ending on or after December 15, 2011.

V. **Opportunity for Public Comment**

The Board will seek comment on the proposed standard and related amendments for a 60-day period. Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, DC 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 028 on the subject or reference line and should be received by the Board no later than 5:00 PM (EDT) on September 13, 2010.

^{72/} AU sec. 333.06.



PCAOB Release No. 2010-003
July 13, 2010
Page 46

RELEASE

The Board will consider all comments received. Following the close of the comment period, the Board will determine whether to adopt final rules, with or without amendments. Any final rules adopted will be submitted to the SEC for approval. Pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the "Act"), proposed rules of the Board do not take effect unless approved by the SEC. Standards are rules of the Board under the Act.

On the 13th day of July, in the year 2010, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Secretary

Proposed Auditing Standard

Supersedes AU sec. 330, The Confirmation Process

Confirmation

Introduction

1. This standard establishes requirements for the auditor to perform **confirmation**^{1/} procedures with respect to receivables and cash and in response to certain significant risks.^{2/} Additionally, this standard establishes requirements regarding the design and performance of confirmation procedures.

^{1/} Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

^{2/} Paragraph 71 of PCAOB Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, states, "[f]actors that should be evaluated in determining which risks are significant risks include:

- a. Whether the risk is a fraud risk;

Note: A fraud risk is a significant risk.

- b. Whether the risk is related to recent significant economic, accounting, or other developments;
- c. The complexity of transactions;
- d. Whether the risk involves significant transactions with related parties;
- e. The degree of complexity or judgment in the recognition or measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- f. Whether the risk involves significant transactions that are outside the normal course of business for the company, or that otherwise appear to be unusual due to their timing, size, or nature."

2. This standard does not address inquiries regarding litigation, claims, and assessments, which are addressed in AU section ("sec.") 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

Objective

3. The objective of the auditor in designing and performing confirmation procedures is to obtain relevant and reliable audit evidence.

Relationship of Confirmation to the Auditor's Assessment of Audit Risk

4. The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement due to error or fraud for each relevant assertion^{3/} of each significant account and disclosure.^{4/} In designing the audit procedures to be performed, the auditor should obtain more persuasive audit evidence the higher the auditor's assessment of risk.^{5/}

^{3/} Paragraph 11 of PCAOB Proposed Auditing Standard, *Audit Evidence*, states "[i]n representing that the financial statements are presented fairly in conformity with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the recognition, measurement, presentation and disclosure of the various elements of financial statements and related disclosures." Those assertions can be classified into the following categories: existence or occurrence, completeness, valuation or allocation, rights and obligations, and presentation and disclosure. Paragraph 12 of that proposed auditing standard further states, in part, that "[t]he auditor may base his or her work on assertions that differ from those in this standard if the assertions are sufficient for the auditor to identify the types of potential misstatements and to respond appropriately to the risks of material misstatement."

^{4/} Paragraph 8 of PCAOB Proposed Auditing Standard, *The Auditor's Responses to the Risks of Material Misstatement*.

^{5/} Paragraph 9 of PCAOB Proposed Auditing Standard, *The Auditor's Responses to the Risks of Material Misstatement*, includes additional requirements in designing the audit procedures to be performed.

5. The reliability of audit evidence depends on the nature and source of the evidence and the circumstances in which it is obtained.^{6/} Audit evidence in the form of a **confirmation response**, because it is received directly by the auditor from a confirming party, generally is more reliable than audit evidence generated internally by the company or provided directly by the company.

Confirmation of Specific Accounts

6. **Confirmation requests** address one or more of the assertions of specific accounts and disclosures. Confirmation procedures frequently are used in relation to account balances and their constituent parts.^{7/} These procedures also might be used to confirm the terms of the company's agreements or transactions, or to confirm the absence of certain conditions, such as undisclosed side agreements.

7. Confirmation requests do not address all assertions equally well. For example, properly designed confirmation requests can provide audit evidence to aid in assessing the existence and completeness of accounts and transactions included in the financial statements. The effectiveness of confirmation requests in addressing the existence and completeness assertions depends, in part, on whether the auditor selects from an appropriate population for testing. Receivable confirmation requests would likely be more effective for the existence assertion than for the completeness and valuation assertions. Confirmation of goods held on consignment with a consignee would likely be more effective for the existence and the rights and obligations assertions than for the valuation assertion. Thus, when obtaining audit evidence for assertions that are not adequately addressed by confirmation requests, auditors should perform other audit procedures instead of, or to complement, confirmation procedures.

Receivables That Arise from Credit Sales, Loans, or Other Transactions

8. The auditor should perform confirmation procedures^{8/} for receivables that arise from credit sales, loans, or other transactions. These receivables may be in

^{6/} Paragraph 8 of PCAOB Proposed Auditing Standard, *Audit Evidence*.

^{7/} Paragraph 18 of PCAOB Proposed Auditing Standard, *Audit Evidence*.

^{8/} Such procedures might include confirming account balances or components of account balances, such as individual invoices, debit memos, or credit memos.

the form of loans, notes, and other financial instruments and may be originated by the company or purchased from another entity. The auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk,^{9/} when selecting which receivables to confirm.

Cash with Financial Institutions

9. The auditor should perform confirmation procedures for cash with financial institutions. Confirmation procedures with these financial institutions also should include confirming (a) other relationships, such as lines of credit, other indebtedness, compensating balance arrangements, and contingent liabilities, including guarantees, and (b) whether, during the process of completing the confirmation response, any additional information about other deposit or loan accounts has come to the attention of the financial institution. The auditor should obtain an understanding of the company's cash management and treasury function to determine which cash accounts and other relationships with financial institutions to confirm. The auditor also should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk,^{10/} when selecting which cash accounts and other relationships to confirm. The auditor should not base his or her selection of cash accounts to confirm only on the reported balances of the cash accounts. There might be significant activity in, and risks associated with, a cash account that has an immaterial or zero balance. In addition, there might be other relationships with the financial institution, such as a significant unused line of credit.

Significant Risks

10. The auditor should perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures.^{11/} For example, for significant risks related to agreements or transactions for which confirmation procedures adequately address the relevant assertions, the auditor should confirm the

^{9/} Paragraph 56.f. of Proposed Auditing Standard, *Identifying and Assessing Risks of Material Misstatement*, requires the auditor to "[d]etermine whether any of the identified and assessed risks of material misstatement are significant risks."

^{10/} Ibid.

^{11/} This requirement is applicable to significant risks associated with accounts other than receivables and cash, which are addressed in paragraphs 8 and 9 of this standard, respectively.

amounts and terms of such agreements or transactions, including whether there are any undisclosed oral or undisclosed written modifications to those agreements, such as undisclosed side agreements.

Note: Confirmation procedures might not be specifically responsive to every significant risk because confirmation procedures might not adequately address the relevant assertions.

Other Risks

11. Even when a significant risk does not exist for a particular account, balance, transaction, agreement, or other item, the performance of confirmation procedures still might be an appropriate response to obtain audit evidence for certain relevant assertions regarding that particular account, balance, transaction, agreement, or other item.

Confirmation Procedures

12. When using confirmation procedures, the auditor should maintain control over the confirmation process. Maintaining control includes:

- a. Determining the information and selecting the items to include in confirmation requests (paragraphs 13-14);
- b. Selecting the appropriate confirming parties (paragraph 15);
- c. Designing the confirmation requests, including determining the type of confirmation requests to send and determining that confirmation requests are properly addressed (paragraphs 16-20);
- d. Directly sending the confirmation requests, including follow-up requests when applicable, to the confirming parties (paragraph 21); and
- e. Requesting responses directly from the confirming parties (paragraph 22).

Determining the Information and Selecting the Items to Include in Confirmation Requests

13. The auditor should obtain an understanding of the substance of the company's arrangements and transactions with third parties and the nature of the items that make up account balances to determine the appropriate information

and select the items to include in confirmation requests. Even if the company suggests to the auditor what information and items to confirm, the auditor should determine the information and select the items to include in a confirmation request.

14. The auditor should determine the timing of confirmation procedures and whether related audit procedures are properly coordinated to obtain relevant and reliable audit evidence. For example, when an auditor performs confirmation procedures for receivables at an interim date, the auditor should perform sales cutoff testing at the balance sheet date to reduce audit risk to an appropriately low level for the existence and completeness assertions.

Selecting the Appropriate Confirming Parties

15. The auditor should direct the confirmation request to an appropriate confirming party. For example, when confirming a company's oral and written guarantees with a financial institution, the auditor should direct the confirmation request to an official at the financial institution who is responsible for the financial institution's relationship with the company or who is knowledgeable about the transactions or arrangements for which the confirmation response is requested. Even if the company provides the auditor with the name of an appropriate confirming party, the auditor should select the confirming party.

Designing the Confirmation Requests

16. The auditor should design confirmation requests to obtain relevant and reliable audit evidence. Factors to consider when designing confirmation requests include:

- The assertions being addressed.
- The specific risks of material misstatement, including the risk of material misstatement due to fraud ("fraud risk").
- The nature of the information to be confirmed.
- The layout, presentation, and content of the confirmation request.
- Prior experience on the audit engagement or other similar engagements.
- The method of communication, whether it is in paper form or by electronic or other medium.

- The company's authorization to the confirming parties to respond to the auditor.
- Local customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information.

Determining the Type of Confirmation Requests to Send

17. In designing the confirmation requests, the auditor may use **positive confirmation requests**, **negative confirmation requests**, or a combination of both. A positive confirmation request provides audit evidence only when a response is received directly by the auditor from the confirming party. The absence of a response to a negative confirmation request provides significantly less audit evidence than a response to a positive confirmation request. Unless the auditor receives a response, the auditor does not know whether the intended confirming party received the confirmation request and verified the accuracy of the information contained in the request. Therefore, the auditor should not use negative confirmation requests as the only form of confirmation request to address the assessed risk of material misstatement at the assertion level unless all of the following factors are present:

- The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the design and operating effectiveness of controls relevant to the assertion;^{12/}
- The population of items subject to negative confirmation procedures is made up of a large number of small, homogeneous, account balances, transactions, or other items;
- The auditor reasonably expects a low exception rate; and
- The auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration.

Because negative confirmation requests provide limited audit evidence, even when all of the factors above are present, the auditor should perform other substantive procedures to supplement the use of negative confirmation requests.

^{12/} Also see paragraphs 16-17 of PCAOB Proposed Auditing Standard, *The Auditor's Responses to the Risks of Material Misstatement*, for a discussion of tests of controls.

Determining That Confirmation Requests Are Properly Addressed

18. The auditor should design confirmation requests to establish direct communication between the confirming party and the auditor to minimize the possibility that the audit evidence resulting from the confirmation procedures might not be reliable as a result of interception, alteration, or fraud.

19. The auditor should perform procedures to determine the validity of the addresses on the confirmation requests, including substantive procedures or tests of controls. The nature and extent of the procedures depend on the associated risks and materiality of the items being confirmed. For example, the auditor should perform substantive procedures to determine the validity of addresses on the confirmation requests for transactions or accounts that involve significant risks or are material to the financial statements. Other factors to consider in determining the nature and extent of procedures to perform to validate addresses on confirmation requests include the following:

- The company has a new customer base;
- An address is a post office box; or
- An e-mail address is not consistent with the confirming party's Web site address (e.g., situations in which the e-mail address has a domain name that differs from the domain name of the Web site).

20. If the auditor identifies an invalid address, the auditor should perform the following procedures:

- a. Investigate the reasons for the invalid address and attempt to obtain a valid address;
- b. Evaluate the implications of the invalid address on the auditor's planned confirmation procedures and the auditor's assessment of the relevant risks of material misstatement, including fraud risk, and on the nature, timing, and extent of other audit procedures; and
- c. Perform other audit procedures designed to obtain relevant and reliable audit evidence with respect to the account, balance, or other item if a valid address cannot be obtained for the confirmation request.

Directly Sending the Confirmation Requests

21. The auditor should send the confirmation requests directly to the intended confirming parties or intended intermediaries^{13/} and should not permit the company or any other party to send the confirmation requests.

Requesting Responses Directly from the Confirming Parties

22. When performing confirmation procedures, the auditor should request that the confirming parties or intended intermediaries respond directly to the auditor and not to the company or any other party. If a confirming party sends a confirmation response to anyone other than the auditor, the auditor should contact the confirming party and request that the confirming party re-send the response directly to the auditor.

Management Requests Not to Confirm

23. If management requests the auditor not to confirm certain accounts, balances, or other items, the auditor should:

- a. Obtain an understanding of management's reasons for the request;
- b. Obtain audit evidence as to the appropriateness of management's reasons for the request; and
- c. Determine whether management's request is appropriate.

24. If the auditor agrees to management's request and does not confirm certain accounts, balances, or other items, the auditor should perform the following procedures:

- a. Evaluate the implications of management's request on the auditor's assessment of the relevant risks of material misstatement, including fraud risk, and on the nature, timing, and extent of other audit procedures;
- b. Perform other audit procedures to obtain relevant and reliable audit evidence with respect to the accounts, balances, or other items not being confirmed;

^{13/} An intermediary is an entity used by the intended confirming party and the auditor to facilitate confirmation between the confirming party and the auditor.

Note: The auditor should perform procedures to obtain more persuasive audit evidence than he or she would have obtained had there been no response to a confirmation request or had the auditor made a decision not to perform confirmation procedures.

- c. Communicate management's request to the audit committee, or equivalent;
 - d. Include management's reason for the request in the management representation letter; and
 - e. Evaluate the implications for the audit report.^{14/}
25. If the auditor does not agree to management's request and management refuses to authorize the confirmation request, the auditor should communicate management's refusal to the audit committee, or equivalent, and evaluate the implications for the audit report.^{15/}

Evaluation

26. The auditor should evaluate the audit evidence obtained from performing confirmation procedures and should not rely on the company or any other party for this evaluation. Such evaluation includes:
- a. Performing appropriate alternative procedures for each **non-response** (paragraphs 27-29);
 - b. Investigating each **exception** in confirmation responses (paragraph 30);
 - c. Assessing the reliability of confirmation responses, including performing additional procedures for electronic confirmation responses (paragraphs 31-35);
 - d. Considering the effect of disclaimers and restrictive language (paragraphs 36-38); and

^{14/} Management's request might represent a significant client-imposed scope limitation on the audit. See paragraphs .22-.34 of AU sec. 508, *Reports on Audited Financial Statements*.

^{15/} AU secs. 508.22-.34.

- e. Evaluating results to determine whether relevant and reliable audit evidence has been obtained (paragraph 39).

Non-responses

27. When using positive confirmation requests and a response from a confirming party has not been received, the auditor should follow up with a second request and should consider following up with a third request.

28. The auditor should perform appropriate alternative procedures for all non-responses to positive confirmation requests. Such alternative procedures should address the risks for the related assertion(s) intended to be addressed by the confirmation requests. For example, when the auditor performs confirmation procedures for the terms of a transaction or agreement and does not receive a response to the confirmation request, he or she should perform alternative procedures, such as inspecting the original signed contract and amendments thereto, comparing contractual terms to industry norms, and confirming or discussing significant information with other parties involved in the transaction or agreement. In addition to performing alternative procedures, the auditor should, for significant transactions or agreements, include the terms of the transactions or agreements in the management representation letter and communicate the terms of the transactions or agreements to the audit committee, or equivalent. The auditor also should consider inquiring of, and obtaining written representation from, the company personnel involved with the significant transaction or agreement.

Note: The item being confirmed, the account, the assertion in question, and the risk of material misstatement affect the nature of the alternative audit procedures that the auditor should perform. For example, when performing confirmation procedures for the existence assertion for receivables that arise from credit sales, loans, or other transactions, the auditor's alternative procedures should include examining one or more of the following: (1) subsequent cash receipts (including matching such receipts with the actual invoices being paid), (2) shipping documents, or (3) other supporting documentation. In addition, if the auditor is confirming the account balance for a receivable, and the account balance is made up of numerous invoices, debit memos, credit memos and other adjustments, the auditor's alternative procedures should include (1) testing subsequent cash receipts or other supporting documentation for the invoices, and (2) testing documentation for the debit memos, credit memos, and other adjustments that make up that account balance. When performing confirmation procedures

for the completeness assertion for accounts payable, the auditor's alternative procedures should include examining one or more of the following: (1) subsequent cash disbursements, (2) correspondence from vendors and suppliers, or (3) other documentation or records.

When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

29. When a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. Such circumstances include the following:

- The information to corroborate management's assertion(s) is available only outside the company.
- Specific fraud risk factors, such as the risk of management override of controls or the risk of collusion, which can involve employee(s), management, or outside parties, prevent the auditor from relying on evidence from the company.

If the auditor does not obtain a confirmation response in such circumstances, the auditor should determine the implications for the audit and the audit report.^{16/}

Exceptions

30. The auditor should investigate all exceptions in confirmation responses to determine why each exception occurred and whether any exceptions, individually or in the aggregate, are indicative of a misstatement or of a previously unidentified risk of material misstatement.

Note: The item being confirmed, the account, the assertion in question, and the risk of material misstatement affect the nature of the procedures that the auditor should perform to investigate exceptions in confirmation responses.

Reliability of Confirmation Responses

31. The auditor should assess the reliability of confirmation responses. Any confirmation response carries some risk of interception, alteration, or fraud although such risks are mitigated by properly designing confirmation requests

^{16/} Ibid.

and properly performing confirmation procedures. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that the auditor should take into account in assessing the reliability of confirmation responses include, but are not limited to, whether confirmation responses:

- Are returned to the auditor indirectly because the confirming parties forwarded the confirmation responses to the company (paragraph 22).
- Appear not to have come from the originally intended confirming parties.
- Contradict other information obtained during the audit.
- Come from addresses other than the addresses to which the auditor sent the confirmation requests.
- Are not the original confirmation requests that were sent to the confirming parties.
- Do not include the signatures of or acknowledgements by the confirming parties.
- Reflect local customs that may affect the confirmation responses, such as customs that create an environment in which confirmation responses are inherently unreliable.

32. When evaluating the reliability of the response received from a confirming party, the auditor should assess any indication that the confirming party:

- Is not competent, or knowledgeable.
- Has questionable motives.
- Is not objective or free from bias with respect to the company.^{17/}

^{17/} Paragraphs .09-.10 of AU sec. 334, *Related Parties*, provide requirements for examining related-party transactions that have been identified by the auditor.

Note: Circumstances might indicate the need for additional audit evidence to conclude whether the confirmation request is being sent to or received from a confirming party from whom the auditor can expect the response to provide relevant and reliable audit evidence. Such circumstances could include significant, unusual period-end transactions that have a material effect on the financial statements; when management of the company has significant influence over the confirming party; when the confirming party has significant influence over management of the company; when the confirming party is the custodian and servicer of a material amount of the company's assets; or when a confirmation response is from an affiliated party.

33. If conditions indicate that a confirmation response might not be reliable, the auditor should obtain additional audit evidence.

Additional Procedures for Electronic Confirmation Responses

34. As indicated in paragraph 31, any confirmation response involves risks relating to reliability because proof of origin might be difficult to establish and alterations can be difficult to detect. Confirmation responses received electronically (e.g., by facsimile, e-mail, through an intermediary, or **direct access**^{18/}) might involve additional risks relating to reliability. The auditor should assess the reliability of the information obtained through the electronic confirmation response. In assessing the reliability of the confirmation response, the auditor should take into account risks that:

- The confirmation process might not be secure or might not be properly controlled;

^{18/} Auditors might obtain electronic access (e.g., using a Web site link) into a confirming party's (e.g., the company's customer, bank, or other party) electronic records of transactions or balances with the company. For example, a brokerage firm can set up a web portal and grant the auditor a unique ID and password for limited-time access to the company's detailed account statements or information specifically generated for, or made available to, the auditor.

- The information obtained might not be from a proper source; and
- The integrity of the transmission might have been compromised.

35. The auditor should perform procedures to address the risks that electronic confirmation responses might not be reliable. Such procedures depend on the form of electronic communication and include the following:

- If information is provided via facsimile response, the auditor should verify the source and contents of the facsimile response by directly contacting the intended confirming party (e.g., by a telephone call to the intended confirming party).
- If information is provided via an e-mail response, the auditor should verify the source and contents of the e-mail response, such as verifying the e-mail address of the intended confirming party or contacting the intended confirming party by telephone.
- If an intermediary is used to facilitate confirmation, the auditor should obtain an understanding of the controls over the procedures used by the intermediary to process the confirmation requests and responses. The auditor should perform procedures to determine whether the auditor can use the intermediary's process. Risks to consider in performing these procedures and making this determination include (1) the process might not be secure or might not be properly controlled, (2) the information obtained might not be from a proper source, and (3) the integrity of the transmission might have been compromised. In addition, the auditor should determine whether the intermediary is authorized to respond on behalf of the intended confirming party.
- If information is provided via direct access, the auditor should evaluate whether direct access is an appropriate means to confirm information about the particular item that is the subject of the confirmation request. Direct access is not an appropriate confirmation procedure in all cases. For example, when confirming revenue agreements, the auditor should evaluate whether the revenue agreements could include terms and oral modifications that would make direct access an inappropriate mechanism for confirmation.

Note: Direct access to information held by a confirming party constitutes a confirmation response

only if (1) the auditor's access is provided by the confirming party rather than the company, and (2) the confirming party represents to the auditor, in writing, that (a) it is aware of the auditor's request for and intended use of the information, and (b) the files to be accessed contain information responsive to the auditor's request.

Disclaimers and Restrictive Language

36. A response to a confirmation request might contain disclaimers or restrictive language. For example, a response might include a disclaimer as to its accuracy and appropriateness for use in the preparation of financial statements, which has a negative effect on the reliability of the response as audit evidence.

37. The auditor should evaluate the effect of a disclaimer or restrictive language on the reliability of a confirmation response.^{19/} If a disclaimer or restrictive language causes doubts about the reliability of a confirmation response, the auditor should obtain additional appropriate audit evidence.

38. If disclaimers or restrictive language preclude the auditor from treating the response as a confirmation response, the auditor should treat such a response as a non-response and perform appropriate alternative procedures to obtain relevant and reliable audit evidence.

Evaluating Results

39. The auditor should evaluate whether the results of the confirmation procedures, including alternative procedures, provide the necessary relevant and reliable audit evidence or whether additional audit evidence is necessary. In performing such evaluation, the auditor should take into account:

- The reliability of the audit evidence obtained from confirmation responses and alternative procedures;
- The nature and extent of non-responses to positive confirmation requests, including the implications of those non-responses; and

^{19/} Disclaimers and restrictive language could affect the reliability of a confirmation response whether it is in paper form or by electronic or other medium.

- The nature and extent of any exceptions, including the implications of those exceptions.

If the confirmation procedures, including alternative procedures, do not provide the necessary relevant and reliable audit evidence, the auditor should send additional confirmation requests or perform additional tests^{20/} and evaluate the implications, if any, for the audit report.^{21/}

^{20/} The evaluation requirements in the PCAOB Proposed Auditing Standard, *Evaluating Audit Results*, also apply in addition to these requirements, which are specific to the confirmation process.

^{21/} AU secs. 508.22-.34.

APPENDIX A – Definitions

A1. For purposes of this standard, the terms listed below are defined as follows:

A2. Confirmation – The process of obtaining and evaluating a direct communication from a third party in response to a request, either in paper form or by electronic or other medium, for information about a particular item affecting financial statement assertions.

A3. Confirmation request – A request, either in paper form or by electronic or other medium, sent by the auditor to a confirming party requesting information about a particular item affecting financial statement assertions.

A4. Confirmation response – Audit evidence obtained as a direct communication to the auditor from a third party, either in paper form or by electronic or other medium. An oral response to a confirmation request is audit evidence, but it does not meet the definition of a confirmation response.

A5. Direct access – An auditor's electronic access into a confirming party's electronic records of transactions or balances with the company. If access codes or information necessary to access data held by a confirming party are provided to the auditor by management of the company and not by the confirming party, evidence obtained by the auditor from access to such information does not meet the definition of a confirmation response. Rather that information constitutes other audit evidence.

A6. Exception – A confirmation response that indicates a difference between the information about a particular item for which a confirmation response is requested and the information provided by the confirming party.

A7. Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

A8. Non-response – When, after sending a positive confirmation request, a confirmation request is returned undelivered, or the auditor does not receive a full response from the intended confirming party, or direct access to the information. A non-response includes a situation in which the auditor receives correspondence from the intended confirming party indicating that the confirming party is unable or unwilling to respond to the confirmation request. A non-response also includes a situation in which a confirmation response contains a



disclaimer or restrictive language that precludes the auditor from treating the response as a confirmation response.

A9. Positive confirmation request – A request that the confirming party respond directly to the auditor and provide the requested information or indicate whether he or she agrees or disagrees with the information included in the request.

APPENDIX 2

Proposed Amendments to PCAOB Auditing Standards

AU sec. 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements"

Statement on Auditing Standards ("SAS") No. 65, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements – 1991" (AU sec. 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements"), as amended, is amended as follows:

The last sentence of paragraph .22 is replaced with –

Assertions about the existence of prepaid assets and fixed-asset additions are examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence.

AU sec. 331, "Inventories"

SAS No. 43, "Omnibus Statement on Auditing Standards – 1982" (AU sec. 331, "Inventories"), as amended, is amended as follows:

The first sentence of paragraph .14 is replaced with –

If inventories are in the hands of public warehouses or other outside custodians, the auditor should confirm such inventories with the custodians.

AU sec. 333, "Management Representations"

SAS No. 85, "Management Representations" (AU sec. 333, "Management Representations"), as amended, is amended as follows:

In paragraph .06:

- Subparagraph s-1. is added under the heading, *Recognition, Measurement, and Disclosure*:

If management requests the auditor not to confirm certain accounts, balances, or other items, and the auditor agrees to management's request, the reason for management's request.

- Footnote 12A is added at the end of subparagraph s-1. and states:

See paragraph 24.d. of Proposed Auditing Standard, *Confirmation*.

- Subparagraph s-2. is added under the heading, *Recognition, Measurement, and Disclosure*:

If the auditor does not receive a response to a positive confirmation request when confirming the terms of a significant transaction or agreement, the terms of the transaction or agreement.

- Footnote 12B is added at the end of subparagraph s-2. and states:

See paragraph 28 of Proposed Auditing Standard, *Confirmation*.

The first sentence of paragraph .11 is replaced with –

When the auditor performs confirmation procedures for the terms of a significant transaction or agreement and does not receive a response to the confirmation request, the auditor should consider inquiring of, and obtaining written representation from, the company personnel involved with the transaction or agreement. In certain other circumstances, the auditor may want to obtain written representation from other individuals.

RELEASE

APPENDIX 3

Comparison of the Objectives and Requirements of the Proposed Auditing Standard and the Analogous Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board of the American Institute of Certified Public Accountants

Introduction

This appendix discusses certain significant differences between the requirements of the accompanying proposed standard in this release and the analogous standards of the International Auditing and Assurance Standards Board ("IAASB")^{1/} and the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants ("AICPA").^{2/} The comparable IAASB standard is International Standard on Auditing ("ISA") 505, *External Confirmations*. The comparable ASB standard is Proposed Statement on Auditing Standards, *External Confirmations* (the "ASB's proposed SAS").^{3/} This analysis does not cover the application and other explanatory material in ISA 505 or the ASB's proposed SAS.^{4/}

^{1/} International Standard on Auditing ("ISA") 505, *External Confirmations* (April 2009).

^{2/} Proposed Statement on Auditing Standards, *External Confirmations* (the "ASB's proposed SAS") (May 28, 2009).

^{3/} Other proposed or adopted standards of the IAASB and the ASB were considered in this comparison to the extent they include comparable requirements. These include ISA 330, *The Auditor's Responses to Assessed Risks*, and the ASB's Statement on Auditing Standards, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

^{4/} Paragraph A59 of ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, indicates that the application and other explanatory material section of the ISAs "does not in itself impose a requirement," but "is relevant to the proper application of the requirements of an ISA." Paragraph A63 of the ASB's standard, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*, states that although application and other explanatory material "does not in itself impose a

This appendix is provided for informational purposes only. It is not a substitute for the proposed standard itself, which is presented in Appendix 1 of this release.

This analysis does not represent the views of the IAASB and the ASB regarding the interpretation of their standards.

Objective of the Auditor

PCAOB

Under the proposed standard, the objective of the auditor in designing and performing confirmation procedures is to obtain relevant and reliable audit evidence. The Board has proposed that the objective focus the auditor on obtaining relevant and reliable audit evidence from confirmation procedures because confirmation responses might not provide sufficient audit evidence in all cases and might need to be supplemented with other substantive procedures.

IAASB and ASB

ISA 505 and the ASB's proposed SAS include a similar objective for the auditor to design and perform confirmation procedures to obtain relevant and reliable audit evidence.

Confirmation of Specific Accounts

Receivables That Arise from Credit Sales, Loans, or Other Transactions

PCAOB

The proposed standard requires the auditor to perform confirmation procedures for receivables that arise from credit sales, loans, or other transactions. These receivables may be in the form of loans, notes, and other financial instruments and may be originated by the company or purchased from another entity. The proposed standard indicates that the auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which receivables to confirm.

requirement, it is relevant to the proper application of the requirements of an AU section."

The proposed standard does not use the term "accounts receivable" and instead uses "receivables that arise from credit sales, loans, or other transactions" to broaden the requirement to include notes receivable, accounts receivable, purchased loans, lease receivables, and other similar receivables. The Board is retaining the presumption from the existing standard that the auditor confirm receivables, because (1) audit evidence from a third party generally is more reliable than audit evidence generated internally by a company or provided directly by a company, and (2) academic research supports the effectiveness of confirmation procedures in testing the existence of receivables.^{5/} Also, the Board is proposing to broaden the requirement to receivables that arise from credit sales, loans, or other transactions, because confirmation of such receivables can provide audit evidence regarding the occurrence assertion for revenue and potentially address the risk of material misstatement due to fraud relating to revenue recognition.^{6/} In addition, a company might have material receivables that arise from the sale of assets or the sale of a business.

The proposed standard does not carry forward the exceptions for not confirming receivables for several reasons. First, AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*, establishes requirements regarding the auditor's consideration of materiality in planning and performing an audit.^{7/} Auditors should follow that standard when considering materiality. Second, if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness

^{5/} Paul Caster, Randal J. Elder, and Diane J. Janvrin, "A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory* 27, no.2 (November 2008). Also, see Diane Janvrin, Paul Caster, and Randy Elder, "Enforcement Release Evidence on the Audit Confirmation Process: Implications for Standard Setters," *Research in Accounting Regulation* 22 (April 2010).

^{6/} Paragraph .41 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, states, "[m]aterial misstatements due to fraudulent financial reporting often result from an overstatement of revenues... or an understatement of revenues. Therefore, the auditor should ordinarily presume that there is a risk of material misstatement due to fraud relating to revenue recognition."

^{7/} AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*. PCAOB Proposed Auditing Standard, *Consideration of Materiality in Planning and Performing an Audit*, would supersede AU sec. 312 after it is adopted by the Board and approved by the U.S. Securities and Exchange Commission.

of confirmation procedures. For example, it might be ineffective to confirm a particular accounts receivable balance, but it might be effective to confirm individual transactions that make up that accounts receivable balance. In addition, useful information can be obtained from the confirmation responses. Finally, AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, requires the auditor to presume there is a risk of material misstatement due to fraud relating to revenue recognition and receivables often are related to revenue recognition.^{8/}

IAASB and ASB

ISA 505 does not include similar requirements. However, ISA 330, *The Auditor's Responses to Assessed Risks*, states, "[t]he auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures."^{9/} The ASB's proposed SAS includes conforming amendments to Statement on Auditing Standards, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, which include similar language.^{10/} In addition, the ASB's proposed SAS includes conforming amendments to Statement on Auditing Standards, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, which require the auditor to use external confirmation procedures for material accounts receivable, except when one or more of the following is applicable:

- a. External confirmation procedures for accounts receivable would be ineffective.
- b. The auditor's assessed level of risk of material misstatement is low, and the auditor plans to obtain sufficient appropriate audit evidence by performing substantive procedures. In many situations, use of external confirmation procedures for accounts receivable and the performance of other substantive tests are necessary to reduce audit risk to an acceptably low level for the relevant assertions.^{11/}

Additionally, the ASB's proposed SAS includes conforming amendments to the ASB's Statement on Auditing Standards, *Performing Audit Procedures in*

^{8/} AU sec. 316.41.

^{9/} Paragraph 19 of ISA 330.

^{10/} Paragraph A29 of the ASB's proposed SAS.

^{11/} Ibid.

Response to Assessed Risks and Evaluating the Audit Evidence Obtained, which state, "[f]or the purpose of this SAS, *accounts receivable* means

- a. the entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and
- b. a financial institution's loans."^{12/}

Cash with Financial Institutions

PCAOB

The Board is including a requirement in the proposed standard for the auditor to perform confirmation procedures for cash with financial institutions. It further requires that confirmation procedures with these financial institutions should include confirming (a) other relationships, such as lines of credit, other indebtedness, compensating balance arrangements, and contingent liabilities, including guarantees, and (b) whether, during the process of completing the confirmation response, any additional information about other deposit or loan accounts has come to the attention of the financial institution. The proposed standard requires the auditor to obtain an understanding of the company's cash management and treasury function to determine which cash accounts and other relationships with financial institutions to confirm. The auditor also should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which cash accounts and other relationships to confirm. The auditor should not base his or her selection of cash accounts to confirm only on the reported balances of the cash accounts. There might be significant activity in, and risks associated with, a cash account that has an immaterial or zero balance. In addition, there might be other relationships with the financial institution, such as a significant unused line of credit.

The Board is including these requirements because confirmation procedures can provide audit evidence to address the risk of material misstatement due to fraud and because of the importance of cash to a company's liquidity and ongoing operations. The Board also is including these requirements because properly designed confirmation requests can provide audit evidence regarding other relationships with financial institutions, such as lines of credit, other indebtedness, compensating balance arrangements, and contingent liabilities, including guarantees.

^{12/} Ibid.



IAASB and ASB

ISA 505 and the ASB's proposed SAS do not include similar requirements.

Significant Risks

PCAOB

In response to comments on *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (the "Concept Release")^{13/} that the use of confirmation procedures should be a function of the auditor's risk assessment, the Board is including procedures that address the risk of material misstatement due to error or fraud. The proposed standard requires the auditor to perform confirmation procedures in response to significant risks that relate to relevant assertions that can be adequately addressed by confirmation procedures. The proposed standard acknowledges that confirmation procedures might not be specifically responsive to every significant risk because confirmation procedures might not adequately address the relevant financial statement assertions.

The Board also revised the existing requirement regarding confirmation of terms and amounts of agreements to make it consistent with the proposed requirement to perform confirmation procedures in response to significant risks. Therefore, the proposed standard requires that for significant risks related to agreements or transactions for which confirmation procedures adequately address the relevant assertions, the auditor should confirm the amounts and terms of such agreements or transactions, including whether there are any undisclosed oral or undisclosed written modifications to those agreements, such as undisclosed side agreements.

IAASB and ASB

ISA 505 and the ASB's proposed SAS do not include similar requirements.

^{13/} PCAOB Release No. 2009-002, *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*. Comments on the concept release are available on the Board's Web site at <http://pcaobus.org/Rules/Rulemaking/Pages/Docket028.aspx>.

Other Risks

PCAOB

The proposed standard acknowledges that performing confirmation procedures might be an appropriate response to other risks of material misstatement. Even when a significant risk does not exist for a particular account, balance, transaction, agreement, or other item, the performance of confirmation procedures still might be an appropriate response to obtain audit evidence for certain relevant assertions regarding that particular account, balance, transaction, agreement, or other item. The Board is including this to encourage the use of confirmation procedures because audit evidence obtained from a knowledgeable source that is independent of the company generally is more reliable than evidence obtained only from internal company sources.^{14/}

IAASB and ASB

ISA 330, *The Auditor's Responses to Assessed Risks*, states, "[t]he auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures."^{15/} The ASB's proposed SAS states "[t]he auditor should consider whether external confirmation procedures are to be performed as substantive audit procedures."^{16/}

Confirmation Procedures

PCAOB

Consistent with the Board's existing confirmation standard, the proposed standard requires that when using confirmation procedures, the auditor should maintain control over the confirmation process. The proposed standard recognizes that it is important for the auditor to maintain control over the confirmation process, including both confirmation requests and confirmation responses, to minimize the possibility that the results will be biased because of interception and alteration of such confirmation requests or responses. Maintaining control includes:

^{14/} Paragraph 8 of PCAOB Proposed Auditing Standard, *Audit Evidence*

^{15/} Paragraph 19 of ISA 330.

^{16/} Paragraph A29 of the ASB's proposed SAS.

- a. Determining the information and selecting the items to include in confirmation requests;
- b. Selecting the appropriate confirming parties;
- c. Designing the confirmation requests, including determining the type of confirmation requests to send and determining that confirmation requests are properly addressed;
- d. Directly sending the confirmation requests, including follow-up requests when applicable, to the confirming parties; and
- e. Requesting responses directly from the confirming parties.

IAASB and ASB

ISA 505 and the ASB's proposed SAS include similar requirements for maintaining control over confirmation requests but not specifically for maintaining control over confirmation responses.

Determining the Information and Selecting the Items to Include in Confirmation Requests

PCAOB

The proposed standard requires the auditor to obtain an understanding of the substance of the company's arrangements and transactions with third parties and the nature of the items that make up account balances to determine the appropriate information and select the items to include in confirmation requests. In addition, the proposed standard indicates that even if the company suggests to the auditor what information and items to confirm, the auditor should determine the information and select the items to include in a confirmation request. The Board is including the requirement to understand the substance of a company's arrangements and the nature of the items that make up the account balance because they are integral to performing confirmation procedures effectively. The Board also is including the requirement for the auditor to determine the information and items to confirm because it is essential to maintaining control over the confirmation process.

The proposed standard also requires the auditor to determine the timing of confirmation procedures and whether related audit procedures are properly coordinated to obtain relevant and reliable audit evidence. For example, when an auditor performs confirmation procedures for receivables at an interim date, the

auditor should perform sales cutoff testing at the balance sheet date to reduce audit risk to an appropriately low level for the existence and completeness assertions. The Board is including this requirement in the proposed standard because auditors frequently perform confirmation procedures at an interim date. The proposed requirement reminds auditors of the importance of coordinating the timing of audit procedures when confirmation procedures are performed prior to the balance sheet date.

IAASB and ASB

ISA 505 provides that the auditor shall maintain control over external confirmation requests, including determining the information to be confirmed or requested. The ASB's proposed SAS provides that the auditor should maintain control over external confirmation requests by determining the information to be confirmed or requested.

ISA 505 and the ASB's proposed SAS do not include similar requirements with regard to coordinating the timing of audit procedures.

Selecting the Appropriate Confirming Parties

PCAOB

The proposed standard requires the auditor to direct the confirmation request to an appropriate confirming party. In addition, the proposed standard indicates that even if the company provides the auditor with the name of an appropriate confirming party, the auditor should select the confirming party. The Board is including the requirement to direct the confirmation to an appropriate confirming party because it is integral to performing confirmation procedures effectively. The Board also is including the requirement for the auditor to select the confirming party because it is essential to maintaining control over the confirmation process.

IAASB and ASB

ISA 505 and the ASB's proposed SAS require that the auditor maintain control over external confirmation requests, including selecting the appropriate confirming party.

Designing the Confirmation Requests

PCAOB

The proposed standard requires the auditor to design confirmation requests to obtain relevant and reliable audit evidence. Factors to consider when designing confirmation requests include:

- The assertions being addressed.
- The specific risks of material misstatement, including the risk of material misstatement due to fraud ("fraud risk").
- The nature of the information to be confirmed.
- The layout, presentation, and content of the confirmation request.
- Prior experience on the audit engagement or other similar engagements.
- The method of communication, whether it is in paper form or by electronic or other medium.
- The company's authorization to the confirming parties to respond to the auditor.
- Local customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information.

IAASB and ASB

ISA 505 and the ASB's proposed SAS require the auditor to maintain control over external confirmation requests, design the confirmation requests, and determine that requests are properly addressed and contain return information for responses to be sent directly to the auditor.

Determining the Type of Confirmation Requests to Send

PCAOB

In designing confirmation requests, the auditor may use positive confirmation requests, negative confirmation requests, or a combination of both.

The proposed standard continues to permit the use of negative confirmation requests, and includes the requirement that the auditor should not use negative confirmation requests as the only form of confirmation request to address the assessed risk of material misstatement at the assertion level unless all of the following factors are present:

- The auditor has assessed the risk of material misstatement as low and the auditor has obtained sufficient appropriate audit evidence regarding the design and operating effectiveness of controls relevant to the assertion;
- The population of items subject to negative confirmation procedures is made up of a large number of small, homogeneous account balances, transactions, or other items;
- The auditor reasonably expects a low exception rate; and
- The auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration.

Because negative confirmation requests provide limited audit evidence, the Board is including the requirement that the auditor should perform other substantive procedures to supplement the use of negative confirmation requests.

The proposed standard continues to permit the use of negative confirmation requests because (1) negative confirmation requests might provide some evidence of the existence of confirming parties if the requests are not returned with an indication that the addressees are unknown, and (2) negative confirmation requests might be used effectively in conjunction with positive confirmation requests.

IAASB and ASB

ISA 505 and the ASB's proposed SAS permit negative confirmation procedures to be the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level if certain conditions are met. Those conditions are somewhat similar to the factors in the Board's proposed standard. In contrast to the Board's proposed standard, ISA 505 and the ASB's proposed SAS do not require the auditor to perform other substantive procedures to supplement the use of negative confirmation requests.

Determining That Confirmation Requests Are Properly Addressed

PCAOB

As part of designing confirmation requests, the proposed standard includes the requirement for the auditor to determine the validity of the addresses on the confirmation requests as well as requirements for when a confirmation request does not include a valid address. The proposed standard provides that the auditor should perform procedures to determine the validity of the addresses on the confirmation requests, including substantive procedures or tests of controls. The nature and extent of the procedures depend on the associated risks and materiality of the items being confirmed. For example, the auditor should perform substantive procedures to determine the validity of addresses on the confirmation requests for transactions or accounts that involve significant risks or are material to the financial statements. Other factors to consider in determining the nature and extent of procedures to perform to validate addresses on confirmation requests include the following:

- The company has a new customer base;
- An address is a post office box; or
- An e-mail address is not consistent with the confirming party's Web site address (e.g., situations in which the e-mail address has a domain name that differs from the domain name of the Web site).

The proposed standard states that if the auditor identifies an invalid address, the auditor should perform the following procedures:

- a. Investigate the reasons for the invalid address and attempt to obtain a valid address;
- b. Evaluate the implications of the invalid address on the auditor's planned confirmation procedures and the assessment of the relevant risks of material misstatement, including fraud risk, and on the nature, timing, and extent of other audit procedures; and
- c. Perform other audit procedures designed to obtain relevant and reliable audit evidence with respect to the account, balance, or other item if a valid address cannot be obtained for the confirmation request.

IAASB and ASB

ISA 505 and the ASB's proposed SAS similarly require the auditor to determine whether confirmation requests are properly addressed; however, neither standard includes requirements for when an auditor determines that a confirmation request does not include a valid address.

Directly Sending the Confirmation Requests

PCAOB

The proposed standard requires the auditor to send the confirmation requests directly to the intended confirming parties or intended intermediaries^{17/} and does not permit the company or any other party to send the confirmation requests. The Board is including this requirement because it is essential to maintaining control over confirmation requests.

IAASB and ASB

ISA 505 and the ASB's proposed SAS require the auditor to send the requests, including follow-up requests when applicable, to the confirming party.

Requesting Responses Directly from the Confirming Parties

PCAOB

The proposed standard requires the auditor to request that the confirming parties or intended intermediaries respond directly to the auditor and not to the company or any other party. It also states that if a confirming party sends a confirmation response to anyone other than the auditor, the auditor should contact the confirming party and request that the confirming party re-send the response directly to the auditor. The Board is including these requirements because they are essential to maintaining control over confirmation responses.

IAASB and ASB

ISA 505 includes the requirement that confirmation requests contain return information for responses to be sent directly to the auditor. The ASB's proposed

^{17/} An intermediary is an entity used by the intended confirming party and the auditor to facilitate confirmation between the confirming party and the auditor.

SAS includes the requirement that confirmation requests provide for being responded to directly to the auditor. However, ISA 505 and the ASB's proposed SAS do not include a requirement when a confirmation request is sent to someone other than the auditor.

Management Requests Not to Confirm

PCAOB

The Board is including requirements in the proposed standard for when management requests the auditor not to confirm an account, balance, or other item. Consequently, the proposed standard includes the requirement that if management requests that the auditor not confirm certain accounts, balances, or other items, the auditor should:

- a. Obtain an understanding of management's reasons for the request;
- b. Obtain audit evidence as to the appropriateness of management's reasons for the request; and
- c. Determine whether management's request is appropriate.

The proposed standard also requires that if the auditor agrees to management's request and does not confirm certain accounts, balances, or other items, the auditor should perform the following procedures:

- a. Evaluate the implications of management's request on the auditor's assessment of the relevant risks of material misstatement, including fraud risk, and on the nature, timing, and extent of other audit procedures;
- b. Perform other audit procedures designed to obtain relevant and reliable audit evidence with respect to the accounts, balances, or other items not being confirmed;
- c. Communicate management's request to the audit committee, or equivalent;
- d. Include management's reason for the request in the management representation letter; and

- e. Evaluate the implications on the audit report.^{18/}

If the auditor does not agree to management's request and management refuses to authorize the confirmation request, the auditor should communicate management's refusal to the audit committee, or equivalent, and evaluate the implications for the audit report.

The Board is including these requirements in the proposed standard in response to comments the Board received on the Concept Release. In addition, management requests to not confirm certain items impose limitations on the audit, and as a consequence the auditor should evaluate the implications on the audit report.

IAASB and ASB

ISA 505 and the ASB's proposed SAS provide requirements for when management refuses to allow the auditor to send a confirmation request. ISA 505 and the ASB's proposed SAS require the auditor to communicate with those charged with governance only if management's refusal is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative procedures. However, ISA 505 and the ASB's proposed SAS do not include requirements when the auditor agrees to management's request or when the auditor does not agree to management's request and management refuses to sign the confirmation request.

Evaluation

Non-responses

PCAOB

The proposed standard includes a requirement that when using positive confirmation requests and a response from a confirming party has not been received, the auditor should follow up with a second request and should consider following up with a third request.

When the auditor has not received replies to positive confirmation requests, the proposed standard requires the auditor to perform appropriate alternative procedures. Such alternative procedures should be responsive to the

^{18/} Management's request might represent a significant client-imposed scope limitation on the audit. See paragraphs .22-.34 of AU sec. 508, *Reports on Audited Financial Statements*.

risks for the related assertion(s) intended to be addressed by the confirmation request. The proposed standard does not permit omitting alternative procedures for non-responses and requires the auditor to perform alternative procedures for all non-responses.

The proposed standard also provides examples of alternative procedures the auditor should perform for specific situations. For example, when the auditor performs confirmation procedures for the terms of a transaction or agreement and does not receive a response to the confirmation request, he or she should perform alternative procedures, such as inspecting the original signed contract and amendments thereto, comparing contractual terms to industry norms, and confirming or discussing significant information with other parties involved in the transaction or agreement. In addition to performing alternative procedures, the auditor should, for significant transactions or agreements, include the terms of the transactions or agreements in the management representation letter and communicate the terms of the transactions or agreements to the audit committee, or equivalent. The auditor also should consider inquiring of and obtaining written representation from the company personnel involved with the significant transaction or agreement.

The proposed standard requires that the item being confirmed, the account, the assertion in question, and the risk of material misstatement affect the nature of the alternative audit procedures that the auditor should perform. For example, when performing confirmation procedures for the existence assertion for receivables that arise from credit sales, loans, or other transactions, the auditor's alternative procedures should include examining one or more of the following: (1) subsequent cash receipts (including matching such receipts with the actual invoices being paid), (2) shipping documents, or (3) other supporting documentation. In addition, if the auditor is confirming the account balance for a receivable, and the account balance is made up of numerous invoices, debit memos, credit memos and other adjustments, the auditor's alternative procedures should include (1) testing subsequent cash receipts or other supporting documentation for the invoices, and (2) testing documentation for the debit memos, credit memos, and other adjustments that make up that account balance. When performing confirmation procedures for the completeness assertion for accounts payable, the auditor's alternative procedures should include examining one or more of the following: (1) subsequent cash disbursements, (2) correspondence from vendors and suppliers, or (3) other documentation or records.

IAASB and ASB

ISA 505 and the ASB's proposed SAS require the auditor to send the requests, including follow-up requests when applicable, to the confirming party. However, sending follow-up requests is not required by these standards.

ISA 505 and the ASB's proposed SAS include a similar requirement for the auditor to perform alternative procedures when the auditor does not receive replies to positive confirmation requests. Similar to the Board's proposed standard, ISA 505 does not permit omitting alternative procedures for non-responses. However, the ASB's proposed SAS indicates that omission of alternative procedures may be acceptable when testing for overstatement of amounts when (a) the non-responses in the aggregate, projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated, and (b) the auditor has not identified unusual qualitative factors or systematic characteristics related to the non-responses, such as that all non-responses pertain to year-end transactions.

Exceptions

PCAOB

The proposed standard requires the auditor to investigate all exceptions in confirmation responses to determine why each exception occurred and whether any exceptions, individually or in the aggregate, are indicative of a misstatement or a previously unidentified risk of material misstatement. The proposed standard also states that the item being confirmed, the account, the assertion in question, and the risk of material misstatement affect the nature of the procedures that the auditor should perform to investigate exceptions in confirmation responses.

IAASB and ASB

ISA 505 and the ASB's proposed SAS include the requirement for the auditor to investigate exceptions to determine whether or not they are indicative of misstatements.

Reliability of Confirmation Responses

PCAOB

The proposed standard includes the requirement for the auditor to assess the reliability of confirmation responses. The proposed standard also includes factors that the auditor should take into account in assessing the reliability of a response including, but not limited to, whether confirmation responses:

- Are returned to the auditor indirectly because the confirming parties forwarded the confirmation responses to the company.
- Appear not to have come from the originally intended confirming parties.
- Contradict other information obtained during the audit.
- Come from addresses other than the addresses to which the auditor sent the confirmation requests.
- Are not the original confirmation requests that were sent to the confirming parties.
- Do not include the signatures of or acknowledgements by the confirming parties.
- Reflect local customs that may affect the confirmation responses, such as customs that create an environment in which confirmation responses are inherently unreliable.

When evaluating the reliability of the response received from a confirming party, the proposed standard requires the auditor to assess any indication that the confirming party:

- Is not competent, or knowledgeable.
- Has questionable motives.
- Is not objective or free from bias with respect to the company.

The proposed standard also provides that if conditions indicate that a confirmation response might not be reliable, the auditor should obtain additional audit evidence.

The Board is including these requirements in response to comments the Board received on the Concept Release. Numerous commenters recommended that the proposed standard require the auditor to obtain further audit evidence to resolve doubts about the reliability of confirmation responses, and when a confirmation response is not reliable, to evaluate the implications on the assessment of the relevant risks of material misstatement, including fraud risk, and on the related nature, timing, and extent of other audit procedures.

IAASB and ASB

ISA 505 and the ASB's proposed SAS indicate that if the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor is required to obtain further audit evidence to resolve those doubts. In addition, if the auditor determines that a response to a confirmation request is not reliable, the auditor is required to evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. However, ISA 505 and the ASB's proposed SAS do not include factors about the confirming party that the auditor should assess when evaluating the reliability of a confirmation response.

Additional Procedures for Electronic Confirmation Responses

PCAOB

The proposed standard permits confirmation responses received electronically (e.g., by facsimile, e-mail, through an intermediary, or direct access), but it clarifies that such responses, like all confirmation responses, involve risks relating to reliability. The proposed standard requires the auditor to perform additional procedures to address the risks associated with electronic confirmation responses. Such procedures depend on the form of electronic communication and include:

- If information is provided via facsimile response, the auditor should verify the source and contents of the facsimile response by directly contacting the intended confirming party (e.g., by a telephone call to the intended confirming party).

- If information is provided via an e-mail response, the auditor should verify the source and contents of the e-mail response, such as verifying the e-mail address of the intended confirming party or contacting the intended confirming party by telephone.
- If an intermediary is used to facilitate confirmation, the auditor should obtain an understanding of the controls over the procedures used by the intermediary to process the confirmation requests and responses. The auditor should perform procedures to determine whether the auditor can use the intermediary's process. Risks to consider in performing the procedures and making this determination include (1) the process might not be secure or might not be properly controlled, (2) the information obtained might not be from a proper source, and (3) the integrity of the transmission might have been compromised. In addition, the auditor should determine whether the intermediary is authorized to respond on behalf of the intended confirming party.
- If information is provided via direct access, the auditor should evaluate whether direct access is an appropriate means to confirm information about the particular item that is the subject of the confirmation request. Direct access is not an appropriate confirmation procedure in all cases. For example, when confirming revenue agreements, the auditor should evaluate whether the revenue agreements could include terms and oral modifications that would make direct access an inappropriate mechanism for confirmation.

The proposed standard also states that direct access to information held by a confirming party constitutes a confirmation response only if (1) the auditor's access is provided by the confirming party rather than the company, and (2) the confirming party represents to the auditor, in writing, that (a) it is aware of the auditor's request for and intended use of the information, and (b) the files to be accessed contain information responsive to the auditor's request.

The Board is including requirements in the proposed standard relating to electronic confirmation procedures because information received electronically may pose risks relating to reliability because proof of origin might be difficult to establish and alterations can be difficult to detect. Several commenters to the Concept Release also requested additional explanation for evaluating electronic confirmation responses. In addition, the application and other explanatory material of ISA 505 and the ASB's proposed SAS include guidance related to electronic confirmation responses. The Board considered this guidance and,

where appropriate, included it as a requirement in the proposed standard. For example, ISA 505 states that "[i]f a confirming party uses a third party to coordinate and provide responses to confirmation requests, the auditor may perform procedures to address the risks that: (a) The response may not be from the proper source; (b) A respondent may not be authorized to respond; and (c) The integrity of the transmission may have been compromised."^{19/} The Board considers this guidance appropriate and included it as a requirement in the proposed standard.

IAASB and ASB

ISA 505 and the ASB's proposed SAS do not include similar requirements regarding electronic confirmation responses. In addition, neither standard provides requirements as to when direct access meets the definition of a confirmation response. The ASB's proposed SAS defines external confirmation as audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form or by electronic or other medium or through the auditor's direct access to information held by a third party.

Disclaimers and Restrictive Language

PCAOB

Because of deficiencies in auditors' procedures involving disclaimers and restrictive language in confirmation responses, which were noted through the PCAOB's inspection process,^{20/} the Board is providing specific requirements in the proposed standard to address such disclaimers and restrictive language. The proposed standard requires the auditor to evaluate the effect of disclaimers or restrictive language on the reliability of a confirmation response. The proposed standard also requires that if a disclaimer or restrictive language causes doubts about the reliability of a confirmation response, the auditor should obtain additional appropriate evidence. The proposed standard further states that if disclaimers or restrictive language preclude the auditor from treating the response as a confirmation response, the auditor should treat such a response as a non-response and perform appropriate alternative procedures to obtain relevant and reliable audit evidence.

^{19/} Paragraph A13 of ISA 505.

^{20/} Page 14 of PCAOB Release No. 2008-008, *Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms* (December 5, 2008).

The application and other explanatory material of ISA 505 and the ASB's proposed SAS include guidance related to disclaimers and restrictive language in confirmation responses. The Board considered this guidance and, where appropriate, included it as a requirement in the proposed standard. For example, the ASB's proposed SAS states that "[i]f the restrictive language precludes the auditor's use of the information provided therein as audit evidence, the auditor may conclude that it is necessary to treat such a response as a nonresponse."^{21/} The Board considers this guidance appropriate and included it as a requirement in the proposed standard.

IAASB and ASB

ISA 505 and the ASB's proposed SAS do not include similar requirements.

Evaluating Results

PCAOB

The proposed standard provides that the auditor should evaluate whether the results of the confirmation procedures, including alternative procedures, provide the necessary relevant and reliable audit evidence or whether additional audit evidence is necessary. In performing such evaluation, the auditor should take into account:

- The reliability of the audit evidence obtained from confirmation responses and alternative procedures;
- The nature and extent of non-responses to positive confirmation requests, including the implications of those non-responses; and
- The nature and extent of any exceptions, including the implications of those exceptions.

If the confirmation procedures, including alternative procedures, do not provide the necessary relevant and reliable audit evidence, the auditor should send

^{21/} Paragraph A16 of the ASB's proposed SAS.

additional confirmation requests or perform additional tests^{22/} and evaluate the implications, if any, for the audit report.^{23/}

The requirements in the Board's existing confirmation standard related to evaluating the results of confirmation procedures were retained, with limited revisions, in the proposed standard because the requirements were considered to be relevant and appropriate.

IAASB and ASB

ISA 505 and the ASB's proposed SAS require the auditor to evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary.

^{22/} The evaluation requirements in the PCAOB Proposed Auditing Standard, *Evaluating Audit Results*, also apply in addition to these requirements, which are specific to the confirmation process.

^{23/} AU secs. 508.22-.34.



Exhibit 2(a)(D)

Alphabetical List of Commenters on the Proposal in PCAOB Release No. 2022-009
--

1	AllianceBernstein
2	American Accounting Association
3	American Bankers Association
4	Association of College and University Auditors
5	Bansal & Co LLP
6	Chris Barnard
7	BDO USA, LLP
8	CASE Credit Union
9	Center for Audit Quality
10	CFA Institute
11	Michele Eddy Chaisson, CIA, CRMA
12	Circuit
13	Cohen Computer Consulting
14	CohnReznick LLP
15	Council of Institutional Investors
16	Crowe LLP
17	Deloitte & Touche LLP
18	Ernst & Young LLP
19	Denis Gorgemans, CIA
20	Grant Thornton LLP
21	Tim Hungerford
22	ICAEW
23	Illinois CPA Society
24	Institut der Wirtschaftsprüfer

Alphabetical List of Commenters on the Proposal in PCAOB Release No. 2022-009	
25	Johnson Global Accountancy
26	Joshua R. Kirby, CIA
27	KPMG LLP
28	Kristin Kruse
29	MDU Resources Group, Inc.
30	Members of the IAG
31	Midwest BankCentre
32	National Association of State Boards of Accountancy
33	Karen Percent, MHA, CPA, CIA
34	Plante & Moran, PLLC; Plante Moran, P.C.
35	PricewaterhouseCoopers LLP
36	Property & Casualty Insurance Group, USAA
37	QuikTrip Corporation
38	RSM US LLP
39	Paul F. Schneider
40	Texas Society of Certified Public Accountants
41	The Institute of Internal Auditors
42	The Wendy's Company
43	Thomson Reuters Tax & Accounting Professionals
44	U.S. Chamber of Commerce, Center for Capital Markets Competitiveness
45	U.S. Government Accountability Office
46	Virginia Community Colleges – System Office

From: Martorello, Beth-Ann <Bethann.Martorello@alliancebernstein.com>
Sent: Tuesday, February 7, 2023 1:03 PM
To: Comments
Subject: [EXT]: PCAOB Rulemaking Docket Matter No. 028

It is absolutely breathtaking the complete and total lack of understanding of the Internal Audit profession as demonstrated by this proposed standard. It is an absolute insult to every Internal Auditor who are held to the same code of ethics and governance standards as any external auditor. This is further compounded when the PCAOB suggests this sudden change to the confirmation process is necessary “**to make sure that internal auditors don’t manipulate** the confirmation requests before they go out or the responses after they come back. This statement is an outrage and again demonstrates that the PCAOB clearly do not understand the role of internal audit. Given the stunning misunderstanding, let me be clear, Internal Auditors provide independent assessments of the company internal controls systems ability to mitigate risk. To do so, we ensure we are organizationally independent, as well as free from conflict for every audit we undertake. Unlike external auditors who are dependent to stay in the good graces of company executives to keep their contracts and engagements in place. Internal Auditors and External Auditors are bound by the IIA Code of Ethics, and Professional Standards. We take steps to ensure that our auditors are free from conflict. The IIA Code of Ethics, and the Integrity and Objectivity Rules of conduct require that Internal Auditors:

Integrity:

- Shall perform their work with honesty, diligence, and responsibility.
- Shall observe the law and make disclosures expected by the law and the profession.
- Shall not knowingly be a party to any illegal activity or engage in acts that are discreditable to the profession of internal auditing or to the organization.
- Shall respect and contribute to the legitimate and ethical objectives of the organization.

Objectivity:

- Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may conflict with the interests of the organization.
- Shall not accept anything that may impair or be presumed to impair their professional judgment.
- Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

The IIA Standards also mandate Independence and Objectivity:

1100 – INDEPENDENCE AND OBJECTIVITY - The internal audit activity must be independent, and internal auditors must be objective in performing their work.

1110 – ORGANIZATIONAL INDEPENDENCE The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

1110.A1 - The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. The chief audit executive must disclose such interference to the board and discuss the implication.

1111– DIRECT INTERACTION WITH THE BOARD - The chief audit executive must communicate and interact directly with the board.

It also seemingly ignores the fact that Internal Audit Departments are externally reviewed to ensure the departments fulfilled the core tenants of its mission by providing timely, high quality al audits to facilitate firm risk mitigation, regulatory compliance, and operational excellence, with competent, well-credentialed personnel. Internal Audit departments are evaluated and rated pursuant to the IIA QA Evaluations standards and when receiving a Generally Conforms the department has shone that it has appropriate structure, policies, procedures, and processes to comply with the requirements of the individual *Standard* or elements of the Code of Ethics in all material respects. This new proposal renders the Quality Assurance reviews and standards useless by stating that even when a department Generally Conforms it cannot be trusted to uphold the tenant of the Internal Audit Profession. This new proposal also undermines the faith we place in External Auditors by implying they do not possess the skills or ability to assess the internal auditors competence and objectivity. If External Auditors cannot evaluate Internal Auditors, how can we trust them evaluating the reliability and associate risks of using other intermediaries. It is a ridiculous argument External Auditors are to incompetent to assess Internal Audit, a profession they know well, but they are well qualified to evaluate another third party in a profession/industry about which they may know little.

This proposal is insulting to the Internal Audit and External Audit professions. It suggests that Internal Audit is untrustworthy and External Audit is too incompetent to assess the skills and objectivity of Internal Audit. There is no good rationale for this to go forward and frankly the PCAOB should be ashamed of themselves for this proposal and their rationale for it.

Beth-Ann Martorello, CISA, CCSA, CRISC
 SVP/Chief Audit Officer
 Pronouns: she/her/hers
 T +1 212 823 3220 M +1 917 848 4578
bethann.martorello@AllianceBernstein.com



501 Commerce Street, 17th floor
 Nashville, TN 37203
AllianceBernstein.com

[Twitter](#) | [LinkedIn](#) | [YouTube](#) | [Facebook](#)

.....

For further important information about AllianceBernstein please click here
<http://www.alliancebernstein.com/disclaimer/email/disclaimer.html>

Comments by the Ad Hoc Task Force of the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the Proposed Auditing Standard, *The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*

Contributing Committee Member:

Colleen M. Boland (University of Wisconsin – Milwaukee)

Ad hoc Task Force Members:

Paul Caster (Fairfield University)

Randal J. Elder (University of North Carolina at Greensboro)

Diane Janvrin (Iowa State University)

SUMMARY: On December 20, 2022, the Public Company Accounting Oversight Board (PCAOB) issued a request for comment on its proposed auditing standard, *The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*. The proposed auditing standard describes principles-based requirements that apply to paper-based and electronic confirmations; improves integration with risk assessment standards; requires confirmation for cash held by third parties and carries over existing requirements regarding confirming accounts receivable. Further, it considers additional audit procedures when using negative confirmation requests and clarifies certain activities where the auditor should not use an internal auditor to provide direct assistance. The proposed standard is important as the audit confirmation process touches nearly every audit. The comment period ended on February 20, 2023. This commentary summarizes the participating members’ views on the questions posed by the PCAOB.

Note: The views expressed in this letter are those of the participating members of the Committee and do not reflect an official position of the American Accounting Association. The comments do not necessarily reflect the views of every member.

Data Availability: Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards, including questions for respondents, is available at: [PCAOB Proposes New Standard for the Auditor’s Use of Confirmation | PCAOB \(pcaobus.org\)](https://pcaob.org/auditing-standards/auditor-use-of-confirmation)

I. INTRODUCTION

The PCAOB believes that a new audit standard is needed due to the increased use of electronic confirmations, third-party intermediaries, and inspection findings. Further, they assert that the new standard will improve audit quality and investor protection since the audit confirmation process touches nearly every audit. This ad hoc Task Force of the American Accounting Association Audit Section Standards Committee commends the PCAOB (“the Board”) for addressing the use of confirmations, including electronic confirmations, third-party intermediaries, confirmations of other accounts, and special terms.¹ We agree that a new standard is needed to reflect changes in audit technology and to align with the PCAOB risk assessment standards and that the proposed standard significantly improves the confirmation process. In

¹ Throughout our response, we use or adapt certain language from the PCAOB (2022) proposal.

general, we support this principles-based approach that allows for more use of auditor judgment in proposing new standards. We agree with the decision to maintain the presumption that the auditor will request confirmation of accounts receivable and the provision in paragraph .21 and Appendix B that negative confirmations alone do not provide sufficient appropriate evidence.

We understand that a principles-based approach tries not to be overly prescriptive, but we believe auditors would benefit from additional guidance in several areas. Examples of such areas include when the auditor should consider confirming special terms, using confirmations for other accounts (e.g., accounts payable), and evaluating exceptions and nonresponses. We suggest that the PCAOB develop separate guidance on the confirmation process, either in an appendix to the standard or a separate confirmation guide. The following section presents several specific comments or suggestions organized along the lines of the questions posed by the Board in the release of the proposed standard.

II. QUESTION-SPECIFIC COMMENTARY

Question 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?*

Footnote 1 on page 5 of the Release refers to paragraph .08 in AS 1105, *Audit Evidence* that “[e]vidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources.” Although confirmation evidence may be more reliable, it is not truly “independent.” For example, a supplier/customer relationship exists for accounts receivable and payable. Caster, Elder, and Janvrin (2008) find that collusion involving the audit client and the confirming party was the most common challenge in the confirmation process. We believe it is important to acknowledge those business relationships that exist between clients and the confirming parties, avoiding the term “independent.” Potential bias of the confirming party is addressed in paragraph .19 of the proposed standard but there is little guidance on the types of information that would heighten concern about potential bias in the confirming party's response.

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? If so, what type of information would be useful to investors and how might it be provided?*

Investors have many sources of information. Unless confirmations were used to address a risk of material misstatement that rose to the level of a critical audit matter (CAM), it is unclear what potential benefit would accrue by disclosing the use of confirmations.

Question 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 confirmation process? If so, how?*

Paragraph .24 indicates that the auditor or confirming party can engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses.

We note that the proposed standard does not discuss the faster response times when auditors use electronic rather than postal mail transmission. Further, due to technology efficiencies, audit firms may be able to confirm a higher percentage of all cash and/or accounts receivable accounts. We also note that using an intermediary for electronic confirmations may be too expensive for smaller audit firms, thus providing challenges as smaller audit firms attempt to stay competitive with larger firms.

Question 4: *Is the objective of the new proposed standard clear? If not, how should it be clarified?*

While we agree with the commenters on the 2010 proposal that the objective is generic, it is consistent with objectives in other PCAOB auditing standards, and we believe it is sufficiently clear. Because the proposed standard is designed to address all confirmation methods and uses, it is necessary to have a broad objective. We also note that paragraph .06 of the proposed standard provides examples of assertions and the types of confirmations that would be relevant for each assertion.

Question 5: *Does the new proposed standard provide for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard?*

In general, we support the approach to be more principles-based and allow for more use of auditor judgment than to be more rules-based in proposing new standards. However, please see our response to Question 21 as we believe that as a result of the emphasis on cash and accounts receivable confirmations in the proposed standard, auditors may not fully recognize all situations in which confirmations may be appropriate.

Question 6: *Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?*

We do not believe there are additional accounts or financial statement assertions for which confirmation procedures should be required. We note that confirmation for accounts payable should be considered (but not required) when auditors assess controls over the recording of liabilities as ineffective. Further, we recommend considering expanding the examples in paragraph .06 to include inventory held at third-party warehouses and insurance policies under the Existence assertion and investments and insurance policies as examples under the Valuation and Allocation assertion. In the spirit of issuing principles-based standards, we encourage the PCAOB to continue to use examples to aid auditors in considering other accounts to confirm rather than to require confirmation for additional accounts or financial statement assertions.

Question 7: *As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?*

We believe that not including this requirement to send confirmation requests in response to significant risks is appropriate. We understand the intent in the earlier proposed standard to require the use of confirmations to address significant risks because of the perceived high quality of evidence from confirmation. As the Auditing Standards Committee of the Auditing Section of the American Accounting Association (ASC) noted in their comment on the earlier proposal (Elder, Bierstaker, Caster, and Janvrin, 2011), confirmations may not be responsive to every significant risk, and other forms of evidence may be more effective in addressing the significant risk.

We note that a requirement to use confirmations to address significant risks would be inconsistent with paragraph .14 in the current proposed standard that allows the auditor to overcome the presumption to confirm accounts receivable where other substantive audit procedures provide evidence at least as persuasive as that expected to be obtained from confirmation. AS 2301.11 already requires the auditor to perform substantive procedures, including tests of details, that are specifically responsive to the assessed significant risks. Such tests of details could include confirmation procedures based on the auditor's judgment. Further, paragraph .15 in the proposed confirmation standard indicates "For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction."

Question 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?*

We think the proposed standard is sufficiently flexible to accommodate other situations where an auditor may choose to confirm information. Paragraph .06 presents several assertions where a confirmation would provide high quality evidence. As described in paragraph .08, the auditor's responsibilities to understand how the specific asset (transaction) functions are clear.

Question 9: *Are there ways in which the new proposed standard should be changed to further align with the PCAOB's risk assessment standards? If so, how should the new proposed standard be changed?*

We do not believe the proposed standard needs changes to align further with the PCAOB's risk assessment standards. However, in our response to question 20, we discuss the need for more clarity and guidance on confirming unusual transactions and special terms.

Question 10: *Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?*

The proposed standard for confirming cash held by third parties and other financial relationships is sufficiently clear and appropriate.

Question 11: *Are there substantive audit procedures other than confirmation that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash? If so, please describe these procedures.*

We are not aware of other substantive audit procedures that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash.

Question 12: *For other financial relationships with the confirming party, is the requirement in the new proposed standard that the auditor should consider confirmation sufficiently clear and appropriate?*

The proposed standard's requirement to consider other financial relationships with the confirming party is sufficiently clear and appropriate.

Question 13: *Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?*

We believe the standard is sufficiently risk-based concerning selecting which cash accounts and other relationships to confirm. The guidance makes it clear that the auditor needs to consider the significance of the cash balances and the nature of any other relationships with the confirming party.

For example, paragraph .02 states "The objective of the auditor in designing and executing the confirmation process is to obtain relevant and reliable audit evidence about one or more relevant financial statement assertions of a significant account or disclosure." It is clear that the standard does not apply to insignificant accounts.

Paragraph .09 indicates "For cash and cash equivalents held by third parties ("cash"), the auditor should perform confirmation procedures." Considering the objective in paragraph .02, the auditor should know that cash confirmations are not required for insignificant accounts. However, from a risk perspective, insignificant accounts may have attributes that would suggest confirmations are appropriate, as evidenced by the paragraph .10 discussion of the auditor's need to understand the company's cash management and treasury function, arrangements, and transactions with third parties. Paragraph .11 indicates that the auditor should consider sending confirmation requests about other financial relationships and provides examples.

Question 14: *Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?*

The continued requirement to confirm accounts receivable is sufficiently clear and appropriate. See our answer to question 17 regarding other potential approaches to consider.

Question 15: *Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?*

The provisions of the new proposed standard are sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable.

Question 16: *Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?*

The description of accounts receivable is sufficiently clear. We do not believe identifying other types of receivables to be confirmed is necessary.

Question 17: *Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?*

We appreciate that the proposed standard allows auditors flexibility on whether to send accounts receivable confirmations. However, given that confirmations come from a third party, “evidence that is at least as persuasive as performing confirmation procedures” is a high bar to meet. The standard for audit procedures generally is that they provide sufficient appropriate evidence. Combined with the requirement to inform the audit committee if the presumption to confirm accounts receivable has been overcome, this may discourage auditors from using other procedures in place of confirmations, even in cases where the other procedures are considered highly persuasive.

Question 18: *Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?*

As noted in question 17, “evidence that is at least as persuasive as performing confirmation procedures” is a high bar to meet. We believe that the reliability of evidence is the benchmark to measure against confirmation procedures. To overcome that presumption and use other procedures, it would appear that controls should be effective, and there should not be significant risks beyond the assumption that there is a fraud risk related to revenue recognition.

Question 19: *Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor’s determination sufficiently clear and appropriate? Why or why not?*

Unless the auditor determines that specific audit procedures address a risk of material misstatement that rises to the level of a critical audit matter (CAM), we do not believe this information needs to be communicated to the audit committee. While the requirement is “clear,” we do not believe it is “appropriate.”

Question 20: *Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?*

The provision relating to confirming the terms of certain transactions is clear. However, because this provision in paragraph .15 immediately follows the discussion in paragraph .14 about overcoming the presumption to confirm receivables, it could be helpful to clarify that the requirement to confirm certain transactions applies to all unusual transactions, not just transactions involving revenue. It would also be helpful to amend AS 2401 to note this requirement or reference the requirement in AS 2310.

We note that 2401.54 suggests that if there is an identified fraud risk involving revenue recognition, the auditor should consider confirming with customers certain relevant contract terms and the absence of side agreements. However, because there is a presumption of fraud risk for revenue recognition on most engagements, it is unclear when confirmation of special terms should be considered or used. We believe it would be helpful to include special terms with reference to AS 2401 in the proposed standard and distinguish confirmation of special terms from confirmation of unusual transactions.

Question 21: *Is the new proposed standard sufficiently clear that an auditor's use of confirmation is not limited to the circumstances discussed in paragraphs .09 through .15 of the new proposed standard? If not, how should it be clarified?*

We do not believe the standard is clear on the use of confirmation in circumstances other than those discussed in paragraphs .09 through .15 related to cash and accounts receivable. The ability to use confirmations in other circumstances may be inferred from the examples included in paragraph .06. However, the first bullet in paragraph .08 could be expanded to note that the use of confirmations is not limited to the circumstances discussed in paragraphs .09 through .15 and can provide sufficient appropriate evidence to address significant risks of material misstatement for other accounts and assertions.

Question 22: *Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?*

We believe that the provisions of the new proposed standard related to identifying information to confirm is sufficiently clear. However, the information on page 29 of the release indicates that blank forms generally provide more reliable evidence but does not mention the possible negative impact on response rates. Although the research on blank forms is very old, Sauls (1970; 1972) finds that blank forms have significantly lower response rates, and the evidence on effectiveness is mixed (Sauls 1970; Warren 1974).

To our knowledge, blank form confirmations are not commonly used. Auditors often confirm invoices rather than balances (Allen and Elder 2001) and balance and invoice confirmations differ in response rates (Krogstad and Romney 1980; Ashton and Hylas 1981) and effectiveness (Allen and Elder 2001). Discussion of various types of confirmations could be incorporated in a separate confirmation guide.

Question 23: *Are the provisions of the new proposed standard related to identifying confirming parties sufficiently clear and appropriate?*

We believe the provisions of the new standard related to identifying confirming parties are sufficiently clear and appropriate. However, given the rapidly growing practice of using an intermediary to facilitate electronic transmission of confirmation requests and responses (e.g., Caster, Elder, and Janvrin 2021), we believe the PCAOB should consider describing this process in the body of the audit standard rather than in Appendix B.

Question 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?*

We believe that the requirement to send a confirmation request directly to the confirming party and to determine that the request is properly addressed is sufficiently clear and appropriate. We think the requirements in paragraph .19 to consider the potential confirmation party's (i) motivation, ability, or willingness to respond, or (ii) objectivity and freedom from bias with respect to the audited entity to be particularly helpful. However, the standard does not appear to address procedures to verify the recipient's mail or email address. We believe this should be incorporated in the standard with further guidance in a separate confirmation guide.

Question 25: *Are the provisions of the new proposed standard related to the auditor's use of negative confirmation requests sufficiently clear and appropriate?*

Paragraph .21 states "...Therefore, the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence for addressing the risk of material misstatement to a financial statement assertion." Thus paragraph .21 could be interpreted that negative confirmations combined with a substantive analytical procedure would provide sufficient evidence. The examples on page 32 include examples of evidence "(e.g., examining subsequent cash receipts, including comparing the receipts with the amounts of respective invoices being paid, examining shipping documents, examining subsequent cash disbursements, or sending positive confirmation requests)" that clearly indicates the evidence should provide direct evidence on the assertions being tested. We believe that using negative confirmations in conjunction with positive confirmations can be a very effective audit technique, depending on the characteristics of the accounts receivable population. However, more guidance on how to use negative confirmations is needed, perhaps in a separate confirmation guide or in an expanded Appendix B.

We agree with eliminating the requirement that recipients be expected to give confirmations adequate consideration as a requirement for sending negative confirmations. While we also agree it is possible that email confirmations may be more likely to be ignored or caught by a spam filter, we note that technology does allow for the use of read receipts and other methods to determine whether an email was opened and read.

Question 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 account when using an intermediary in the confirmation process?

We believe that additional examples or guidance, in the standard or in a separate confirmation guide, may be appropriate to encourage auditors to consider the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses.

Question 27: *Is the potential interaction between using an intermediary in the new proposed standard and the proposed requirements in QC 1000 related to third-party providers sufficiently clear?*

While the proposed standard is silent on the specific nature of the interaction between the standard and the proposed requirements in QC 1000, the proposed requirements related to third-party providers are sufficiently clear.

Question 28: *Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?*

We believe that the provisions of the new proposed standard related to evaluating the reliability of confirmation responses are sufficiently clear and appropriate.

Question 29: *Are the provisions of the new proposed standard related to confirmation exceptions and nonresponses sufficiently clear and appropriate?*

We believe the provisions on nonresponses are clear and appropriate. While auditors should recognize that exceptions in a sample of accounts receivable should be projected to the population with adequate consideration of sampling risk, we believe it would be helpful to provide a footnote or other reference to AS 2315 in paragraph .27.

A similar concern applies to the note at the bottom of paragraph .31. Existing AS 2310.15 is clear that untested amounts should be projected as 100% misstatements. The existing standard also notes that alternative procedures may not be necessary for all nonresponses. If an accounts receivable balance or individual invoice has been selected for confirmation, we prefer that it be subject to alternative procedures. However, the auditor may not need to perform alternative procedures for the entire balance.

Question 30: *Are the provisions about when the auditor should send a second positive confirmation request sufficiently clear and appropriate? Would this provision be a change from current practice?*

The provisions regarding sending a second positive confirmation request are clear. We defer to practicing auditors as to whether this is a change from current practice.

Question 31: *Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?*

We agree that proposed circumstances under which the auditor would generally be required to perform alternative procedures are sufficiently clear and appropriate. However, see our response to Question 29. We believe further guidance is needed with respect to the note below paragraph .31.c that alternative procedures may not be necessary if the auditor's evaluation of the uncorrected misstatements would not change the outcome of the evaluation.

Question 32: *Are there any additional examples of alternative procedures that we should consider for inclusion as examples in the new proposed standard?*

We are unaware of other alternative procedures that should be included.

Question 33: *Are the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses sufficiently clear and appropriate? If not, what changes should be considered?*

The requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses are sufficiently clear and appropriate. However, we note that specific prohibitions are contrary to the spirit of principles based standards.

Question 34: *Based upon information available, we understand auditors' use of internal audit in a direct assistance capacity to send confirmation requests or receive confirmation responses to be infrequent. Are commenters aware of information to the contrary?*

We believe auditors infrequently use internal audit to send or receive confirmations.

Question 35: *In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?*

While we agree that the potential scope limitation or fraud risk from a request not to confirm is addressed in other PCAOB standards, we believe it is appropriate to provide some guidance in AS 2310 unique to confirmations. For example, the account for which the request not to confirm is made should be included in the auditor's sample (if the request occurs before the sample is selected, the item should be included in the population from which the sample is drawn). At a minimum, since the proposed standard does not address requests not to confirm, it could include a footnote that indicates the auditor should evaluate any requests not to confirm using the guidance in the standards referenced on p. 44-45 of the release.

Question 36: *Based upon information available, we understand management requests not to confirm certain items or accounts to be infrequent. Are commenters aware of information to the contrary? If so, in what circumstances do management requests not to confirm commonly arise in practice?*

We have no current knowledge of the extent of management requests not to confirm. Janvrin, Caster, and Elder (2010) review AAERs involving confirmations from 1982 to 2006. None of the AAERs involve requests not to confirm. Although this does not necessarily indicate that such requests are infrequent, it suggests that they have not been used by management to hide misstated receivables in documented AAER cases.

Question 37: *Are the definitions included in the new proposed standard sufficiently clear and appropriate? If not, what changes should be made to the definitions?*

The definitions included in the new proposed standard are sufficiently clear and appropriate.

Question 38: *Are there other amendments that should be made to the PCAOB's existing standards to conform them with the new proposed standard?*

We are not aware of necessary amendments to the PCAOB's existing standards other than those noted in our other responses. In our response to question 1, we note that we do not believe that AS 1105 should refer to external third party evidence as "independent." Our response to Question 20 suggests an amendment to AS 2401.

Question 39: *We request comment generally on the baseline for evaluating the economic impacts of the new proposed standard. Are there additional data (e.g., data on the use of electronic confirmation, types of accounts confirmed, or confirmation response rates) or academic studies that we should consider?*

We are unaware of additional data that should be considered. However, in our response to Question 22 we note academic literature on response rates by type of confirmation.

Question 40: *We request comment generally on the analysis provided above regarding the need for the new proposed standard. Should we consider any additional arguments, academic studies, or data related to the need for standard setting?*

The Peregrine fraud (Elder, Janvrin, and Caster, 2014) demonstrated a weakness in paper confirmation requests. Using Photoshop, Chairman of the Board Russell Wassendorf Sr., inflated bank statement balances and replaced the bank's address with a post office box number that he controlled. Confirmation requests were sent to the post office box, and he confirmed the inflated balances. The twenty-year fraud unraveled when Peregrine was required to allow the regulator's auditors to use electronic confirmation with the bank through a third-party service provider. Further, Huang and Vasarhelyi (2019) explore how "bots" may be used to increase the efficiency of the electronic confirmation process.

Question 41: *Are there additional potential benefits that should be considered?*

Evolving technology continues to provide potential benefits. For example, some large national and multinational audit firms now use "bots" (programs) to select random samples of accounts receivable to confirm, obtain email addresses from clients' systems, send first and second requests, and compile responses that human auditors evaluate (Huang and Vasarhelyi 2019).

Outside of the software development costs, automating the confirmation procedure reduces time and effort and therefore reduces costs auditors incur when sending confirmation requests. In addition, some CPA firms have established confirmation centers, similar to what financial institutions have done, to centralize all cash confirmation requests made throughout their audit practice. These confirmation specialists are usually college graduates but are not required to be accounting majors. Their remuneration is much lower than audit staff, thus reducing the cost of the cash confirmation procedures.

A possible additional benefit is a deterrent effect the use of confirmations may have on clients' likelihood of creating fictitious accounts. However, we are unaware of any studies that demonstrate that confirmations are a deterrent, and we cannot quantify the extent of any such benefit.

Question 42: *Are there additional potential costs that should be considered? If so, what are they?*

The proposed standard requires the auditor to evaluate the reliability of the confirmation response. Although this requirement does not require authentication, it is unclear how reliability would be established without authentication. Authenticating confirmation replies, particularly when email confirmation requests are sent directly by the auditor, is extremely difficult, and requiring it would add significant expense to the audit. Further, confirmation centers within audit firms require significant resources to establish and centralized confirmation centers are only successful if there is appropriate communication and trust between the local audit office and the confirmation center. Finally, smaller audit firms may not have the appropriate resources to establish a confirmation center, which may provide larger audit firms with economic advantages.

Question 43: *Are there additional academic studies or data related to the potential benefits and costs of the proposed requirements? If so, please provide citations and other reference information for such studies and data.*

We are unaware of additional academic studies or data related to the potential benefits and costs of the proposed requirements other than those noted previously.

Question 44: *We request comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that we should consider? If so, what responses should be considered?*

We are unaware of any unintended consequences.

Question 45: *We request comment generally on the alternative approaches described in this release that we considered but are not proposing. Are any of these approaches, or any other approaches, preferable to the approaches that are being proposed? What reasons support those approaches over the approaches proposed?*

Although we have provided numerous comments on the proposed standard, we do not believe any of the alternative approaches described in the release are preferable to those proposed in the standard.

Question 46: *Are there additional economic impacts or considerations associated with this proposal that should be considered? If so, what are those considerations?*

We are unaware of any additional economic impacts or considerations associated with this proposal at this time.

Question 47: *We request comment generally on the analysis of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?*

The requirement to obtain evidence from a confirming party has existed in the U.S. since 1939 without providing exceptions to organizations based on economic or other considerations. We do not believe the proposed standard imposes new or unusual burdens on EGCs that would justify an exemption from the standard.

Question 48: *How much time following SEC approval would audit firms need to implement the proposed requirements?*

We defer to practicing auditors on this question, but we do not believe that auditors will need significant time to implement the proposed requirements.

Question 49: *Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?*

Similar to our response to Question 48, we defer to practicing auditors on this issue.

III. REFERENCES

- Allen, R., and R. Elder. 2001. An empirical investigation of the effectiveness of balance and invoice confirmations. *Journal of Forensic Accounting* 2: 3–16.
- Ashton, R. and R. Hylas. 1981. A study of the response to balance and invoice confirmation requests. *Journal of Accounting, Auditing and Finance* 4: 325–332.
- Caster, P., R. Elder, and D. Janvrin. 2021. An exploration of bank confirmation process automation: A longitudinal study, *Journal of Information Systems* 35 (3): 1-16.
- Caster, P., R. Elder, and D. Janvrin. 2008. A summary of research and enforcement release evidence on confirmation use and effectiveness. *Auditing: A Journal of Practice & Theory* 27 (2): 253–279.
- Elder, R. J., Bierstaker, J. L., Caster, P., and Janvrin, D. 2011. Comments by the Auditing Standards Committee of the Auditing Section of the American Accounting Association on the PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2010-003, Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards. *Current Issues in Auditing* 5 (1):C28.
- Elder, R. J., D. Janvrin, and P. Caster. 2014. Peregrine - Twenty years of fraudulent cash balances. *Issues in Accounting Education* 29 (2): 337 – 348.
- Huang, F., and M. A. Vasarhelyi. 2019. Applying robotic process automation (RPA) in auditing: A framework. *International Journal of Accounting Information Systems* 35: 100433.
- Janvrin, D., P. Caster, R. J. Elder. 2010. Enforcement release evidence on the audit confirmation process: Implications for standard setters. *Research in Accounting Regulation*. 22: 1-17
- Krogstad, J., and M. Romney. 1980. Accounts receivable confirmation: An alternative approach. *Journal of Accountancy* 149 (February): 68–74.
- Public Company Accounting Oversight Board (PCAOB). 2010. *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*. Washington, DC: PCAOB. Available at: <https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-028-proposed-auditing-standard-related-to-confirmation>
- Public Company Accounting Oversight Board (PCAOB). 2022. *Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*. Washington, DC: PCAOB. Available at: <https://pcaobus.org/about/rules-rulemaking/rulemaking-dockets/docket-028-proposed-auditing-standard-related-to-confirmation>
- Sauls, E. 1970. An experiment on nonsampling errors. *Journal of Accounting Research* (Supplement): 157–171.
- Sauls, E. 1972. Nonsampling errors in accounts receivable confirmation. *The Accounting Review* 47 (January): 109–115.
- Warren, C. 1974. Confirmation informativeness. *Journal of Accounting Research* 12(1): 158–177.



Building Success. Together.

Joshua Stein
Vice President –Accounting and Financial Management
202-663-5318

March 15, 2023

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

Via website submission: comments@pcaobus.org

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

To Whom It May Concern:

The American Bankers Association¹ (ABA) welcomes the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB) Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards (the Proposal). The Proposal seeks to modernize the confirmation process, which is based on standards that took effect in 1992 and adopted as a PCAOB interim standard in 2003 (AS 2310). Currently, third-party confirmation procedures are pervasive both in audits of bank financial statements as well as auditors’ use of confirmations, in which banks are requested to confirm balances of the auditees. We commend the PCAOB for taking steps towards modernizing the confirmation process standards to better reflect the significant advances in technology since the current standard was developed over thirty years ago.

Along with advances in technology have come new risks and opportunities that need further consideration. Specifically, the PCAOB should reconsider the confirmation process in the context of imposter scams such as phishing because fraudsters can use confirmation as a pretext for obtaining financial information. In addition, the procedures will be less effective given industry and government efforts advising customers not to provide financial information in response to unexpected requests.

ABA’s specific comments on the Proposal are as follows:

Direct Solicitation of Financial Information from Consumers Via the Use of Confirmations as Required by the Proposal may be Used to Scam Consumers and are Inconsistent with Government and Banking Industry Efforts to Prevent Scams

In addition to circumstances discussed below when the required use of third-party confirmations are ineffective and outdated, the PCAOB should reconsider confirmation requirements broadly, as they may be used to defraud consumers. For example, fraudsters attempting to perpetuate

¹ The American Bankers Association is the voice of the nation’s \$23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$19.2 trillion in deposits and extend nearly \$12.2 trillion in loans.

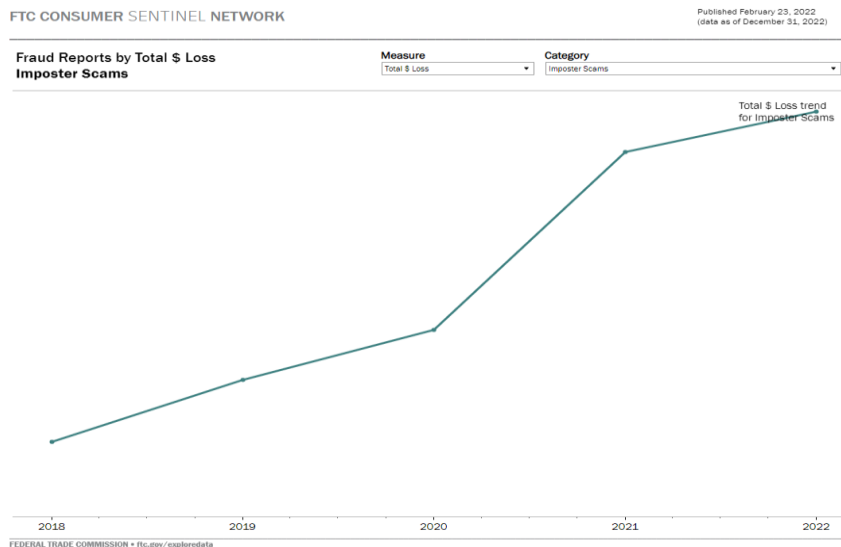
PCAOB Rulemaking Docket Matter No. 028: Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards

March 15, 2023

Page 2

phishing schemes could claim to be independent auditors of the financial institution where the consumer banks and point to PCAOB auditing standards regarding confirmations as their justification for obtaining sensitive financial information. In many cases, the fraudsters can refer the consumer to public records available from trusted sources (for example, the bank’s website or the Securities Exchange Commission) that prove the audit firm they claim to represent is, in fact, the auditor of the bank. To pressure the consumer to provide the information, the fraudster can point to requirements in the Proposal. For example, paragraph 16 of the Proposal,² the fraudster can justify why the consumer must provide the information to the fraudster, rather than merely confirming information the fraudster is providing to the consumer. This simple example demonstrates why the PCAOB should consider these implications in its rulemaking.

Imposter scams where fraudsters disguise themselves as legitimate parties have grown significantly in recent history, as demonstrated by the following chart³ from the Federal Trade Commission (FTC) in which, over the last 5 years, losses reported to the FTC for imposter scams have increased from \$492 million in 2018 to nearly \$2.7 billion in 2022:



Additionally, of the 2.4 million fraud reports submitted to the FTC in 2022, imposter scams were the most common.

One way the banking industry combats these scams is through consumer education, and banks devote significant resources to consumer education in order to protect their customers from scams. Consumer education includes cautions to customers at the time of a transaction and also other communications sent on a periodic basis through various media that they should be careful about divulging financial information. Messages include, for example, warnings describing red flags that identify common and emerging scams and how to avoid them. ABA, on behalf of its

² “Using a blank form confirmation request may provide more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., customer account balance).”

³ The below chart and other data obtained from the FTC’s Sentinel Network a summary of consumer fraud can be found in https://www.ftc.gov/system/files/ftc_gov/pdf/CSN-Data-Book-2022.pdf.

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

March 15, 2023

Page 3

members, also educates consumers about fraud prevention. Below are a few ABA resources available to all banks (including nonmembers) free of charge:

- “Banks Never Ask That”⁴ Campaign. More than 2,000 banks have participated since the campaign began in 2020.
- ABA Foundation's Safe Banking for Seniors program.
- ABA Foundation infographics developed in conjunction with the Federal Trade Commission, including “How to Safely Use Mobile Payment Apps and Services” and “Phishing: Don’t Take the Bait,” which are available to banks and the public.
- Publicly-available information on ABA’s Consumer Resources pages to help people understand how to “Protect Yourself and Your Money.”

Many government agencies also provide consumer education on how to avoid a scam, for example the FTC⁵, Consumer Financial Protection Bureau (CFPB)⁶, and the Federal Deposit Insurance Corporation (FDIC)⁷.

All of these efforts recommend consumers conduct themselves in a manner that would render a confirmation request ineffective. For example, the FTC brochure on “How to Avoid a Scam” includes:

- “Don’t give your personal or financial information in response to a request that you didn’t expect”
- “If you get an email or text message from a company you do business with and you think it’s real, it’s still best not to click on any links. Instead, contact them using a website you know is trustworthy. Or look up their phone number. Don’t call a number they gave you or the number from your caller ID.”⁸

In this example, to complete a confirmation request, consumers must disregard the FTC’s advice not to provide financial information in response to an unexpected request. Consumers who are inclined to verify the validity of the request will normally be unable to do so through the bank’s website or customer service. The PCAOB should consider how to avoid the situation where an auditor is required to solicit information from bank costumers when the banking industry is telling that same customer that such information will never be requested for any legitimate

⁴ “Banks Never Ask That” is an ABA led industry effort to educate bank customers on scams and steps customers should take to protect themselves from scams see more: <https://www.banksneveraskthat.com/>.

⁵ “Pass It On” (<https://consumer.ftc.gov/features/pass-it-on>).

⁶ Resources to help avoid scams <https://www.consumerfinance.gov/coronavirus/avoiding-scams/>.

⁷ Avoiding Scams and Scammers <https://www.fdic.gov/resources/consumers/consumer-news/2021-10.html>.

⁸ “How to Avoid a Scam” is consumer-directed education provided at: <https://consumer.ftc.gov/articles/how-avoid-scam>.

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

March 15, 2023

Page 4

reason. ABA welcomes a meeting with the PCAOB staff to share information and further educate the PCAOB staff on the banking industry efforts to combat scams.

The Use of Third-party Confirmation Continues to Diminish as Technology Advances

Technological innovation has changed the way businesses and consumers supply and consume financial information. This has diminished the use of third-party confirmations as audit evidence. More specifically, these changes have significantly increased the circumstances where alternative procedures may provide equally persuasive evidence in a more efficient manner. For example, the concept of sending a confirmation⁹ request fails to consider the direct, secure and regulated availability of financial information. ABA believes that there are circumstances when obtaining equally persuasive evidence information can be achieved without sending a confirmation request.

To illustrate this point, consider confirming cash with a regulated banking entity. In 2023, regulated banking entities typically provide their customers the ability to directly access bank account information electronically. Audit procedures designed to (1) verify that the information was from the correct external source (via the bank website or portal), (2) observe the client as they access the information at the same time, and (3) direct the auditee to provide the information to the auditor would appear to obtain the same level of audit evidence obtained via confirmation. In fact, this procedure may also be more effective and efficient, as it is performed without incremental participation of an external source.

However, paragraph 8 of the Proposal precludes this procedure and requires the auditor to send a third-party confirmation request. ABA recommends that the final standard allow the auditor to exercise appropriate judgment in assessing the persuasiveness of audit evidence under either circumstance and where available and how a standard can withstand future innovations that will make financial information from external knowledgeable sources more accessible.

The Proposal Further Limits the Use of Alternative Procedures as the Use of Confirmation is Becoming Less Effective

The increased incremental effort for a confirming party to identify, consider, and complete a confirmation request has reduced the effectiveness of the use of confirmations in many circumstances. In other words, history has demonstrated that the percentage of confirmations that are returned continues to decline and are already at rates that do not provide efficient audit evidence. However, the Proposal removes the guidance in AS 2310 paragraph 34 that allows the auditor to exercise professional judgment when determining that the use of confirmations would be ineffective. The Proposal also changes how the presumption of the use of third-party confirmation is overcome. Under AS 2310, if an auditor determines that the combination of inherent risk, control risk and alternate audit procedures reduce the audit risk to an acceptably low level, then the reliance on third-party confirmation can be reduced. However, the threshold

⁹ The Proposal requires the auditor to direct (send) a confirmation to the confirming party (paragraph .18) and for the auditor to maintain control of the confirmation through the process (paragraphs .22-.24).

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

March 15, 2023

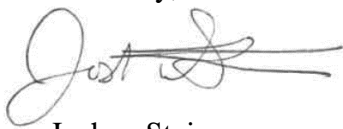
Page 5

to overcome the rebuttable presumption¹⁰ in the Proposal is more restrictive compared to AS2310.

The Proposal also adds a requirement to communicate those instances to the Audit Committee. Based on these changes the Proposal will require expanded use of confirmations even when the auditor is aware that the use of confirmations will be ineffective. The ABA believes that any presumption that confirmations are necessary is outdated and the PCAOB should amend the Proposal to eliminate paragraphs 9, 12, and 14.

In summary, the PCAOB efforts to modernize the confirmation process should go beyond the current efforts to update the current framework and include the broader considerations surrounding the impact of the use of confirmations¹¹ and other current and future procedures that can effectively provide the necessary audit evidence. We will contact the PCAOB staff to establish a meeting date on these important issues. Thank you for considering our comments. If you need additional information or have questions, please contact me (jstein@aba.com; 202-663-5318).

Sincerely,

A handwritten signature in black ink, appearing to read "Joshua Stein", with a stylized flourish extending to the right.

Joshua Stein

¹⁰ Paragraph 14 of the Proposal states the threshold as “performing other substantive procedures (without using confirmation) would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures.”

¹¹ Including those highlighted in this letter regarding consumer protection and the Proposal’s direct conflict with consumer education efforts.



1120 20th Street, NW
 Suite 750
 Washington, DC 20036
 email: info@acua.org
 Phone: (202) 449-1090
 Website: www.acua.org

2/20/2023

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

Re: IIA Comments Regarding PCAOB Rulemaking Docket Matter No. 028

Dear Chair Williams and PCAOB Members DesParte, Ho, Stein, and Thompson:

On behalf of the Association of College & University Auditors (ACUA), a professional association representing over 2,000 college and university auditors in the U.S. and abroad, I appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard, "[The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards.](#)"

While the proposed policy change does not apply to the not-for-profit public and private higher education institutions served by ACUA, the proposed language by the PCAOB represents a concerning shift in the PCAOB's attitude toward professional internal auditors and the important relationship between internal and external audit providers.

More specifically, Section III(I) of the PCAOB proposal states:

Involving internal auditors or other company employees in these activities [confirmation process] would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered.

Then, upon publication of the proposed auditing standard, PCAOB officials indicated in a Wall Street Journal article, "The goal is to make sure that internal auditors don't manipulate the confirmation requests before they go out or the responses after they come back."

Both the language in the PCAOB proposal and the PCAOB's comments to the *Wall Street Journal* are offensive to our members and mislead the public about the nature of work performed by internal auditors. The wholesale characterization of internal auditors as people who would "manipulate," inappropriately "intercept," or "alter" documentation to the false benefit of their employers demonstrates a surprising – and frankly disappointing – lack of comprehension by the PCAOB of the internal audit profession.

Just as PCAOB sets auditing standards to ensure consistency and quality of audit work for its constituents, so does the internal audit profession. The Institute of Internal Auditors (IIA) promulgates the International Professional Practices Framework (IPPF), which contains Core Principles, a Code of Ethics, and *International Standards for the Professional Practice of Internal Auditing (Standards.)* For some 230,000 internal auditors around the world, the IPPF, Code of Ethics and *Standards* represent the primary authoritative guidance.

ACUA CORE VALUES

INTEGRITY □ OPEN SHARING OF KNOWLEDGE □ MUTUAL TRUST & FRIENDSHIP □ RESPECT □ COMMITMENT TO EXCELLENCE □ INNOVATION

To conform with the IIA *Standards* defining independence, internal auditors should possess the same independent reporting relationship as external auditors – a direct line to an organization’s board of directors and/or audit committee. In accordance with the *Standards*, internal auditors should provide objective assurance that is independent from organizational management.

The *Standards* also require internal auditors to exercise proficiency and due professional care in the conduct of their responsibilities, just as external auditors must do. In fact, all internal auditors operating in accordance with the *Standards* are required to obtain continuing education annually, regardless of certification status.

Prior to this new proposal, the PCAOB’s standard for evaluating internal auditors has been Accounting Standard 2605 (AS 2605) entitled, “[Consideration of the Internal Audit Function](#).” In that standard, the PCAOB specifically acknowledges that “**internal auditors maintain objectivity** with respect to the activity being audited.” AS 2605 further states that when internal auditors provide direct assistance to external auditors, the external auditor should assess the **internal auditors’ competence and objectivity** and supervise, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances.

The PCAOB’s new proposal is a radical departure from AS 2605, implying that internal auditors are not to be considered trustworthy under any circumstances. This position disregards the long history of collaboration and cooperation between external and internal auditors, effectively asserting that NO assessment of competence and objectivity can possibly permit internal auditors to assist external auditors in certain facets of the confirmation process.

ACUA respectfully requests the PCAOB to retain AS 2605 as the standard for defining how external auditors and internal auditors can collaborate in certain aspects of work, retaining the external auditor’s current duties of accountability and due diligence in ensuring the integrity, thoroughness, accuracy, and custody safeguards of the confirmation process.

To be clear, ACUA’s concerns and those of the internal audit profession as a whole are not about confirmations. The concerns are that the PCAOB’s proposal and comments impugn the integrity of the entire internal audit profession and its 230,000 members, including ACUA’s.

I thank you for consideration of ACUA’s views on PCAOB’s proposal.

Sincerely,

DocuSigned by:

6928160C224249C...

Melissa B. Hall, CPA, CFE, CCEP
President
Association of College and University Auditors

From: Surinder Bansal <Skb@bansalco.com>
Sent: Wednesday, February 15, 2023 7:43 AM
To: Comments
Cc: Surinder Bansal
Subject: [EXT]: Comment on PCAOB release no. 2022-009 Dec 20,2022

Comment on Proposed auditing standard- The auditor's use of confirmation, and other proposed Amendments to PCAOB Standards.

PCAOB Released no. 2022-009

Dec 20, 2022

PCAOB Rulemaking

Docket Matter No. 028

To the Secretary,

The new proposed standard, AS 2310 has largely considered the required amendments.

The aspects of the confirmation of recoverable and the difficulty faced by the auditors in auditor's use of confirmation has been describe in generic to the confirmation from the related parties. The confirmation process and receiving of the confirmation from related party is required to be detailed in the exposure draft.

Related parties are not defined in detail, with regard to the relationship of the person having substantial interest in the ownership or in the management of the company (reporting entity) whose financial statements are being audited. As per the accounting standard, related party is a person or entity that is related to the entity preparing the financial statement (reporting entity). A person or a closed member of the person's family is specified as a related party. ASC 850 covers transaction and relationship with the related party and it applies to all the entities.

1. The related party includes, affiliates of the entity, entities for which investments in their securities would be required, absent the election of the fair value options. The trust benefits, principles owners, management of entities and members of their immediate family and the parties that can significantly influence the other to an extend that one or more of their transacting parties might be prevented from fully pursuing its own separate investment. Immediate family is limited to the spouse, parents, stepparents, foster parents, father-in-law, mother-in-law, children, step children, foster children, son-in-law, daughter-in-law, grandparents, grand-children, brothers, sisters, aunts, uncles,

niece, nephew, first cousin (children of the aunt or uncle) is a long list of related parties. Keeping in view related party definition beside the immediate family there is other factor of control and management and ownership. As such there is no rules and regulations addressing related parties that have been issued by the SEC impact ASC definition of related party. Auditors are to rely upon the declaration given by the persons or directors of their interest in the parties who are related to them. There are transaction which has been taking place among the related parties though not considered by the auditor management as related parties and there is no evidence with the auditor's regarding the related parties other than the declaration given by the person interested.

2. In such cases the recoverable or payable amount towards related party stands outstanding (sometime for a period more than they become bad for non-payable) and thus, such transaction have a significant impact on the financial statements and sometime the risk assessment for not being fully known resulting to auditor's response to risk of material misstatements. Keeping on view above the standards requires to specify and simplify the related parties transaction.

Regards,

Surinder K Bansal

Chartered Accountant

Bansal & Co LLP

A6, Maharani Bagh,

New Delhi

Please note that the comments expressed herein are solely my personal views

Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803
United States
www.pcaobus.org

Chris Barnard
Actuary

13 February 2023

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

Dear Sir.

Thank you for giving us the opportunity to comment on your Proposed Auditing Standard relating to The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards.

You are currently proposing to replace your auditing standard relating to an auditor’s use of confirmation, AS 2310, The Confirmation Process, with a new proposed standard, AS 2310, The Auditor’s Use of Confirmation, and to make conforming amendments to certain related PCAOB auditing standards. This proposing release follows a previous public comment period on amendments that were proposed in a 2010 PCAOB release. The new proposed standard is designed to improve the quality of audits when confirmation is used by the auditor and to reflect changes in the means of communication and in business practice since the standard was originally issued.

I support these proposed changes, which will improve the consistency and effectiveness of the confirmation process and enhance audit quality. This should lead to more reliable audits and financial reporting, which will increase market certainty and promote confidence in financial markets.

Regarding the audit committee, I support that in principle, communications between the auditors and the audit committee should always encompass the following:

- any outstanding matters of material significance, including misstatements
- suspected bias in critical accounting estimates, and significant sensitivities thereon

Please note that the comments expressed herein are solely my personal views

- disagreements with management
- any judged shortfalls in processes or personnel in critical functions including governance, compliance, internal audit, risk management and legal, whether currently material or not
- any other matters of relevance

All such communications should preferably be in writing in my view. Therefore in answer to your question 19, the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination is sufficiently clear and appropriate.

Yours faithfully

C.R.B.

Chris Barnard



Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

330 North Wabash, Suite 3200
Chicago, IL 60611

February 20, 2023

Via E-mail: comments@pcaobus.org

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

Re: PCAOB Rulemaking Docket Matter No. 028

Dear Office of the Secretary:

BDO USA, LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB” or the “Board”) Proposed Auditing Standard - *The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards* (the “Release”). We support the PCAOB’s efforts to modernize and improve the quality of audits when confirmation is used by the auditor and to reflect changes in the means of communication and in business practice since the standard was originally issued.

We are supportive of the proposed standard and its approach to integrate with the PCAOB’s risk assessment standards. Furthermore, the modernization of the standard to align with all methods of confirmation is appropriate given the current environment and leaves enough judgment-based application for further advances in technology and approach.

Our comments below align with the Key Provisions of the New Proposed Standard on pages 4 and 5 of the Release, as well as other matters noted in our consideration of the proposal.

Use of Negative Confirmation Requests

We agree with the clarification regarding the use of negative confirmation requests. The addition of the proposed Appendix B which provides examples of those situations where the use of negative confirmation requests in combination with the performance of other substantive audit procedures may provide sufficient appropriate audit evidence will assist auditors in applying this requirement.

Identification of Situations in which Alternative Procedures Should be Performed

We agree with the situations discussed regarding the use of alternative procedures. However, in regard to the Note at the bottom of paragraph .31, the wording of the Note could be confusing. The language used on page 41 of the Release is clearer, where it states: “*performing alternative procedures may not be necessary where items selected for confirmation for which the auditor was not able to complete audit procedures would not - if misstated - change the outcome of the auditor’s evaluation of the effect of*



Office of the Secretary
Public Company Accounting Oversight Board
Page 2 of 3

uncorrected misstatements performed in accordance with AS 2810.17.” We recommend using the language from the Release.

Clarification of Activities for which the Auditor May Not Use Internal Auditors

AS 2605, *The Auditor’s Consideration of the Internal Audit Function*, allows internal audit to perform tests of controls or substantive tests and requires the auditor to supervise, review, evaluate, and test the work performed by internal audit. We agree with the intent of the new standard to ensure the auditor maintains control over the confirmation process.

Other Matters

Designing Confirmation Request

We agree with the standard’s approach to an agnostic form of confirmation (paper or electronic). The inclusion of factors the auditor may consider in assessing the reliability and accuracy of the addressed confirming party, especially as it relates to electronic confirmations (i.e. how might an auditor ensure the noted email address is appropriate prior to sending the confirmation) would further promote consistent quality in auditor’s addressing this critical factor of a confirmation.

Use of Intermediaries

We agree with 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. While we appreciate that the proposed standard provides for flexibility and auditor judgment in obtaining an understanding of the intermediary’s controls that address the risk of interception and alteration of the confirmation requests and responses, and determining that the relevant controls used by the intermediary are designed and operating effectively, we recommend providing additional application guidance or examples of how these requirements would be applied in practice under different facts and circumstances. Specifically, we recommend providing additional examples within proposed Appendix B (paragraph .B2) of the type of procedures that the auditor could perform to meet these objectives, including those listed on pages 35 and 36 of the Release, which notes that the auditor could: (i) use, where available, an independent service auditor’s report on service organization controls that evaluates the design and operating effectiveness of the relevant controls at the intermediary; or (ii) test the intermediary’s controls that address the risk of interception and alteration directly; and that the auditor’s evaluation of the intermediary’s controls could be performed by an engagement team, an audit firm’s national office, or combination of both.

Additionally, we believe it would also be helpful if the term ‘intermediary’ was clarified and included in Appendix A Definitions. For example, certain financial institutions have their own confirmation process which may require that an entity initiates that process. In



Office of the Secretary
Public Company Accounting Oversight Board
Page 3 of 3

such a case, or similar situations, a framework to understand whether requirements instituted by the confirming party would make them an intermediary would be helpful.

Other Persuasive Evidence

We believe that the use of the term “as persuasive as” in paragraph .14 with regards to evidence obtained from other substantive procedures is not consistent with a risk-based approach. As stated on page 54 of the Release it is presumed that confirmations are “among the most persuasive forms of audit evidence.” By requiring that the evidence needed is as robust as that which a positive confirmation provides insinuates that all these accounts are of greater inherent risk. As such, the professional judgement used to obtain evidence that meets the level of persuasion needed in response to the auditors’ assessment of the risk of material misstatement is rendered obsolete.

Proposed Effective Date

We believe that an effective date for audits of fiscal years beginning on or after December 15, 2024 would allow for an effective implementation. This proposal has both methodology and operational implications that begin in the planning stages of the audit. This will necessitate updates to firm materials and other support prior to the beginning of the audit cycle.

* * * *

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Ashwin Chandran at 214-689-5667 (achandran@bdo.com), or James D’Arcangelo at 203-905-6234 (jdarcangelo@bdo.com).

Very truly yours,

BDO USA, LLP

BDO USA, LLP



February 16, 2023

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

RE: CASE Credit Union Comments Regarding PCAOB Rulemaking Docket Matter No. 028

Dear Chair Williams and PCAOB Members DesParte, Ho, Stein, and Thompson:

On behalf of CASE Credit Union, a Community Development Credit Union that serves over 45,000 members, operates five branches throughout the Greater Lansing area, and controls over \$400 million in assets, we appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard, "The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards."

Section III(I) of the PCAOB proposal states:

Involving internal auditors or other company employees in these activities [confirmation process] would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered.

Upon publication of the proposed auditing standard, PCAOB officials indicated in a Wall Street Journal article, "The goal is to make sure that internal auditors don't manipulate the confirmation requests before they go out or the responses after they come back."

CASE Credit Union is concerned about and objects to this proposed change in PCAOB standards which is presented without any explanation or evidence for the need for such a change. In addition, we are deeply concerned by the PCAOB's characterization of internal auditors – both in the release and in comments made by PCAOB staff to the press – which imply that internal auditors are untrustworthy or incapable of exhibiting due care in the performance of their duties.

Internal auditors pride themselves on their commitment to providing objective assurance, independent from management, in accordance with the globally recognized International Standards for Professional Practice of Internal Auditing (Standards) and the requirements of the IIA's Code of Ethics. Adherence to the mandatory principles-based IIA Standards promotes a sound ethical culture and establishes the basis for relying upon the work and judgment of internal audit professionals. The Standards, coupled with the Code of Ethics, creates a process for evaluating the performance and efficacy of internal audit services.



It is also important to note that internal auditors and external auditors possess the same independent reporting relationship to an organization's audit committee. Both internal auditors and external auditors also have an obligation to exercise due care in the handling of all information.

Further, Accounting Standard 2605 (AS 2605) entitled, "Consideration of the Internal Audit Function," unequivocally grants external auditors the authority to utilize an internal audit function, as needed, to provide direct assistance during an audit. When direct assistance is provided, the auditor should assess the internal auditors' competence and objectivity. However, PCAOB's new proposal seemingly implies no assessment of competence and objectivity can possibly permit internal auditors to assist external auditors in certain facets of the confirmation process. The incongruity between AS 2605 and the present proposal creates regulatory mixed messages.

According to the PCAOB's language, internal auditors are presumptively never to be trusted. Such a position is offensive to the longstanding history of collaboration and cooperation between external auditors and internal audit functions and unnecessarily casts suspicion on the integrity of all internal auditors. While the scope of responsibilities for each profession is different, internal and external auditors must work in harmony to ensure that governance, risk, and control processes are in place and adequately working. Disparagement of either audit function – particularly from a government regulatory agency – undermines this partnership and risks engendering public mistrust in the auditing profession.

While internal auditors are not often involved in the confirmation process, they should be treated without prejudice and external auditors should be trusted to evaluate the objectivity, competence, and independence of the internal audit function from management. Here at CASE Credit Union, it is imperative that our internal audit function and external auditors collaborate and cooperate during the confirmation process for a myriad of reasons, such as to ensure that confirmations are not mailed to members who have a court mandate that they not be contacted.

Therefore, I respectfully ask that you maintain AS 2605 as the standard for evaluating internal auditors' involvement in the confirmation process.

Respectfully,

DocuSigned by:

Craig Godfrey

Craig Godfrey, CPA
Board Vice Chairperson

DocuSigned by:

Charmaine Shellman

Charmaine Shellman
Audit Committee Chairperson

DocuSigned by:

Jeffrey S. Benson

Jeffrey Benson, CPA
President/CEO

DocuSigned by:

Bryanna Benoit

Bryanna Benoit
Chief Financial Officer

DocuSigned by:

Corrie Jameson

Corrie A. Jameson, CPA
Chief Risk Management Officer



February 17, 2023

By email: comments@pcaobus.org

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

Re: The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards; PCAOB Rulemaking Docket Matter No. 028

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditor firm and audits to dynamic market conditions. This letter represents the observations of the CAQ based upon feedback and discussions with certain of our member firms, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

General Support

The CAQ appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board's (PCAOB or the Board) proposed Auditor's Use of Confirmation standard and related amendments (the "proposed standard"). We agree that when properly designed and executed by the auditor the confirmation process may provide relevant, reliable third-party evidence that auditors obtain as part of an audit of a company's financial statements as stated in the release text accompanying the proposed standard (the "Release").¹

Auditors are committed to performing high-quality audits in accordance with professional standards, and external confirmations play an important role in many audits. We support the Board's objective of updating its interim standard related to the confirmation process as the confirmation process has

¹ See Release page 4.





continued to evolve since adoption. Throughout the Release and proposed standard, we have observed and appreciate the Board’s consideration of public comments on both the 2009 Concept Release² and 2010 proposed standard,³ as well as ISA 505 (Revised and Redrafted), *External Confirmations*, finalized by the International Auditing and Assurance Standards Board (IAASB) in September 2008.⁴ For example, advances in information technology and the use of third-party intermediaries have had a significant impact on the confirmation process. We agree with the Board’s view that the use of electronic confirmations and third-party intermediaries should be explicitly addressed in the proposed standard. The proposed standard excludes various presumptive requirements included in the 2010 proposal, such as the confirmation of other accounts like investments or significant risks that could be addressed by confirmations. We agree that these could be viewed as unduly prescriptive as stated in the Release and support the Board determination to exclude such requirements.

General Observations

We support the objectives of the proposal as set forth by the Board but have some concerns about specific proposed requirements that we encourage the Board to address in the final standard. Our specific concerns are highlighted in the responses to the questions below. Overarchingly, we are concerned about 1) the auditor’s ability to apply professional judgment consistent with their risk assessment and response determinations and 2) the emphasis the proposed standard places on the persuasiveness of audit evidence obtained through confirmation procedures over other forms of audit evidence.

Risk Assessment and Auditor Judgment

In an audit performed in accordance with PCAOB standards, the auditor’s risk assessment and planned audit response create the foundation for the entire audit process. Auditors are required to identify and assess audit risks and perform audit procedures to address those risks.⁵ Auditors apply professional judgment to determine which audit procedures will produce sufficient appropriate audit evidence to provide a reasonable basis for their audit opinions.⁶

The Release states that, “the new proposed standard would be more expressly integrated with the Board’s risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor’s responsibilities for obtaining relevant and reliable audit evidence through the confirmation process.”⁷ We support the integration of the Board’s risk assessment standards with the proposed standard. However, we are concerned that some portions of the proposed standard remove or limit the auditor’s judgment to design and perform audit procedures in a manner that addresses the assessed risks of material misstatement. Instead, the proposed standard includes certain prescriptive requirements for the confirmation process, regardless of the assessed level of risk.

² See [Concept Release on Possible Revisions to the PCAOB’s Standard on Audit Confirmations](#)

³ See [Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards](#)

⁴ See <https://www.iaasb.org/projects/external-confirmations>.

⁵ For example, see various provisions in AS 2110, *Identifying and Assessing Risks of Material Misstatement*, and AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*.

⁶ See paragraph .04 of AS 1105, *Audit Evidence*.

⁷ See page 4 of the Release.



Specifically, the proposed standard:

- Creates a new requirement for the auditor to confirm cash with no ability to overcome the presumption to confirm cash;
- Modifies the auditor’s ability to overcome the presumption to confirm accounts receivable to a much higher threshold (see discussion of *Persuasiveness of Audit Evidence* below); and
- Requires the auditor to consider confirming other financial relationships and the terms of certain transactions that have a significant risk of material misstatement and, if not confirming, document their conclusion.

Certain new proposed provisions could detract from the auditor’s ability to apply professional judgment to risk and response determinations. We believe a high-quality audit is not a predefined set of steps that are applied to every audit engagement, but instead includes a customized set of procedures designed to be responsive to the risks identified. Confirmation procedures are one of many procedures through which auditors can obtain sufficient appropriate audit evidence commensurate with the risks they have identified. Auditors develop and perform audit procedures based on their risk assessment given the facts and circumstances of each engagement. In certain circumstances, confirmation procedures may be appropriate to address risks associated with accounts and disclosures specified in the proposed standard, as well as other accounts and disclosures not specified. However, there are circumstances where an auditor may determine that confirmation procedures are not necessary or would be ineffective to address certain risks. In such circumstances, where reasonable, auditors should be able to overcome presumptions to confirm or consider confirming certain account balances or disclosures without undue effort or documentation burden that would not enhance audit quality.

Introducing prescriptive requirements to confirm certain account balances or disclosures, without permitting the ability to overcome the presumption to confirm or appropriately consider risk assessment, promotes a “checklist” mentality without an apparent corresponding increase to audit quality. This could result in unnecessary audit procedures and documentation in situations where an auditor would have determined that confirmation procedures were not appropriate or necessary.

Persuasiveness of Audit Evidence

Paragraph .09(a) of AS 2301 states, “[i]n designing the audit procedures to be performed, the auditor should obtain more persuasive audit evidence the higher the auditor's assessment of risk.” Paragraph .06 of the proposed standard states, “[a]udit evidence obtained through the confirmation process from an external knowledgeable source is generally more reliable than evidence obtained only from internal company sources.” When combined with other proposed provisions (e.g., proposed paragraphs .09 -.15), we are concerned that proposed paragraph .06 overemphasizes confirmation as the most persuasive audit procedure and prescribes the type of audit evidence to be obtained for certain accounts without allowing for auditor judgment regarding the assessed risks of material misstatement. This concept is reinforced by the Release text which states, “the Board is not aware of other types of substantive procedures that would provide audit evidence that is as persuasive as audit evidence obtained through confirmation of cash.”⁸

⁸ See Release page 21.



Pursuant to an auditor’s risk assessment (and in accordance with AS 2301 and .04 paragraph of AS 1105, *Audit Evidence*), as risk increases, so must the amount of audit evidence that the auditor obtains to address the risk. Accounts and disclosures with elevated risks due to error or fraud may warrant more persuasive audit evidence, which may include, but is not limited to, confirmations. In cases where the proposed standard includes requirements to confirm or consider confirming an account or disclosure, the provisions of the proposed standard unduly prescribe the nature of the audit procedures an auditor may perform to address risks of material misstatement by positioning confirmations as the most persuasive form of audit evidence, not allowing for other forms of external audit evidence, and increasing the level of documentation burden without a commensurate benefit to audit quality.

Paragraph .14 of the proposed standard provides that the auditor could overcome the presumption to confirm AR “when the auditor determines that performing other substantive procedures (without using confirmation) would provide audit evidence that is *at least as persuasive* as the evidence that the auditor might expect to obtain through performing confirmation procedures.” (*emphasis added*) Given the weight placed on the persuasiveness of audit evidence provided by confirmations in paragraph .06 of the proposed standard, the auditor may be challenged to identify other substantive procedures that would provide audit evidence at least as persuasive as that obtained from confirmations. This may be inconsistent with the foundational requirements set forth in paragraph .08 of AS 2301 that an auditor design and perform audit procedures that address the assessed risk of material misstatement as other audit procedures may be effective enough to address assessed risks given the circumstances. We are concerned with the premise that audit evidence obtained to overcome the presumption to confirm AR should be “as persuasive as” that which would otherwise be obtained through confirmation; such evidence should be sufficient and appropriate pursuant to the auditor’s risk assessment.

For example, in the audit of a utilities company, the risk of material misstatement of accounts receivable (“AR” in this example) related to usage may be assessed as low due to the effectiveness of controls over usage, low days sales outstanding, and high number of usage accounts with low balances, among other factors. Under extant AS 2310, *The Confirmation Process*, the auditor may be able to overcome the presumption to confirm AR to more efficiently obtain sufficient appropriate audit evidence. Under the proposed standard, if the auditor were to perform audit procedures to obtain audit evidence at least as persuasive as that obtained through a confirmation (as positioned by the proposed standard), we believe such procedures may go far beyond the requirements of AS 2301 and AS 1105 given the associated risk. Furthermore, confirmation response rates are declining.⁹ Therefore, if the auditor was not able to overcome the presumption to confirm AR (which may likely be the case given the high bar for persuasiveness), the auditor would be required to 1) send confirmations to customers, 2) send second confirmations for any incomplete responses or nonresponses, and 3) perform alternative procedures that provide sufficient appropriate audit evidence for AR (e.g., obtaining subsequent cash payments and vouching them to customer invoices). The auditor may have otherwise determined from the outset that these alternative procedures would have been appropriate to address the assessed risks of AR. It is not clear to us why such a high bar for audit evidence has been established by the proposed standard.

⁹ See Release page 54.



Other Matters

Fraud Identification

The Release also highlights various PCAOB and SEC enforcement cases alleging auditor failures to execute effective confirmation procedures to address fraud.¹⁰ We do not dispute the results of these proceedings; however, we are concerned that the Release may inadvertently set an unrealistic expectation that confirmation procedures would uncover most frauds. When appropriately designed and executed, confirmation procedures may adequately address certain risks of material misstatement, including those due to fraud; however, when third parties collude with auditees, detection of the fraud is much more difficult.¹¹ We believe the tone set by the proposed standard, in conjunction with the Release text, could lead to improper reliance on confirmation procedures when other audit procedures may be more appropriate to respond to an assessed risk of material misstatement due to fraud. It may also lead to a misunderstanding among stakeholders regarding the effectiveness of audit evidence obtained through confirmation procedures.

Innovation

Technologies used to perform audit procedures have evolved and will continue to evolve over time. In the final standard, we encourage the Board to consider that technological advancements will continue. Positioning audit evidence obtained through confirmation as the highest form of audit evidence anchors the confirmation process to present day when “auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence.”¹² For example, auditors continue to enhance the audit through the use of audit data analytics (ADAs). ADAs that are being developed to better incorporate the testing of internal data against external data sources and corroboration with multiple independent data sources (assuming they do not come from the same root source) can greatly enhance the persuasiveness of audit evidence.

With rising concerns around cybersecurity, the response rate and reliability of confirmations may continue to wane, making the availability to consider alternative forms of audit evidence key. We are concerned the proposed standard may stifle the innovation of new forms and ways of obtaining audit evidence by always requiring confirmation, or the consideration of confirmation, for certain accounts and transactions, particularly if there is not a clear and operable way to overcome the presumption.

Key Recommendations

Given the above, we highlight our key recommendations for the Board to consider in order to promote consistency in application and operability of the final standard.

¹⁰ See Release pages 11 and 12.

¹¹ See, e.g., Paul Caster, Randal J. Elder, and Diane J. Janvrin, A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness, 27 *Auditing: A Journal of Practice & Theory*, 5 (2008).

¹² See Release page 13.



We recommend that the Board consider making the following revisions to the final standard:

- Retain the criteria to overcome the required confirmation of accounts receivable in extant AS 2310 (see further discussion in Q17 below);
- Include criteria to overcome the required confirmation of cash held by third parties similar to those included in paragraph .34 of extant 2310 for accounts receivable (see further discussion in Q10 below); and
- Indicate that an auditor "may consider" confirming other financial relationships and the terms of complex or significant unusual transactions connected to a significant risk (see further discussion in Q10 below).

See below for responses to specific questions outlined in the Release and further recommendations.

Specific Feedback

Q5. Does the new proposed standard provide for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard?

We believe the proposed standard generally provides for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard. As discussed in our General Observations above, it is critical that an auditor is able to apply professional judgment in determining whether the use of confirmations is appropriate and effective based on their risk assessment.

Q6. Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?

We do not believe there are accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures. The use of confirmation procedures to obtain audit evidence should be based on the auditor's risk assessment given the facts and circumstances of each audit.

Q7. As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?

Yes. The proposed approach is appropriate as it is consistent with PCAOB standards on risk assessment and allows for the use of professional judgment in determining the most effective approach to obtain audit evidence in response to the assessed risk.



Q10. Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

We do not believe the requirements in the proposed standard regarding confirming cash held by third parties, as well as other financial relationships, are sufficiently clear and appropriate, as detailed in our response to this question and Q11, as well as our General Observations above. We encourage the Board to clarify certain proposed requirements which will enable the application of auditor judgment.

Cash and cash equivalents

Paragraph .02 of the proposed standard indicates that “the objective of the auditor in designing and executing the confirmation process is to obtain relevant and reliable audit evidence about one or more relevant financial statement assertions of a *significant account or disclosure*.” (*emphasis added*) Therefore, it appears that when cash is determined to be a significant account confirmation is required for at least a selection of cash items pursuant to proposed paragraphs .09 and .10. We do not believe this is appropriate in all cases where cash is determined to be a significant account, for example where an auditor determines that confirmations would not be effective due to the likelihood of receiving incomplete responses or nonresponses. Excluding a provision to overcome the confirmation of cash eliminates the auditor’s ability to use professional judgment in determining whether confirmations are an appropriate procedure based on the assessed level of risk and comes at a cost of time and effort without a commensurate benefit to audit quality.

We recommend the Board include criteria to overcome the required confirmation of cash held by third parties similar to those included in paragraph .34 of extant 2310 for accounts receivable.

Other financial relationships

Proposed paragraph .11 states that, “the auditor should consider sending confirmation requests about other financial relationships with the confirming party.”

Consistent with feedback in our General Observations, paragraph .11, read in conjunction with paragraph .06, intimates that confirmations are the most persuasive form of audit evidence that could be obtained in connection with responding to risks associated with other financial relationships. We believe this inherently limits an auditor’s judgment in developing audit responses for other financial relationships and the types of procedures they may seek to provide audit evidence. We acknowledge that confirmation procedures may be appropriate for certain financial relationships, but not all financial relationships in all circumstances. Auditors already consider these financial relationships during their risk assessment. Therefore, if an auditor determines, based on risk assessment, that they do not need to perform confirmation procedures for one or more other financial relationships with a confirming party (i.e., they can obtain the necessary audit evidence through other audit procedures), this proposed provision creates



an increase in required audit documentation (pursuant to PCAOB Rule 3101(a)(2))¹³ about the auditor's consideration for not sending a confirmation without a commensurate benefit to audit quality.

Furthermore, it is not clear if that is a consideration that an auditor should make as part of their risk assessment when determining which items to select in accordance with paragraph .10.

For example, a company has a Cash Account X which the auditor has determined to confirm. Cash Account X is held at a banking institution where the company also maintains a line of credit arrangement ("LOC Y"). Absent any requirements in the proposed standard, the auditor determined that LOC Y presented a remote risk of material misstatement in accordance with AS 2110 through procedures like materiality assessment, consideration of prior year audit results, historical knowledge of the company, review of contracts and agreements applicable to the current year audit, and review of committee minutes, among others. Paragraph .11 of the proposed standard appears to require that the auditor reconsider this risk assessment and then document why they did not perform confirmation procedures related to LOC Y. This circumvents the auditor's risk assessment and increases the level of audit documentation without an apparent benefit to audit quality. Furthermore, this is inconsistent with the principles-based requirements for identifying and assessing risks of material misstatement set forth in AS 2110. If LOC Y did present a risk of material misstatement, an auditor should be able to apply their own judgment based on the facts and circumstances of the engagement to determine the appropriate audit procedure(s), which may or may not include confirmation procedures.

We recommend that the Board revise proposed paragraph .11 to indicate that an auditor "may consider" confirming other financial relationships. Pursuant to PCAOB Rule 3101(a)(3),¹⁴ the auditor would have a responsibility to consider performing confirmation procedures over such terms and exercise professional judgment in the circumstances consistent with the objectives of the standard.

Q11. Are there substantive audit procedures other than confirmation that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash? If so, please describe these procedures.

We do not believe that audit evidence obtained in response to risks associated with cash needs to be "as persuasive as" that which would otherwise be obtained through confirmation. Audit evidence should be sufficient and appropriate in response to the assessed risk of material misstatement. Given the emphasis

¹³ PCAOB Rule 3101(a)(2) states, in part, "The word "should" indicates responsibilities that are presumptively mandatory. The auditor must comply with requirements of this type specified in the Board's standards unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard."

¹⁴ PCAOB Rule 3101(a)(3) states, "The words "may," "might," "could," and other terms and phrases describe actions and procedures that auditors have a responsibility to consider. Matters described in this fashion require the auditor's attention and understanding. How and whether the auditor implements these matters in the audit will depend on the exercise of professional judgment in the circumstances consistent with the objectives of the standard."



placed on the reliability of confirmation procedures in proposed paragraph .06 (see our General Observations above), it does not appear that the proposed standard allows for other substantive audit procedures for cash items that provide less persuasive audit evidence than confirmations – even if they would be effective at addressing the associated risks. Further, if an auditor is not able to obtain a confirmation response for a cash item, it is not clear what alternative procedures would be deemed sufficient under the proposed standard.

Forms of audit evidence and audit procedures continue to evolve in ways appropriately responsive to assessed risks. For example, some auditors are employing new auditing techniques that involve obtaining direct view-only access to client banking information. An auditor may (1) assess the risk of material misstatement as low, (2) test the design and operating effectiveness of relevant controls, and (3) test bank reconciliations and inspect bank statements through direct access to this external information. While we agree these are not confirmation procedures, they may provide the auditor with sufficient appropriate audit evidence that is persuasive, reliable, and responsive to assessed risks of material misstatement.

As we discussed in our General Observations above, requiring the confirmation of cash, with no ability to overcome the presumption to confirm, limits the auditor's ability to effectively and efficiently obtain alternative forms of audit evidence that would be sufficient and appropriate. This may impact the longevity of the final standard and hinder innovation in auditing techniques.

Q12. For other financial relationships with the confirming party, is the requirement in the new proposed standard that the auditor should consider confirmation sufficiently clear and appropriate?

See our response to Q10 above.

Q13. Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

See our response to Q10 above. We believe it is important that auditors can apply professional judgment in the selection of cash accounts and other financial relationships through a risk-based approach.

Q14. Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?

Yes. The continued requirement to confirm accounts receivable is sufficiently clear and appropriate for the reasons stated in the Release. We have highlighted some concerns related to the auditor's ability to overcome the presumption to confirm accounts receivable in our General Observations and response to Q17 below. We also highlight that auditors have observed the trend in declining confirmation response rates referenced in the Release. Factors like increased skepticism related to cybersecurity may escalate



that trend, which makes it essential that auditors are able to perform procedures other than confirmation to obtain audit evidence for accounts receivable and other accounts or disclosures.

Q15. Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?

Yes. The language included in proposed paragraph .13 allows for the auditor to make judgments regarding which accounts to select pursuant to their understanding of the company's arrangements and transactions with third parties and the nature of items that make up the account balances. This is consistent with the auditor judgment promulgated in the risk assessment standard. No two audits are exactly alike. Therefore, auditors must be able to apply professional judgment based on the facts and circumstances of the audit in order to appropriately identify risks and procedures that address those risks.

As discussed in our General Observations, we are concerned about the provision in paragraph .14 of the proposed standard to overcome the confirmation of accounts receivable. See our response to Q17 below.

Q16. Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?

Yes. The description of accounts receivable is sufficiently clear for the reasons stated in the Release. We do not believe there is any reason to broaden the description to include other types of receivables, as other types of receivables are likely to be contemplated in the auditor's risk assessment, allowing the auditor to design further audit procedures related to those receivables based on the facts and circumstances that gave risk to such receivable, if necessary.

Q17. Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

When overcoming the presumption to confirm accounts receivable, we do not believe that audit evidence obtained in response to the related risks must be "as persuasive as" that which would otherwise be obtained through confirmation; it should be sufficient and appropriate to respond to the assessed risk of material misstatement. As written, it is unclear how an auditor would be able to obtain evidence that is at least as persuasive as performing confirmation procedures under the proposed standard given the proposed standard appears to state that there is no evidence as reliable as confirmations. Thus, while the standard includes a provision to overcome the presumption to confirm accounts receivable, it does not appear to be an actionable opportunity given the high bar of evidence to overcome.

Paragraph 34 of extant AS 2310, includes a presumption that the auditor confirms accounts receivable and allows the auditor to exercise professional judgment in determining whether the use of confirmations



would be effective. In situations, for example, where an auditor determines that confirmations would not be effective or the auditor's combined level of control and inherent risk are at a sufficiently low level (combined with other evidence obtained as part of the audit), existing PCAOB standards do not require the auditor to request confirmations. We believe that the proposed standard, which establishes a significantly higher threshold to overcome the confirmation of accounts receivable, will significantly reduce the auditor's ability to use their professional judgment in determining whether confirmations are an appropriate procedure based on the assessed level of risk. Auditors should design audit procedures that will provide audit evidence commensurate with addressing the risks identified. This should contemplate the auditor's expectation of response rate, because performing procedures that will not produce relevant, reliable audit evidence comes at a cost of time and effort without a commensurate benefit to audit quality.

Page 25 of the Release states, "[t]he new proposed standard would not carry forward the provisions addressing materiality or a combination of risk assessments that are currently available to overcome the presumption to confirm accounts receivable, as these matters would be considered by the auditor as part of identifying and assessing the risks of material misstatement and designing and implementing an audit response under PCAOB risk assessment standards." Therefore, we do not believe it is the intent of the Board that, for example, the auditor would be required to confirm accounts receivable when the combined level of control and inherent risk are at a sufficiently low level (combined with other evidence obtained as part of the audit). However, we do not find the text of the proposed standard accurately reflects this notion.

To improve the clarity and operability of the final standard, we recommend the Board retain the criteria to overcome the required confirmation of accounts receivable in extant AS 2310, even if it views that some aspects (like consideration for materiality and risk assessment) are contemplated by other PCAOB standards.

Q18. Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?

As discussed in our General Observations and in various questions above, we do not agree that the ability for an auditor to overcome the presumption to confirm accounts receivable should be dependent on obtaining audit evidence that is at least as persuasive as the evidence that which the auditor might expect to obtain through performing confirmation procedures. Audit evidence obtained by an auditor should be sufficient and appropriate in responding to the assessed risk associated with a given account or disclosure.



Q19. Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

We do not believe the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome is appropriate in all cases. It may not provide a benefit to audit quality and investor protection commensurate with costs and time required to prepare and make such communications. Such a requirement may also direct the audit committee's attention away from other more significant issues that the auditor is communicating to them.

Existing auditing standards related to information communicated to the audit committee sufficiently address circumstances in which the auditor should communicate overcoming the confirmation of accounts receivable.

According to paragraph .03 of AS 1301, *Communications with Audit Committees*, the objectives of the auditor's communication to the audit committee include, in part:

- "c. Communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and
- d. Provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process."

We acknowledge these objectives could include the auditor's determination to overcome the confirmation of accounts receivable in some circumstances – for example, when accounts receivable presents a significant risk of material misstatement or fraud risk, impacting the auditor's overall strategy. However, we do not believe that such communication is relevant in all instances. An auditor may assess a lower risk of material misstatement associated with accounts receivable and overcome the presumption to confirm it. In this case, it is not clear what benefit communicating this to the audit committee provides to audit quality as it elevates the communication of low-risk accounts receivable over other, perhaps higher risk, accounts not required to be communicated to the audit committee.

Requirements within PCAOB auditing standards focus audit committee communications on key judgments made throughout the audit and other matters that may be relevant to their oversight responsibilities. In some cases, the auditor's determination to overcome the confirmation of accounts receivable may be insignificant in the context of the overall audit (e.g., in lower risks). Existing standards already address instances where audit committee communication would be appropriate.

Q20. Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?



We believe the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement require additional clarity to ensure the proposed provisions are operational.

Under paragraph .15 of the proposed standard, an auditor would either need to perform confirmation procedures for all significant risks of material misstatement associated with a complex or significant unusual transaction or document their consideration (pursuant to PCAOB Rule 3101(a)(2)) for why they did not perform such procedures.

The Release acknowledges the new proposed provision is intended to be similar to that in extant AS 2310.¹⁵ In and of themselves, the extant and proposed provisions appear similar. However, in the context of preceding provisions in the proposed standard (e.g., the emphasis on persuasiveness of audit evidence provided by confirmations), the new proposed provision appears to add an increased burden of documentation in instances where an auditor may conclude that confirmation procedures are not necessary to obtain sufficient appropriate audit evidence to address a significant risk of material misstatement associated with either a complex transaction or a significant unusual transaction.

For example, an auditor may assess a significant risk over the existence assertion of a significant contract entered into in Q1 of a reporting year and design and perform a combination of procedures, not including confirmation procedures, to address that risk including, but not limited to, obtaining and reviewing the original executed contract and independently validating aspects of the terms being executed over the period. Under extant AS 2310, the auditor would document their professional judgment for not performing confirmation procedures. Under the proposed standard, the auditor would document that same judgment, but under the presumption that confirmation responses are a superior form of audit evidence relative to all other types of audit evidence. This documentation hurdle may be challenging to clear, the burden of which we do not see enhancing audit quality.

We recommend that the Board revise proposed paragraph .15 to indicate that an auditor "may consider" confirming terms of complex or significant unusual transactions connected to a significant risk. Pursuant to PCAOB Rule 3101(a)(3), the auditor would have a responsibility to consider performing confirmation procedures over such terms and exercise professional judgment in the circumstances consistent with the objectives of the standard.

Q22. Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

We believe that modification of the proposed requirements related to identifying information to confirm will aid auditor execution of the new proposed standard.

Based on the Release text, it appears that the intent of proposed paragraph 17 is that the auditor should test the accuracy and completeness of information produced by the company that the auditor uses as

¹⁵ See Release page 28.



audit evidence.¹⁶ However, the text of the proposed provision requires an auditor “test the accuracy and completeness of information produced by the company that *the auditor uses in selecting items to confirm.*” (*emphasis added*) We believe this proposed provision could be interpreted to require that an auditor test that information for accuracy and completeness before selecting items for confirmation. We acknowledge that making selections from a complete and accurate population is important. However, in many cases, confirmations may be designed to address the risk of accuracy for a given account balance or disclosure (and sometimes completeness). As such, we believe that requiring the auditor to test information produced by the company for accuracy (or completeness) before selecting items for confirmation may be duplicative if the confirmation is designed to test that assertion. We believe that paragraph 10 of AS 1105 appropriately addresses this concept and that proposed paragraph 17 is not necessary.

Furthermore, the footnote to proposed paragraph 17 references paragraph 10 of AS 1105 which permits auditors to test the accuracy and completeness of the information produced by the company as audit evidence, or the *controls over the accuracy and completeness of that information*. However, proposed paragraph 17 appears to limit the auditor’s ability to test the accuracy and completeness of information produced by the company that the auditor uses in selecting the items to confirm to just that information, not the controls over that information. We believe that, if proposed paragraph 17 is retained, it should explicitly state that the auditor may also test the controls over the accuracy and completeness of the information produced by the company that the auditor uses in selecting the items to confirm.

Q26. 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 account when using an intermediary in the confirmation process?

We believe that the requirements in the new proposed standard to evaluate the use of an intermediary to facilitate direct electronic transmission of confirmation requests and responses are appropriate; however, additional clarity may be required to ensure the proposed provisions are operational.

Appendix .B3 of the proposed standard states that an auditor should not use an intermediary to send confirmation requests or receive confirmation responses if there are indicators the necessary controls at the intermediary are not designed or operating effectively, among other indicators. Indicators, in and of themselves, do not necessarily reflect that an intermediary is not fit for use. In many circumstances, an auditor can perform additional procedures to overcome negative indicators about the intermediary’s reliability. For example, an auditor may be able to obtain an understanding of how a specific control failure impacts (or does not impact) the confirmation process and perform additional tests of controls or other procedures at the intermediary to overcome the issue.

¹⁶ See Release page 29.



We have included suggested text to consider in revising Appendix .B3 of the proposed standard (language that is proposed to be added is underlined):

“If information obtained by the auditor indicates that (i) the intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses, (ii) the necessary controls are not designed or operating effectively, or (iii) circumstances exist that give the company the ability to override the intermediary’s controls, the auditor may consider performing additional audit procedures to address these indicators. If, after performing additional audit procedures, the auditor concludes that the indicators cannot be resolved, the auditor should not use the intermediary to send confirmation requests or receive confirmation responses.

For operational or other reasons, many confirming parties will only participate in the confirmation process through an intermediary. Anecdotally, we have observed there has been a concentration of such intermediaries used in the marketplace (for example, confirming with certain financial institutions). If a highly concentrated intermediary received a qualified SOC report with a negative indicator regarding its reliability, and the standard did not permit auditors to perform additional procedures to address the negative indicator, this could have severe and pervasive effects on how auditors across the profession to perform confirmation procedures.

We also highlight a need for clarity relative to the use of third-party intermediaries in the confirmation process. An auditor may become aware of an issue at a third-party intermediary that they are unable to resolve through additional procedures. If the confirming party only allows for cash confirmation through said third-party intermediary, the proposed standard does not provide an opportunity to overcome the presumption to confirm cash. This could put the auditor in a position of not being able to comply with certain provisions of the proposed standard (e.g., aspects of sending confirmations and receiving confirmations responses) due to circumstances outside their control. If this circumstance arose with respect to accounts receivable, the standard is also not clear if the auditor could overcome the confirmation of accounts receivable due to circumstances outside of their control.

Q28. Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?

Yes. The provisions of the new proposed standard related to evaluating the reliability of confirmation responses are sufficiently clear and appropriate for the reasons stated in the Release.

Q31. Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?

In general, we believe the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures are sufficiently clear and appropriate. It is



also beneficial that the proposed standard includes examples of alternative procedures for accounts receivable and transaction terms, as they are presumed items to confirm or consider confirming. Given that cash is a presumed account to confirm, we believe that the final standard should include examples of alternative procedures that either individually or in combination would provide sufficient appropriate audit evidence for cash items. These may include examples we referenced in Q11.

Q33. Are the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses sufficiently clear and appropriate? If not, what changes should be considered?

Yes. The requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses are sufficiently clear and appropriate. These provisions ensure auditors maintain control over the confirmation process without limiting their professional judgment in determining to use internal audit for other aspects of testing accounts on which confirmation procedures are being performed. As we stated in our comment letter response¹⁷ to the initial proposal in 2010, we believe that internal audit can assist in many aspects of an auditor's confirmation process and that such assistance, when appropriately supervised, increases audit quality by allowing the auditor to focus their efforts on the areas of higher risk, which is consistent with extant PCAOB guidance (e.g., AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*). The auditor should be able to use the framework provided in AS 2605, *The Auditor's Consideration of the Internal Audit Function*, in determining the appropriate manner to use the work of internal auditors, except as prohibited by paragraph .32 of the proposed standard.

Q35. In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?

We do not believe that there are procedures that the auditor should perform in the event of a management request not to confirm a certain item which are not currently required by other PCAOB standards as discussed on pages 44 and 45 of the Release.

Q48. How much time following SEC approval would audit firms need to implement the proposed requirements?

See response to Q49 below.

¹⁷ See [CAQ September 2010 Comment Letter](#).



Q49. Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?

Yes. We believe that requiring compliance for fiscal years beginning after the year of SEC approval would present challenges for auditors if the final standard is relatively consistent with what is currently reflected in the proposed standard. Considering the feedback we've provided above – particularly related to the confirmation of certain accounts and transaction terms, audit committee communication, and increased documentation – along with the fact that confirmations will be performed for all audits at various points throughout the audit, the final standard will have a significant impact on audits as soon as it is effective (e.g., in the planning stage). Firm methodologies, related tools, and guidance will therefore need to be fully updated prior to the beginning of the audit year in which the final standard becomes effective. Audit firms will also need to develop and implement training and effective quality control processes and procedures to support and facilitate effective implementation of the final standard.

Additionally, the confirmation process often involves intermediaries that will need time to evaluate the impact of the standard on their operations with respect to the confirmation process, update their processes and controls, if necessary, and effectively implement them so they are prepared by the time the final standard becomes effective. A longer implementation period will enable the firms and staff/Board to discuss potential implementation issues and inform additional guidance.

In order for firms and intermediaries to sufficiently prepare, if the SEC approves the final standard before Q1 2024, we strongly recommend that the final standard be effective no earlier than for audits with fiscal years beginning on or after December 15, 2024.

CAQ

The CAQ appreciates the opportunity to comment on the proposed auditor's use of confirmations standard and related amendments, and we look forward to future engagement. As the Board gathers feedback from other interested parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum (vteitelbaum@thecaq.org), Taylor Harris (tharris@thecaq.org), or Dennis McGowan (dmcgowan@thecaq.org).

Sincerely,



Vanessa Teitelbaum, CPA
Senior Director, Professional Practice
Center for Audit Quality

cc:

PCAOB

Erica Y. Williams, Chair
Duane M. DesParte, Board member
Christina Ho, Board member
Kara M. Stein, Board member
Anthony C. Thompson, Board member
Barbara Vanich, Chief Auditor

SEC

Paul Munter, Chief Accountant
Diana Stoltzfus, Deputy Chief Accountant



1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

February 21, 2023

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

[PCAOB Release No. 2022-009: *The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*](#)

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board:

CFA Institute¹, in consultation with its Corporate Disclosure Policy Council (“CDPC”)², appreciates the opportunity to comment and provide our perspectives on the Public Company Accounting Oversight Board (“PCAOB” or “Board”) Proposed Auditing Standards, [*The Auditor's Use Of Confirmation, and Other Proposed Amendments to PCAOB Standards*](#) (“Proposed Standard” or “Proposed Confirmation Standard”).

CFA Institute has a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. We are providing comments consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures and the related audits provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

¹ With offices in Charlottesville, New York, Washington, DC, Brussels, Hong Kong, Mumbai, Beijing, Shanghai, Abu Dhabi and London, CFA Institute is a global, not-for-profit professional association of more than 190,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program.

² The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.



OVERARCHING OBSERVATIONS

Modernization of Interim Standards

In a letter to the new PCAOB Board Members in early 2022, we noted the following with respect to the need to update legacy standards:

Modernize Interim Auditing, Attestation, Quality Control, Ethics and Independence Standards
The PCAOB adopted the compendium of the profession's legacy auditing, attestation, quality control, and ethics standards (i.e., AICPA standards) in 2003. The PCAOB has not updated many of the legacy standards, and the latest standard-setting agenda does not indicate the timing or whether there will be any future consideration of whether the legacy standards in effect remain fit-for-purpose. The PCAOB should prioritize a project, with public input, on whether the standards remain fit-for-purpose and the nature and extent of whether any modernization is necessary.

We recognize this Proposed Confirmation Standard is a movement in this direction and laud the PCAOB for its efforts in this regard.

Communication of Effects of the Standard to Investors

In that same letter, we noted (see excerpt below) the need for the PCAOB to communicate differently with investors to obtain the useful feedback they need, and which investors can provide – if they are communicated to in an investor friendly manner. Investors need information summarized in a contextualized, effects-based communication which is stripped of audit jargon and focused on the changes in the standard and the impact of such changes on the audit and its quality. The PCAOB must always be mindful that investors see nothing of the audit – other than the standard audit opinion supplemented by a critical audit matter (CAM) or two. As such, expecting investors to provide feedback on proposed auditing standards without translation is not realistic.

Investor Outreach Must Be Effects, Not Audit Language Focused

Because investors and auditors speak different languages and the investor (consumer of audit services) gets little insight into the quality of the good, when developing or creating new auditing standards the audit regulator must conduct outreach that explains the nature of the change being proposed and its effects on investors in a language other than auditing-ease. Without such translation, the input the PCAOB will receive will not be as useful as it otherwise could be. Investors are smart. They are not confused (i.e., a common refrain used by other stakeholders to forgo change) by accounting and audit standards when they are communicated in terms of their effects on the audit, the accounting, and the economics of the companies in which they invest. It is always important to remember that investors – not management, the audit committee, the auditors, or the audit regulators – are the one's putting money at risk. Investors simply need the jargon of the audit profession to be translated into the effects on auditors, audits and financial statements. With that translation, you will find investors are able to provide rich and useful feedback to the PCAOB.

We think the PCAOB has room to improve in this regard. With the release of this Proposed Confirmation Standard and the Proposed Standard on Quality Control, [*A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*](#), investors were left with nearly 500 pages of overlapping standard-setting proposals over the holiday period – as well as the earnings release period – that included streams of technical audit



jargon and lacked a consideration of the effects of the proposals on the audit³. This is a challenging ask of investors and reduces the likelihood of obtaining investor feedback, which may be PCAOB’s Achilles heel. As former SEC Commissioner Kathleen Casey noted, “*While there are many other important stakeholders that rely on financial statement reporting, investors’ interests must remain paramount.*”

While the Board has acted to enhance the standard-setting process, including through a reconstituted Investor Advisory Group (IAG) and the appointment of the PCAOB’s first investor advocate, we believe that the PCAOB should complement these changes and enhance investor feedback by making the material digestible in the manner described above.

Further, we believe the PCAOB needs to perform direct investor education and outreach on its proposed standards to ensure investors – including the Investor Advisory Group – understand the proposals and to obtain not only formal input through comment letters but input through discussions with investors. In this way, investors can communicate with the PCAOB without extensive study of dense consultations in a short timeframe in a parlance that may not be familiar to them⁴.

We have read the public statements of the Board members and find the remarks of Board member Kara Stein⁵ particularly helpful in enabling investors to understand why they should care about the Proposed Confirmation Standard and why the revisions have been proposed. More of this contextualization is necessary to effectively get investors interested in the important work of the PCAOB.

³ While we note the PCAOB Staff’s [comparison of the prior, revised and internal standards on confirmations](#), the document is simply a side-by-side comparison of paragraphs, not an analysis or synthesis of the changes. We believe the PCAOB can enhance the quality and timeliness of feedback by preparing a summary document for investors which explains the changes being proposed and why they are being proposed, including the expected effects, in a manner which is investor friendly.

⁴ This is also particularly important given it has been twelve years since the last public consultation on the Proposed Confirmation Standard and the fact that the PCAOB does not undergo a public due process where documents are discussed, and revisions debated, in public over time.

⁵ PCOAB Board Member Kara Stein, *Collecting Better Evidence: Proposal to Strengthen an Auditor’s Use of Confirmation* (<https://pcaobus.org/news-events/speeches/speech-detail/collecting-better-evidence-proposal-to-strengthen-an-auditor-s-use-of-confirmation>).

We also note that Chair Williams statement highlights the origin of the use of confirmations. (<https://pcaobus.org/news-events/speeches/speech-detail/pcaob-chair-williams-statement-on-proposed-new-standard-for-the-auditor-s-use-of-confirmation>)



CONSIDERATION OF SPECIFIC PROVISIONS

We generally support the key provisions of the Proposed Confirmation Standard, with a few additional recommendations, as noted below:

- ***Confirmation with Third Parties Provides Better Quality Evidence*** – We support use of confirmations on significant accounts, balances or transactions as we believe they provide higher quality audit evidence given they are obtained directly from independent third parties – rather than evidence provided internally by management and employees of the company. Board member Stein’s statement includes several vivid illustrations of where confirmations would have, if used, provided better quality evidence.
- ***Application to All Confirmations*** – We believe that the principles set forth within the Proposed Standard should apply to all confirmations, whether done in a paper-based or electronic communication format.
- ***Confirmation of Cash and Accounts Receivable*** – Positive confirmation of cash and accounts and loans receivable is necessary to provide the auditor with persuasive, sufficient and competent evidence for the level of assurance that the auditor’s opinion provides to investors.
- ***When Auditor Overcomes Presumption of Confirmation: Communication with Audit Committee and Investors is Essential***– We are concerned that the Proposed Confirmation Standard provides significant leeway 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.”

It should be difficult to overcome the presumption that it is necessary to carry out generally accepted auditing standards; however, the proposal’s language includes an equivalence threshold. We believe that any exception to confirmations can only be when other audit procedures would result in more persuasive or greater accumulated evidence over what could be obtained through confirmations. We are concerned the Board’s proposal may unintentionally suggest equivalence of substitution. Moreover, the Board should describe the factors that an auditor should consider when making such a determination.

We believe this provision of the Proposed Confirmation Standard should be revised such 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.



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 Proposed Standard, we agree the auditor should communicate this to the audit committee responsible for overseeing the audit.

Furthermore, we believe the final standard must require that this decision also be communicated to investors. In our view, the overall confidence of investors in the quality and utility of the audit has diminished because of a number of highly publicized failures to carry out confirmations.

As a result, the final rule must reinstate the historical obligation to disclose to investors any decision by the auditor not to use positive confirmation. We suggest that this disclosure be made as a critical audit matter (CAM⁶) – as it appears that when an auditor’s judgment results in procedures other than mandatory confirmation, the auditor has also simultaneously made a determination that a critical audit matter exists. An override of confirmations suggests that the auditor has inherently also determined a CAM exists as such determination either: (1) related to material accounts or disclosures, (2) involved especially challenging, subjective, or complex judgments, and (3) were or are required to be communicated to the audit committee (as we note above).

As noted in the Proposed Confirmation Standard, this communication would be entirely consistent with historical practice:

SAP No. 1 required confirmation of accounts receivable by direct communication with customers in all independent audits of financial statements, subject to the auditor’s ability to overcome the presumption to confirm accounts receivable for certain reasons. Following the adoption of SAP No. 1, the accounting profession also adopted a requirement in 1942, which remained in effect until the early 1970s, that auditors should disclose in the auditor’s report when confirmation of accounts receivable was not performed.

Still further, such a disclosure would enhance the transparency of the quality of an audit for investors and provide an appropriate incentive to use confirmations.

- ***Expansion of Positive Confirmations*** – We agree with the comments of the [PCAOB Investors Advisory Group](#) that the use of positive confirmations should be expanded, given the nature of business transactions today, to provide for the use of positive confirmations for the following additional transactions:

⁶ We note, in passing, that the Japanese authorities’ recent requirement to oblige the formatting of CAMs in Inline XBRL format greatly increases their utility to investors. We would suggest that: (a) the audit firms themselves should be obliged to complete this markup, and (b) that exceptions to ordinary procedures, such as a decision not to use positive confirmations procedures, should be tagged using Boolean measures or similar mechanisms that maximise the ability of investors to rapidly highlight these exceptions using machine analytics.



- Those with *unusual terms and conditions and/or the terms of agreements that 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*.⁷
- 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, and liability for custodianship of digital assets*, especially considering losses investors have recently suffered.⁸

We believe that including such transactions ensures a final standard includes some of the most important areas where external third-party confirmation is necessary.

- ***Negative Confirmations Are Not Sufficient Alone*** – 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.
- ***Auditor Must Control Entire Confirmation Process*** – The auditor must maintain control over the confirmations, including over the transmission and receipt of the confirmation directly to and from the third party.
- ***Exceptions Must Be Resolved*** – 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. The PCAOB should limit the auditors ability to assess non-responses as “isolated exceptions.”
- ***Internal Audit Should Have Limited Involvement in Confirmations, Especially Resolution of Exceptions*** – Independent auditors rather than internal auditors should perform this important audit step of confirmation. 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.

⁷ Cf. Vinicios Andrade et al., Vanished \$4 Billion Brings Down Century-Old Retailer in a Week, Bloomberg (Jan. 20, 2023), available at <https://gulfnnews.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.”).

⁸ 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!”).



Thank you for your consideration of our views and perspectives. We would welcome the opportunity to meet with you to provide more detail on our letter. If you have any questions or seek further elaboration of our views, please contact me at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters, CPA, CFA
Senior Head, Global Policy Advocacy
CFA Institute

CC:
Paul Munter, Chief Accountant, U.S. Securities & Exchange Commission

From: Michele Chaisson <Michele.Chaisson@NavEnergy.com>
Sent: Friday, February 17, 2023 10:52 AM
To: Comments
Subject: [EXT]: Docket 028: Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards

I am writing to encourage you to reconsider the proposed auditing standard. As per the IIA, I would like for you to:

- Maintain AS 2605 as the standard for evaluating internal auditors' involvement in the confirmation process.
- Make modifications to the proposed language contained in the section "Using Internal Audit in the Confirmation Process."
- Strike the new addition to section .27 "Using Internal Auditors to Provide Direct Assistance to the Auditor."

The relationship between internal audit departments and the external auditor can and should be maintained between them. Both parties are bound by professional standards and ethics that can protect against the risk that you seek to mitigate. Further, this standard erodes the legitimacy and credibility of an entire profession unnecessarily, putting careers and livelihoods at risk.

I strongly encourage you to consider the damage that will be done to the internal audit profession and to the internal/external auditor relationship by beginning down this path.

Sincerely,

Michele Eddy Chaisson.

CIA, CRMA

Manager Controls & Compliance

Mobile: 303-946-1334

Office: 720-566-2970



385 Interlocken Crescent Suite 400
Broomfield, CO 80021

From: Brian Costello <brian@circit.io>
Sent: Monday, February 20, 2023 12:08 PM
To: Comments <comments@pcaobus.org>
Subject: [EXT]: PCAOB Rulemaking Docket Matter No. 028

Circuit is pleased to offer comments on the Public Company Accounting Oversight Board (the Board) proposed audit standard AS 2310, *The Auditor's Use of Confirmation*.

Circuit is a digital audit evidence collection platform for auditors, their clients and providers to verify assets and relationships at the source, helping to save time on consolidating requests while fostering integrity in the confirmation process. The Circuit platform provides a single interface to create, send and track confirmations to verified providers via their preferred interfaces, as well as gives providers an interface to receive and track such requests. Circuit is designated as an Intermediary in the proposed standard, and it is on those considerations we offer this response to share our perspective from the various due diligence assessments to which we've been subjected by audit firms and providers.

The section **Evaluating the Implications of Using an Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses** in Appendix B of the proposed standard provides high-level basic guidance for third-party risk management of Intermediaries used in the confirmation process. It states that firms engaging Intermediaries should assess the design and operating effective of controls over the risks of interception and alteration of the confirmation process. However, there is not guidance to firms on how to select, scope and test the controls for these risks. It is reasonable to believe then that most firms will default to a SOC2 report to meet this requirement. Indeed, the Spotlight Report *Observations and Reminders on the Use of a Service Provider in the Confirmation Process* published in March 2022 makes the specific statement that firms should either use a SOC report or perform their own audit procedures. While a SOC report is a comfortable and reasonable tool to assess an Intermediary, it is not the only type of assessment available. However, absent more guidance on how to scope such assessments, audit firms are unable to confidently meet the Board's expectations. It is Circuit's experience that many firms that request a SOC2 do not understand which Trust Service Principles apply, nor how to evaluate the scope of controls or their effectiveness. Rather, these firms are willing to accept a SOC2 report without reading past the date, opinion and narrative.

To maximize conformance with the letter and spirit of AS2310, Circuit recommends the Board provide more guidance to firms for evaluating Intermediaries so they and the Intermediary can engage in an objective assessment to arrive at a confident decision regarding the viability of the company and technology under review.

Circuit thanks the Board for its service to the audit profession and for this opportunity to share our perspective on the confirmation process.

Respectfully Submitted,

Brian J. Costello

Brian J. Costello

Compliance & Open Banking Strategy



Ireland | UK | EU | USA | Australia | Hong Kong



+1 617 962 9742

brian@circuit.io

circuit.io

NCI Business Centre, Mayor Street, IFSC, D1 Dublin





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,

Eric E. Cohen
 Cohen Computer Consulting, Mechanicsburg, PA
 559-4-XBRL-GL



March 2, 2023

By email: comments@pcaobus.org

Ms. Phoebe W. Brown
Office of the Secretary, PCAOB
1666 K Street, NW
Washington, DC 20006-2803

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

Dear Secretary Brown:

CohnReznick LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB or Board) Release No. 2022-009, *Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards* (the new proposed standard).

CohnReznick is the 15th largest accounting firm in the US, with origins dating back to 1919. While our domestic and international capabilities (including through our Nexia International membership) allow us to serve a broad array of clients, we are a significant provider of services to the smaller and middle market. Our desire is that our feedback will provide perspectives on the impact that the proposed standard might have on audits of small and medium-sized entities.

In addition to our overall observations below, we respond to some of the specific questions on which the PCAOB is seeking comment in the Appendix to this letter.

OVERALL RESPONSE

General Support

We support the development of the proposed PCAOB Strategic Plan 2022-2026 (“Strategic Plan”) and believe that it will, overall, subject to our comments below and in the Appendix serve the public interest.

Need for Collaboration with Other Standard Setters, Including AICPA and IAASB

We recommend the PCAOB consider that the dual standard setter structure in the United States creates two issues that could erode audit quality:

- The difficulties encountered and resources used by firms in complying with PCAOB standards, American Institute of Certified Public Accountants (AICPA) AU-Cs, and International Auditing and Assurance Standards Board (IAASB) International Standards on Auditing (ISAs). By having to maintain different or overlapping methodologies, the resources of firms, from staff through partner level, both at the engagement team and in national office level, are pulled away from the pure concept of performing high quality audits.

- The lack of robust collaboration between standard setters (the PCAOB and the AICPA Auditing Standards Board (ASB)) prevents brainstorming and information sharing that would benefit audit quality. Many of the same risks of material misstatement in private companies affect public companies and vice versa.

In order to serve the public interest, we recommend the PCAOB consider:

- 1) converging PCAOB standards with ISA/US GAAS, or even reimplementing updated US GAAS as promulgated by the ASB for the audits of public companies, and
- 2) seeking a board seat on the ASB to maintain appropriate continuing involvement in standard setting and continue serving the public interest by contributing its knowledge and observations to standard setting

Benefits of a Reimplementation of US GAAS for Public Company Audits

Audit quality and the public interest are served by the reimplementation of US GAAS for public company audits for multiple reasons:

In particular, audit quality and the public interest will be served by:

- Robust and focused PCAOB involvement in the AICPA's activities. The PCAOB's involvement as a board member of the ASB would help further prioritize efforts aimed at facilitating audit quality. This approach would result in having additional resources focused on research, analysis, and other data-driven audit quality-oriented matters. This would help alleviate the resource-related challenges that arise from having to develop and maintain different sets of standards, many of which have common overarching objectives and principles.
- A universal set of updated and fit-for-purpose standards. Public company audits would gain the benefit of one robust set of updated standards geared for both a US and international environment at a time of growing globalization and cross border financial reporting. We believe that the provisions in US GAAS are generally "fit-for-purpose" for audits of public entities. As such, we suggest that these standards be used as a baseline for auditing and that the rationale for incremental requirements be expressly highlighted.
- Increased time and focus on audit quality. Reducing the amount of time and effort that firms of all sizes spend addressing the nuanced, and non-substantive, differences between PCAOB and US GAAS will free up resources to focus on the more substantive and complex audit matters that are relevant to achieving high-quality audits.
- Increase in talent mobility. Minimizing the differences in the standards that apply to audits of financial statements of companies in the US and around the world will drive more consistent application of the standards across firms. This will help accommodate inter-firm mobility and address resource constraints and pressures, particularly during a period where CPAs numbers at all levels are dwindling.

If you have any questions concerning our comments or would like to discuss any of our responses or recommendations in more detail, please feel free to contact Steven Morrison, Partner, National Director of Audit, at steven.morrison@cohnreznick.com or Diane Jules, Director, Audit Quality Group, at diane.jules@cohnreznick.com.

Yours truly,

A handwritten signature in cursive script that reads "CohnReznick LLP". The signature is written in black ink and is positioned above the printed name of the firm.

CohnReznick LLP

APPENDIX – SPECIFIC RESPONSES TO SELECT QUESTIONS

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? If so, what type of information would be useful to investors and how might it be provided?

The PCAOB may want to consider that providing extensive information on confirmation procedures in the auditor’s report may give undue prominence to areas subject to confirmation at the expense of other accounts that may be more subjective. Also, depending on the nature of information disclosed about the auditor’s use of confirmations, such may imply greater-than-reasonable or even near-absolute level of assurance or, conversely, cast doubt on the effectiveness of confirmations. Further, there is a risk that providing information about specific auditor procedures undertaken (e.g., use of confirmations in the audit) may be distracting/confusing to investors who may not have the appropriate context to draw meaningful conclusions. We believe that the auditor’s report should focus on providing transparency about the outcome of the audit instead of including details about audit procedures and processes which over time could become boilerplate in nature and clutter the auditor’s report.

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 confirmation process? If so, how?

There is a pervasive use of technology in today’s business environment, with an increased use of automated tools, data analytic techniques and other technology-based tools by auditors. We encourage the PCAOB to further modernize the proposed standard and incorporate the use of technology into the auditor’s objective to obtain sufficient appropriate audit evidence similar to how the AICPA did in revising its Statement on Auditing Standards (SAS) 142, *Audit Evidence*. We believe the focus of the auditor should remain on obtaining sufficient appropriate audit evidence.

Regarding the concept of more explicitly addressing the use of technology, including situations where the use of technology might improve the quality of evidence obtained through the confirmation process, we have concerns about referring to specific means by which information should be confirmed in the proposed standard (e.g., fax/facsimile). Given the ever-evolving nature of technology, what is available and effective now, may become dated over time. At best, such examples may just be outdated and unhelpful, at worst, the example might be unintentionally misleading to auditors as technologies evolve as what was once considered persuasive evidence may no longer be so.

4. Is the objective of the new proposed standard clear? If not, how should it be clarified?

We believe the objective of the new proposed standard is clear.

5. Does the new proposed standard provide for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard?

We believe the new proposed standard provides for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard.

6. Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?

No. We believe confirmation should not be required for additional accounts or assertions. We believe the auditor should determine the nature, timing, and extent of further audit procedures (including confirmations) necessary to obtain sufficient appropriate audit evidence. Prescriptive requirements about which accounts or financial statement assertions an auditor should be required to perform confirmation procedures on may detract from audit quality by unnecessarily focusing the auditor on check-the-box audit approach which might achieve compliance as opposed to designing a risk-based audit and obtaining sufficient appropriate audit evidence.

7. As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?

We believe not including such a requirement in the new proposed standard, is appropriate. We believe the auditor should determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. A requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation will likely not improve audit quality. The auditor still has to obtain sufficient appropriate audit evidence and confirmations may not contribute to such in responding to significant risks. Plus, the determination of whether or not a significant risk “could be adequately addressed through confirmation” is overly subjective and will create inspection findings and related responses that may not necessarily contribute to audit quality.

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?

We believe the new proposed standard is sufficiently flexible to accommodate situations where an auditor chooses to confirm information about newer types of assets and recommend the PCAOB remain alert for circumstances in the future indicating the new proposed standard, if implemented, is not sufficiently flexible. Refer also to our response to Question 3.

10. Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

We believe such requirements in the new proposed standard are sufficiently clear and appropriate, except for regarding “third parties.” We believe, as currently proposed, that “third parties” may be interpreted by a number of auditors as “financial institutions” only. We believe adding guidance such as what is underlined below will be helpful to auditors. The underlined wording below is adapted from D(1)(i) on page 21 of PCAOB Release 2022-009.

.09 For cash and cash equivalents held by third parties (“cash”), the auditor should perform confirmation procedures.

Note: The term “third parties” is not limited to financial institutions, but can include others such as money transfer providers.

12. For other financial relationships with the confirming party, is the requirement in the new proposed standard that the auditor should consider confirmation sufficiently clear and appropriate?

We believe such a requirement in the new proposed standard is sufficiently clear and appropriate.

13. Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

We have concerns that the way the new proposed standard is drafted may be interpreted as all cash accounts should be confirmed in all instances. We are proposing that the PCAOB include wording such as that below to expand on the requirement in paragraph .10. Our suggested wording (underlined below) is adapted from D(1)(i) on pages 20 and 21 of PCAOB Release 2022-009.

.09 For cash and cash equivalents held by third parties (“cash”), the auditor should perform confirmation procedures.

.10 In selecting the individual items of cash to confirm, the auditor should take into account the auditor’s understanding of the company’s cash management and treasury function, and the substance of the company’s arrangements and transactions with third parties.

NOTE: An auditor might select bank accounts with balances over a certain amount, accounts with a high volume of transactions, accounts opened or closed during the period under audit, or accounts the auditor identifies as particularly risk-prone. Alternatively, the auditor might determine it is appropriate to confirm all cash accounts. The auditor would also follow the direction in PCAOB standards when determining whether performing procedures in addition to confirmation is necessary to address the assessed risk of material misstatement relating to cash.

We do encourage the PCAOB to ensure the expectations on what is appropriate for auditors to perform (confirm all year-end cash accounts, accounts opened and/or closed, etc.) and document in this regard is specifically articulated in the standard itself and not through the inspection process.

14. Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?

We believe the continued requirement to confirm accounts receivable is sufficiently clear and appropriate.

15. Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?

We believe such provisions are sufficiently principles based.

16. Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?

We believe the description of accounts receivable is sufficiently clear.

17. Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

We believe the description of the ability to overcome the presumption to confirm accounts receivable is not sufficiently clear and appropriate. As drafted, the proposed standard indicates the presumption to confirm accounts receivable may be overcome when the auditor determines that performing other substantive procedures (without using confirmation) would provide audit evidence at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures. We believe this wording is vague and might lead to auditor confusion and inconsistent application in practice. We recommend the PCAOB consider adopting the requirements in AU-C 505 which provides more specific and clearer guidance to assist auditors determine when the presumption to confirm accounts receivable may be overcome. This includes:

- the overall account balance is immaterial,
- external confirmation procedures would be ineffective, or
- the auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk.

18. Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?

Yes, see our response to Question 17

19. Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

We believe the proposed requirement is sufficiently clear but is not appropriate. We believe the proposed communication of the "basis for the auditor's determination" is overly prescriptive and granular and potentially compromises the effectiveness of the audit by making the auditor's procedures too predictable.

20. Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?

We believe the provisions of the new standard would be clearer and more appropriate if "significant unusual transactions" was removed. We believe sufficient appropriate audit evidence may be obtained with the requirement focused on risks of material misstatement. Also, we believe the consideration of significant unusual transactions, if there is a reasonable possibility of a

material misstatement, is included in a focused requirement on “significant risks of material misstatement.” Our proposed change to paragraph 15 is below with a strikethrough:

~~.15 For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction.~~

21. Is the new proposed standard sufficiently clear that an auditor’s use of confirmation is not limited to the circumstances discussed in paragraphs .09 through .15 of the new proposed standard? If not, how should it be clarified?

We believe the new proposed standard is sufficiently clear in this regard.

22. Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

We do not believe the provisions of the new proposed standard are sufficiently clear and appropriate. We have the following concerns:

1. The proposed note to paragraph 16 appears to infer that “blank form” confirmations should be used. We recommend the underlined wording below, from AU-C 505.A6, be added to provide the appropriate context to assist auditors.
2. We believe the requirement to test the accuracy and completeness of information produced by the company will result in duplicative audit procedures. For example, for a listing of cash accounts, the confirmations themselves contribute to the mix of evidence for the auditor to conclude. Also, the relevant requirement regarding information produced by the company already exists in AS 1105.10.

We therefore suggest that the Board consider making the following edits to paragraph 16 of the proposed standard:

~~.16 The auditor should identify the information related to the relevant assertions that the auditor plans to verify with confirming parties or (when using a blank form) obtain from confirming parties.~~

Note: Some forms of **positive confirmation requests** ask the confirming party to indicate whether the confirming party agrees with the information stated on the request. Other forms of positive confirmation requests, referred to as blank forms, do not state the amount (or other information) to be confirmed, but request the confirming party to fill in the balance or furnish other information. ~~Using a blank form confirmation request may provide more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., customer account balance).~~

A risk exists, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request and that ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required from the confirming parties to provide the requested information.

~~.17 The auditor should test the accuracy and completeness of information produced by the company that the auditor uses in selecting the items to confirm.~~6

23. Are the provisions of the new proposed standard related to identifying confirming parties sufficiently clear and appropriate?

We believe the provisions are clear and appropriate and commend the PCAOB for incorporating the concept of bias as the AICPA ASB has done in AU-C 500.

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?

We believe 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, is sufficiently clear and appropriate. We do not believe the new proposed standard should contain specific procedures for the auditor to test information about the confirming party (e.g., the address) as we believe it could encourage a checklist mentality and may not be effective in all audits due to the facts and circumstances in an individual engagement now or in the future as technology evolves. We also recommend that the PCAOB withdraw subparagraph (c) in the note to paragraph 25 of the proposed standard. because it appears to create a de facto requirement that if the original confirmation is not returned that the confirmation response is not valid.

Evaluating Reliability of Confirmation Responses

.25 The auditor should evaluate the reliability of confirmation responses, taking into account any information about events, conditions, or other information that the auditor becomes aware of that (i) contradicts the information used when selecting the confirming party pursuant to paragraphs .18 and .19 or (ii) indicates that the confirmation request or confirmation response may have been intercepted and altered.⁸

Note: The following are examples of indicators that a confirmation response may have been intercepted or altered:

- a. The confirmation response comes from a physical or electronic address other than the address on the confirmation request.
- b. The confirmation response does not include a signature of the confirming party or otherwise identify the confirming party.
- ~~c. The confirmation response does not include a copy of the original confirmation request, e-mail chain, or any other information indicating that the confirming party is responding to the auditor's confirmation request.~~

25. Are the provisions of the new proposed standard related to the auditor's use of negative confirmation requests sufficiently clear and appropriate?

We believe such provisions of the new proposed standard are sufficiently clear and appropriate.

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 account when using an intermediary in the confirmation process?

We believe such provisions of the new proposed standard are sufficiently clear and appropriate. We acknowledge that as a result of the increase in use of services such as Confirmation.com, such guidance is appropriate. We do encourage the PCAOB to ensure its expectations about what is appropriate for auditors to perform and document in this regard be expressly articulated in the final confirmation standard. Doing so will help drive consistency in terms of how the new confirmation standard is implemented across firms and might reduce the likelihood of the Board needing to provide clarifications through the inspection process.

27. Is the potential interaction between using an intermediary in the new proposed standard and the proposed requirements in QC 1000 related to third-party providers sufficiently clear?

We believe the potential interaction in the new proposed standard is sufficiently clear in the proposal, but not in the standard itself.

28. Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?

We believe such provisions of the new proposed standard are sufficiently clear and appropriate.

29. Are the provisions of the new proposed standard related to confirmation exceptions and nonresponses sufficiently clear and appropriate?

We believe such provisions of the new proposed standard are sufficiently clear and appropriate.

30. Are the provisions about when the auditor should send a second positive confirmation request sufficiently clear and appropriate? Would this provision be a change from current practice?

We believe such provisions of the new proposed standard are sufficiently clear and appropriate.

31. Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?

We believe such provisions of the new proposed standard are sufficiently clear and appropriate.

32. Are there any additional examples of alternative procedures that we should consider for inclusion as examples in the new proposed standard?

We believe such provisions of the new proposed standard are sufficiently clear and appropriate.

35. In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?

Management may have legitimate reasons for requesting the auditor not to confirm. We do believe an auditor should be required to consider whether such a request is indicative of a risk of material misstatement. Accordingly, we recommend the PCAOB consider adding a requirement such as the following:

If management requests an auditor not to confirm a certain item, the auditor should request management to indicate the reason for such request. As appropriate, the auditor should consider whether such a request is indicative of a risk of material misstatement.

37. Are the definitions included in the new proposed standard sufficiently clear and appropriate? If not, what changes should be made to the definitions?

We believe the definitions included in the new proposed standard are sufficiently clear but question whether having different wording than what is in AU-C 505, such as for “exception” and positive and negative “confirmation request” is necessary and in the public interest.

44. We request comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that we should consider? If so, what responses should be considered?

Please see our Overall Response.

48. How much time following SEC approval would audit firms need to implement the proposed requirements?

Given that auditors sometimes send confirmations at interim periods, to allow for a proper implementation of the standard, we recommend that compliance be not for fiscal years beginning after the year of SEC approval, but the following year.

49. Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?

Depending on timing of SEC approval, we do believe that requiring compliance for fiscal years beginning after the year of SEC approval may present implementation challenges. Auditors sometimes request confirmations at interim dates and the timing of the SEC approval might be of such that only months will have passed before an auditor is sending confirmations. To allow for a proper implementation of the standard, we recommend that compliance be for fiscal years beginning after the year of SEC approval, but the following year.



Via Email

February 16, 2023

Ms. Phoebe W. Brown
Office of Secretary
Public Company Accounting Oversight Board
1616 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket No. 028: Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards¹

Dear Secretary Brown:

The Council of Institutional Investors (CII) appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board’s (PCAOB or Board) Release No. 2022-009, *Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards* (Proposal).²

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$40 trillion in assets under management.³

CII Policies

As the leading U.S. voice for effective corporate governance and strong shareholder rights, CII believes that accurate and reliable audited financial statements are critical to investors in making informed decisions, and vital to the overall well-being of our capital markets.⁴ That belief is

¹ 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.

² *Id.*

³ For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

⁴ CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), http://www.cii.org/policies_other_issues#indep_acct_audit_standards.

reflected in the following CII membership-approved policy on the **Independence of Accounting and Auditing Standard Setters**:

Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the . . . standards that . . . auditors use in providing assurance that the preparers’ recognition, measurement and disclosures are free of material misstatements or omissions.⁵

This policy establishes the principle that “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.”⁶ Our membership reaffirmed that principle in our policy on **Auditor Independence**.⁷ That policy, as revised, includes the following additional provisions that we believe may be relevant to issues raised by the Proposal:

Audit Committee Responsibilities Regarding Independent Auditors: The audit committee should fully exercise its authority to hire, compensate, oversee and, if necessary, terminate the company’s independent auditor. In doing so, the committee should take proactive steps to promote auditor independence and audit quality. Even in the absence of egregious reasons, the committee should consider the appropriateness of periodically changing the auditor, bearing in mind factors that include, but are not limited to:

-
- the quality and frequency of communication from the auditor to the audit committee
-
- the clarity, utility and insights provided in the auditor’s report and the auditor’s letter to management in relation to the audit
- the level of transparency and robustness of the audit firm with the audit committee and investors, including with respect to audit quality indicators, governance practices and underlying principles, and the financial stability of the audit firm
- enforcement actions (in process or completed), inspection results and fines levied by the Public Company Accounting Oversight Board or other regulators
-

⁵ *Id.*

⁶ *Id.*

⁷ CII, Policies on Corporate Governance, § 2.13 Auditor Independence (updated Sept. 21, 2022), https://www.cii.org/corp_gov_policies.

Page 3 of 5
February 16, 2023

Investors are the “customers” and end users of financial statements and disclosures in the public capital markets. Both the audit committee and the auditor should recognize this principle.⁸

Shareowner Votes on the Board’s Choice of Outside Auditor: Audit Committee charters should provide for annual shareowner votes on the board’s choice of independent, external auditor.⁹

The Proposal

In CII’s September 2020 letter in response to the Request for Public Comment, *Draft 2022-2026 PCAOB Strategic Plan*,¹⁰ we requested that the Board prioritize “as requested by [Securities and Exchange Commission] Chair Gensler, the Board’s standard setting project on ‘Interim Standards’”(September Letter).¹¹ Our prioritization of the interim standards was based, in part, on our policy on the **Independence of Accounting and Auditing Standard Setters** that reflects the view that auditing standards should be the product of an independent standard setting process that focuses on investors’ information needs.¹²

We applaud the Board for issuing the Proposal because it would replace interim standard AS 2310, *The Auditor’s Use of Confirmation* (AS 2310).¹³ 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”¹⁴ By replacing AS 2310, we believe the Proposal would generally be responsive to the recommendation in our September Letter.

⁸ § 2.13a Audit Committee Responsibilities Regarding Independent Auditors.

⁹ § 2.13f Shareowner Votes on the Board’s Choice of Outside Auditor.

¹⁰ 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/defaultsource/about/administration/documents/strategic_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a_4; PCAOB, Strategic Plan, 2022-2026, Draft for Comment (Aug. 2022), https://pcaob-assets.azureedge.net/pcaob-dev/docs/defaultsource/about/administration/documents/strategic_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db_4/%20Draft-2022-2026-Strategic-Plan.pdf.

¹¹ Letter from Jeffrey P. Mahoney, General Counsel, CII to Office of the Secretary, PCAOB 5 (Sept. 15, 2022), [https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20(final).pdf).

¹² *Id.* at 4 (referencing our policy on Independence of Accounting and Auditing Standard Setters in support for Securities and Exchange Commission Chair Gary Gensler’s statement regarding the need for the Public Company Accounting Oversight Board to update the “interim standards”).

¹³ AS 2310: The Confirmation Process, PCAOB (last visited Feb. 10, 2023), <https://pcaobus.org/oversight/standards/auditing-standards/details/AS2310>.

¹⁴ 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>.

Page 4 of 5
February 16, 2023

We note that the Proposal explicitly directs one question to investors. That question and our response thereto follows:

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? If so, what type of information would be useful to investors and how might it be provided?¹⁵

Generally consistent with our policy on **Audit Committee Responsibilities Regarding Independent Auditors**, CII believes that investors would find it useful in making investment or proxy voting decisions, including decisions about the **Shareowner Votes on the Board’s Choice of Outside Auditor**, if investors have more information from the auditor about the auditor’s use of confirmation in the audit of an issuer’s financial statements.

Information that we believe would generally be useful to investors includes disclosure about “instances where the auditor has determined that the presumption to confirm accounts receivable has been overcome.”¹⁶ We understand that the Proposal already requires that the auditor provide this information to the audit committee.¹⁷ We, however, believe that many of the reasons the Board cites as a basis for providing the information to the audit committee may be equally valid for requiring that the information be provided by the auditor to investors. Those reasons include that the information “may reinforce the auditor’s obligation to exercise due professional care before determining that the presumption to confirm accounts receivable has been overcome.”¹⁸ The need for this reinforcement and its potential benefit to investors and the capital markets is amply illustrated in the Proposal’s detailing of recent “PCAOB inspections of registered public accounting firms, and [] enforcement actions relating to deficient confirmation procedures . . .”¹⁹

Finally, we do not express a view on “how might” information from the auditor about the auditor’s use of confirmation in the audit of an issuer’s financial statements be provided to investors. In that regard, we would respectfully request that the Board issue supplemental materials to the Proposal describing the various options of how might the information be made available to investors within the PCAOB’s existing authority, and the advantages and disadvantages of each. CII commits to reviewing and promptly responding to the supplemental materials and addressing in more detail the “how might it be provided” element of the above referenced question.

¹⁵ PCAOB Release No. 2022-009 at 16 (emphasis added).

¹⁶ *Id.* at 24.

¹⁷ *Id.* ¶ 14 at A1-3 (“The auditor should communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor’s determination.”).

¹⁸ *Id.* at 25.

¹⁹ *Id.* at 11.

Page 5 of 5
February 16, 2023

We appreciate the opportunity to provide CII's investor-focused perspective on the Proposal. Please let me know if you have any questions about the content of this letter.

Sincerely,

A handwritten signature in blue ink that reads "Jeff Mahoney". The signature is written in a cursive style with a long, sweeping underline.

Jeffrey P. Mahoney
General Counsel

**Crowe LLP**

Independent Member Crowe Global

One Mid America Plaza, Suite 500

Post Office Box 3697

Oakbrook Terrace, Illinois 60522-3697

Tel +1 630 574 7878

Fax +1 630 574 1608

www.crowe.com

February 20, 2023

By email: comments@pcaobus.org

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

Re: PCAOB Rulemaking Docket Matter No. 028; The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards

To the Office of the Secretary:

Crowe LLP appreciates the opportunity to comment on the Proposed Auditing Standard, *The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards* ("the proposed standard"), as per PCAOB Release No. 2022-009 ("the Release") dated December 20, 2022.

We agree with the Public Company Accounting Oversight Board ("PCAOB" or the "Board") that AS 2310, *The Confirmation Process*, is an important standard for audit quality and investor protection and that a revised standard is appropriate to strengthen and modernize the requirements for the confirmation process. We support the elements of the proposal which reflect advances in information technology and the use of electronic confirmations, as well as the increased use of intermediaries as part of the confirmation process. We believe that it is important that the issued standard is future proof to support the longevity of the standard while allowing for methods for confirmation and forms of audit evidence that are yet to emerge.

We appreciate the considerations given by the Board to public comments provided on PCAOB Release No. 2010-003. We also agree that it's critical that confirmations are properly designed and that confirmation responses are appropriately evaluated, especially when there are confirmation exceptions or concerns about reliability.

General Observations*Risk Assessment and Auditor Judgment*

We agree that confirmation can be a very effective audit procedure. However, we believe that the proposed standard should include operational provisions whereby a requirement to perform confirmation procedures can be overcome. AS 2110, *Identifying and Assessing Risks of Material Misstatement*, ("AS 2110") and AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, ("AS 2301") are cornerstone to the successful execution of an audit. We believe that revisions to the proposed standard can be made to remove certain prescriptive requirements that are inconsistent with the foundational requirements established in AS 2110 and AS 2301, without compromising audit quality.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 2

We believe the standards should allow the auditor to utilize professional judgment to determine audit responses that are sufficient and appropriate for identified risks of material misstatement. There are specific elements of the proposed standard that impose requirements that either reduce or remove the ability of the auditor to determine the appropriate audit response for a particular account. For example, paragraph 2310.09 requires the auditor to confirm cash and cash equivalents held by third parties, with no ability to overcome this requirement. Paragraph 2310.11 in the proposed standard states the auditor “should consider sending confirmation requests about other financial relationships with the confirming party”. Paragraph 2310.15 in the proposed standard indicates that “For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction.” We don’t believe it is necessary for the proposed standard to introduce prescriptive requirements that go beyond the requirements in AS 2110 and AS 2301.

Further, paragraph 2310.14 retains the ability for the auditor to overcome the presumption to confirm accounts receivable. However, the revised language results in a much higher threshold which seems to restrict the ability of the auditor to determine an appropriate audit response that is commensurate with the assessed risk (see our response to Question 17 below).

Confirmation as an Audit Procedure

A confirmation response represents a particular form of audit evidence obtained from a third party. As stated in the Release, “confirmation can be an important source of evidence obtained as part of an audit of a company’s financial statements, and has long been used by auditors”, and “confirmation is one of the specific audit procedures described in PCAOB standards that an auditor could perform when addressing a risk of material misstatement.” We agree that confirmation is an important audit procedure and that a response to a properly designed confirmation can be an important source of audit evidence.

The Release states that “In many situations, confirmation could provide audit evidence that is more persuasive than evidence obtained solely through other substantive procedures.” The Release indicates this may occur, for example, in situations involving fraud risks and significant unusual transactions, or situations where the auditor has determined not to test company controls or has found controls to be ineffective. The Release also states that “we continue to believe that confirmation procedures would generally provide more persuasive audit evidence than other procedures (without confirmation) for cash and accounts receivable.”

However, as stated in AS 1105: *Audit Evidence*, paragraph .04, “the auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion.” Sufficiency of audit evidence is a measure of quantity and is affected by the quality of evidence obtained and the related risk of material misstatement. To be appropriate, audit evidence must be both relevant and reliable. In accordance with AS 2301, the auditor should obtain more persuasive evidence the higher the auditor’s assessment of risk. Thus, the persuasiveness of audit evidence needed and the determination of audit procedures to be performed are subject to auditor judgment based on the related risk assessment. We are concerned with the requirement to perform confirmation procedures, even in situations where the auditor does not believe that obtaining confirmation from an external source is necessary to obtain sufficient appropriate audit evidence. Based on the risk assessment, the auditor may determine that reliable audit evidence that is sufficient and appropriate can be obtained via the performance of another audit procedure or a combination of other audit procedures, without confirmation.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 3

Paragraph 2310.06 in the proposed standard states that “audit evidence obtained through the confirmation process from an external knowledgeable source is generally more reliable than evidence obtained only from internal company sources.” While existing standards acknowledge that evidence obtained from independent sources is more reliable than evidence obtained from the company, it’s not clear why the Release would emphasize audit evidence obtained from an external knowledgeable source specifically “through the confirmation process” over audit evidence obtained from sources independent of the company by the performance of other audit procedures.

As stated in the Release, “we also believe that our auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence.” This concept manifests in the proposed standard specifically related to allowing room for methods of confirmation that are yet to emerge. While we agree with this approach, we maintain that confirmation is not the only way to obtain sufficient appropriate audit evidence; thus we believe the auditing standards should be written to support types of audit evidence and ways to obtain audit evidence that may be available in the future.

Specific Areas of Comment

Overall

Q3: *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 confirmation process? If so, how?*

A: No. We believe the proposed standard should allow room for advances in technology; however, there is no need for additional specific or prescriptive language or examples.

Relationship of the Confirmation Process to the Auditor’s Identification and Assessment of and Response to the Risks of Material Misstatement

Q6: *Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?*

A: No. We believe the standard should allow auditors to apply judgment related to risk assessment and determination of the appropriate audit response.

Q7: *As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?*

A: Yes. As discussed in our general observations, we believe it is appropriate to allow auditors to apply professional judgment related to risk assessment and determination of the appropriate audit response, including for areas of significant risk.

Q9: *Are there ways in which the new proposed standard should be changed to further align with the PCAOB’s risk assessment standards? If so, how should the new proposed standard be changed?*

A: Yes. As noted in our general observations and in various other responses below, we believe that certain aspects of the proposed standard are too prescriptive and inhibit the auditor’s ability to apply professional judgment based on risk assessments performed in accordance with AS 2110.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 4

Confirming Certain Accounts and Terms of Transactions

Q10: *Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?*

A: No, the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, are not sufficiently clear and appropriate.

Cash and cash equivalents: As stated in our general observations, AS 2110 requires the auditor to perform risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement, whether due to error or fraud, and designing further audit procedures. This begins at the financial statement level and with the auditor's overall understanding of the company and its environment and works down to the significant accounts and disclosures and their relevant assertions.

Based on the proposed standard, once the auditor determines that cash is a significant account, the auditor should confirm at least a selection of cash and cash equivalent accounts in accordance with paragraphs 2310.09 and .10. While we do not object to the requirement to perform confirmation procedures for cash and cash equivalents held by third parties, we are concerned that the requirement to confirm cash and cash equivalents is a mandate regardless of the related risk assessment. We believe the standard should include the ability for the auditor to overcome the presumption to confirm cash and cash equivalents, such as when the use of confirmations would be ineffective, or the auditor's combined assessed level of inherent and control risk is low (such that other audit procedures are sufficient to address the audit risk). Please see our response to Question 17 below related to the ability to overcome the presumption to confirm accounts receivable.

Other financial relationships: The Release states that "the requirement in the new proposed standard to consider confirming other financial relationships is designed to allow the auditor to tailor the confirmation procedures based on the auditor's understanding of the company." Paragraph 2310.11 in the proposed standard states "When confirming cash, the auditor should consider sending confirmation requests about other financial relationships with the confirming party." As a presumptive requirement to consider ("should consider"), the auditor would have to document their considerations any time they did not include other financial relationships with the confirming party in the confirmation request, whether or not such financial relationships were assessed by the auditor to present risk of material misstatement. We don't believe it is necessary for the proposed standard to introduce a requirement that goes beyond the principles-based requirements in AS 2110 and AS 2301. We recommend paragraph 2310.11 in the proposed standard be revised from "should consider" to "may consider".

Q11: *Are there substantive audit procedures other than confirmation that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash? If so, please describe these procedures.*

A: As stated in our general observations, the persuasiveness of audit evidence needed, and the determination of audit procedures to be performed, is subject to auditor judgment based on the related risk assessment for an account or assertion. Also, auditors assess the persuasiveness of audit evidence obtained based on the totality of audit procedures performed, not only one audit procedure. We also believe the final standard should be flexible to support innovation in audit procedures in the future.

Audit evidence for the existence of cash: We believe a more appropriate question is "Are there substantive audit procedures other than confirmation that may provide audit evidence that is sufficient and appropriate to address the risk of material misstatement related to cash and cash equivalents?" We believe the answer to this question is yes; as a result, we believe the final standard should include the ability for the auditor to overcome the presumption to confirm cash.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 5

Other procedures the auditor might perform include control testing related to cash management, obtaining original bank statements, auditing bank reconciliations, and obtaining other evidence from the third party holding the cash and cash equivalents. This might include obtaining direct access to the records of the holder of the cash accounts. We don't object to direct access not being characterized as a "confirmation procedure" in the proposed standard; however, we believe it can, when properly executed, be a valid procedure to obtain evidence related to cash existence. As noted in our general observations, audit evidence obtained from sources independent of the company via performance of audit procedures other than confirmation can be reliable and persuasive. The appropriate audit procedures should be determined by the auditor based on the assessed risk of material misstatement. The auditor would apply judgment to determine if the collective audit evidence obtained, based on the suite of audit procedures performed, is sufficiently persuasive to address the assessed risk of material misstatement.

We believe the ability to perform alternative procedures for cash is also critical in the case where the auditor performs confirmation procedures for cash and cash equivalents but is not able to obtain a reliable confirmation response. This could occur related to a nonresponse (even to the required second request) or a situation where the auditor is required to utilize an intermediary for the confirmation (by the confirming party), and there are concerns about the controls of the intermediary that the auditor is not able to satisfactorily resolve (see our response to Question 26 below).

Future proofing the standard to allow for innovation and advances in technology: The Release states that "in general, the Board is not aware of other types of substantive procedures that would provide audit evidence that is as persuasive as audit evidence obtained through confirmation of cash." The Release also notes that "we also believe that our auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence." The requirement to confirm cash and cash equivalents, with no ability to overcome the presumption, appears to discount the possibility that there could be other types of audit procedures that could be performed or other forms of audit evidence that could be obtained, which would be sufficiently persuasive to address the risk of material misstatement related to cash existence. We believe the final standard should include requirements that support the intents of the Board as stated in the Release to allow for auditor innovation and provide room for advances in technology.

Q14: *Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?*

A: Yes, we believe that the continued requirement to confirm accounts receivable is sufficiently clear and appropriate. Please refer to our response to Question 17 below for our concerns related to the auditor's ability to overcome the presumption to confirm accounts receivable.

Q15: *Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?*

A: Yes, the provisions of the new proposed standard are sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable, based on the auditor's risk assessment performed in accordance with AS 2110.

Q16: *Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?*

A: Yes, the description of accounts receivable is sufficiently clear, and it need not be broadened.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 6

Q17: *Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?*

A: No, the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures is not sufficiently clear or appropriate.

As stated in the response to Question 14, we believe that the continued requirement to confirm accounts receivable is appropriate. However, we also observe that various factors related to the current environment have resulted in the confirmation of accounts receivable being less effective. As stated in the Release, "In recent years, however, there has been an increased wariness about phishing attempts and some customers might not understand or trust an unsolicited confirmation request from an auditor." For this reason, we believe it is more important than ever for an auditor to be able to apply professional judgment to determine that performing alternative procedures (to confirmation) is sufficient to address the risk of material misstatement related to accounts receivable.

Paragraph .34 in the extant standard indicates that the presumption to confirm accounts receivable can be overcome if one of the following is true: accounts receivable are immaterial to the financial statements, the use of confirmations would be ineffective, or the auditor's combined assessed level of inherent and control risk is low (such that other audit procedures are sufficient to address the audit risk). The requirement in proposed standard paragraph 2310.14 is that "The presumption to confirm accounts receivable in paragraph .12 may be overcome when the auditor determines that performing other substantive procedures (without using confirmation) would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures." The Release clarifies that the intended comparison is with "*effective* confirmation procedures". Further, the Release states that "an auditor may have determined... that sending ... confirmation requests... has not resulted in obtaining relevant and reliable audit evidence, because of poor rates of response... Accordingly, ... the auditor may design and implement an audit approach that does not involve the use of confirmation."

Paragraph 2310.14, as written, appears to create a higher bar for the auditor to determine it is appropriate to perform alternative procedures (versus confirmation) than the above statement from the Release. One way to resolve this inconsistency is a revision to proposed standard paragraph 2310.14, such as "evidence that the auditor might expect to obtain from confirmation responses obtained from the performance of effective through performing confirmation procedures."

Even with this clarification to paragraph 2310.14, we don't believe the ability to overcome the presumption to confirm accounts receivable only when *another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures* is appropriate. As stated in our general observations and in our response to Question 11, the persuasiveness of audit evidence needed, and the determination of audit procedures to be performed, is subject to auditor judgment based on the related risk assessment for an account or assertion. Therefore, we don't believe it is necessary that alternative procedures provide evidence that is *at least as persuasive as* an accounts receivable confirmation response, as long as the audit evidence obtained is sufficient and appropriate to address the assessed risks of material misstatement. We agree with providing the auditor with the ability to overcome the presumption to confirm accounts receivable; however, we don't believe the revisions in the proposed standard are operational in this regard.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 7

The Release states that “The new proposed standard would not carry forward the provisions addressing materiality or a combination of risk assessments that are currently available to overcome the presumption to confirm accounts receivable, as these matters would be considered by the auditor as part of identifying and assessing the risks of material misstatement and designing and implementing an audit response under PCAOB risk assessment standards.” Consistent with our response to Question 10, we are concerned by the removal of the risk assessment and materiality criteria to overcome the presumption to confirm accounts receivable. If the Board’s intent is that the requirement to confirm accounts receivable in paragraph 2310.12 presumes the auditor has already assessed a risk of material misstatement related to the existence of accounts receivable, revisions are necessary in the proposed standard to make this clear. Alternatively, paragraph .14 could be modified to provide the auditor the ability to overcome the presumption to confirm accounts receivable based on risk assessment (similar to the existing standard).

We believe it would also be appropriate to revise paragraph .14 to reflect the conditions for an auditor to overcome the presumption to confirm accounts receivable as included in existing paragraph 2310.34.

Q18: *Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?*

A: As discussed throughout this letter, we don’t believe the ability of the auditor to perform alternative procedures should be restricted only because the audit evidence obtained via those alternative procedures may not be as persuasive as audit evidence that may be obtained through confirmation procedures. The auditor should obtain audit evidence that is sufficiently persuasive in response to the assessed risk for any significant account or disclosure.

Q19: *Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor’s determination sufficiently clear and appropriate? Why or why not?*

A: No, we do not believe the separate requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor’s determination is appropriate. Existing auditing standard AS 1301, *Communications with Audit Committees*, (AS 1301) requires the auditor to communicate to the audit committee an overview of the overall audit strategy and timing of the audit. Further, the auditor is required to communicate matters arising from the audit that are significant to the financial reporting process. Via these requirements, the audit committee will be informed of decisions related to accounts receivable confirmation or the results of the confirmation procedures when they are a meaningful part of the overall audit strategy or significant to the financial reporting process. If the decision not to confirm accounts receivable is *not* meaningful or significant enough to meet existing requirements for communication to the audit committee, this communication will add to the volume of information provided to the audit committee and may detract from the most important issues about which the auditor needs to communicate with the audit committee.

Further, in accordance with AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, the auditor must assess if matters arising from the audit of the financial statements that were communicated or required to be communicated to the audit committee are critical audit matters. There will be an additional cost to this communication requirement, as the auditor would need to evaluate the communication as a possible critical audit matter.

Finally, as stated elsewhere in this letter, we believe the auditor should apply their professional judgment to determine the appropriate audit responses in accordance with AS 2301, based on a risk assessment performed in accordance with AS 2110.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 8

Q20: *Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?*

A: No, the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement are not sufficiently clear and appropriate. Paragraph 2310.15 in the proposed standard indicates that “For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor *should consider* confirming terms of the transaction with the counterparty to the transaction.” (italicized for emphasis). Consistent with our general observations, we believe the auditor should utilize judgment to determine audit responses that are sufficient and appropriate for the risks assessed related to such transactions. We recommend paragraph 2310.15 in the proposed standard be revised from “should consider” to “may consider”.

Designing Confirmation Requests

Q22: *Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?*

A: No. While we believe that paragraph 2310.16 in the proposed standard is sufficiently clear and appropriate related to identifying information to confirm, we do not believe the inclusion of paragraph 2310.17 in the proposed standard is necessary. Requiring the auditor to “test the accuracy and completeness of information produced by the company that the auditor uses in selecting the items to confirm” is redundant with the requirements in AS 1105, *Audit Evidence*. We are not clear what the Board’s intent is with repeating a procedure that is already required by another auditing standard. We are not aware of anything which makes the information produced by the company that is used in preparing a confirmation request different from other information produced by the company, as it relates to the auditor evaluating whether the information is appropriate for the purpose.

Q24: *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?*

A: Yes, the requirement is sufficiently clear and appropriate. We do not believe there is need for any specific required procedures.

Maintaining Control over the Confirmation Process

Q26: *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 account when using an intermediary in the confirmation process?*

A: No, we don’t believe that the requirements in the proposed standard to evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses are sufficiently clear. We believe that paragraphs .B2 and .B3 require edits to be operational for auditors.

As noted in our response to Question 31 below, we believe that there could be situations where the auditor is unable to obtain a reliable confirmation response related to cash and cash equivalents selected to confirm. In such circumstances, we believe the proposed standard should acknowledge the ability of the auditor to perform alternative procedures. This may be particularly relevant in situations where the party to which the confirmation is sent will only respond to confirmation requests via an intermediary.

PCAOB
 Rulemaking Docket Matter No. 028
 February 20, 2023
 Page 9

As stated in the Release, “Some auditors have used an Independent Service Auditor’s Report on Service Organization Controls (“SOC report”) to evaluate the design and operating effectiveness of the intermediary’s controls relevant to sending and receiving confirmations.” There could be situations where a key confirmation intermediary has qualifications in their SOC report which impact the ability of an auditor to conclude that the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively, as required by paragraph .B2b. Alternatively, the intermediary may not have implemented appropriate controls or, there may not be a SOC report covering the appropriate period for the intermediary.

Paragraph .B3 in the proposed standard states that “If information obtained by the auditor *indicates* that” the controls used by the intermediary to address the risk of interception and alteration are not implemented or designed and operating effectively, “the auditor *should not use* the intermediary to send confirmation requests or receive confirmation responses” (italics added for emphasis). We believe that the proposed standard should acknowledge the ability of the auditor to investigate and resolve such indications. This could be by performing additional tests of controls over the intermediary, for example. We recommend that the wording in paragraph .B3 be modified as follows “If information obtained by the auditor indicates The auditor may obtain information that indicates (i) the intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses, (ii) the necessary controls are not designed or operating effectively, or (iii) circumstances exist that give the company the ability to override the intermediary’s controls. The auditor may consider performing additional audit procedures to address these indicators. If the auditor determines that the risk of interception or alteration has not been sufficiently addressed, the auditor should not use the intermediary to send confirmation requests or receive confirmation responses.”

Paragraph 2310.24 in the proposed standard states that “The auditor or the confirming party can engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party.” In order to avoid confusion, we suggest the word “engage” in this sentence be replaced with another term, such as “utilize”.

Evaluating Confirmation Responses and Confirmation Exceptions, and Addressing Nonresponses and Incomplete Responses

Q28: *Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?*

A: Generally, we believe the provisions of the new proposed standard related to evaluating the reliability of confirmation responses are sufficiently clear. However, we recommend that the wording in paragraph 2310.25 in the proposed standard be revised as follows: “The auditor should evaluate the reliability of confirmation responses, considering taking into account any information about events, conditions, or other information that the auditor becomes aware of...”. We believe this change is consistent with the intent of the Board.

Q29: *Are the provisions of the new proposed standard related to confirmation exceptions and nonresponses sufficiently clear and appropriate?*

A: No; we do not believe the requirements in the proposed standard related to confirmation exceptions is sufficiently clear. As defined in proposed standard 2310.A2, a confirmation exception is information in a confirmation response that differs from information the auditor obtained from the company. We believe that in many cases, the auditor may be able to obtain audit evidence to determine that a difference in information received from a confirmation does not reflect a misstatement or potential misstatement. As noted in the Release, “For various reasons, information in a confirmation response received by the auditor could differ from other information in the company’s records obtained by the auditor.” If it is determined that the confirmation difference was a result of a clerical error or caused by a timing difference, for example, it does not seem necessary to evaluate such items as potential control deficiencies, as required by AS 2310.27 in the proposed standard.

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 10

Q30: *Are the provisions about when the auditor should send a second positive confirmation request sufficiently clear and appropriate? Would this provision be a change from current practice?*

A: No, the provisions about sending a second positive confirmation request are not sufficiently clear and appropriate. Paragraph 2310.28 in the proposed standard indicates that “the auditor should send a second positive confirmation request to the confirming party *unless the auditor has become aware of information that indicates that the confirming party would be unlikely to respond to the auditor*” (italics added for emphasis). It is not clear what documentation would sufficiently support an auditor’s determination that the confirming party would be unlikely to respond, specifically when the confirmation procedure is explicitly required by the proposed standard. Accordingly, we believe that the proposed standard should allow auditor judgment in the determination of sending a second positive confirmation request. Therefore, we recommend that paragraph 28 be revised as follows: “the auditor should consider sending a second positive confirmation request to the confirming party”.

Performing Alternative Procedures

Q31: *Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?*

A: We believe the proposed standard is clear related to circumstances where the auditor would be required to perform alternative procedures. However, we observe that the proposed standard excludes discussion about or examples of alternative procedures that may be acceptable to obtain evidence of the existence of cash. We understand that the proposed standard requires the auditor to perform confirmation procedures for cash and cash equivalents held by third parties (please see our response to Question 10). There could be situations where the auditor is unable to obtain a reliable confirmation response. Similar to accounts receivable, we believe the final standard should acknowledge the ability of the auditor to perform alternative procedures to verify the existence of cash, in such circumstances, and include examples of alternative procedures that may provide sufficient audit evidence either individually or collectively (please see our response to Question 11).

Using Internal Audit in the Confirmation Process

Q33: *Are the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses sufficiently clear and appropriate? If not, what changes should be considered?*

A: Yes, we believe the requirements in the proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses are sufficiently clear and appropriate.

Other Matters

Q35: *In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?*

A: No, we do not believe that there are other procedures that the auditor should perform in the event of a management request not to confirm a certain item; procedures required by other PCAOB standards are sufficient.

Q37: *Are the definitions included in the new proposed standard sufficiently clear and appropriate? If not, what changes should be made to the definitions?*

PCAOB
Rulemaking Docket Matter No. 028
February 20, 2023
Page 11

A: Yes, generally the definitions included in the proposed standard are sufficiently clear and appropriate; however, please refer to our response to Question 29 related to confirmation exceptions.

Effective Date

Q48: *How much time following SEC approval would audit firms need to implement the proposed requirements?*

A: In order for firms and confirmation intermediaries to have sufficient time to prepare for implementation, we recommend that the final standard be effective for audits of fiscal years beginning no sooner than two years after approval by the SEC (or for audits of fiscal years beginning three years after the year of SEC approval if that approval occurs in the third or fourth calendar quarter). See our response to Question 49 below.

Q49: *Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?*

A: Yes, based on the proposed standard, yes, requiring compliance for fiscal years beginning after the year of SEC approval would present challenges for auditors as well as for confirmation intermediaries. For firms, several elements of the proposed standard need to be implemented in the planning stages of an audit. Therefore, firms need to be prepared for full implementation prior to the start of the audit engagements. This includes methodology changes, related training, and the implementation of any related quality control procedures.

In many cases, the auditor chooses to use or is required to use confirmation intermediaries. Based on the requirements in the proposed standard, intermediaries may need to make changes to processes and controls related to the risk of interception and alteration of the confirmation requests and responses. Once changes are implemented, determination needs to be made as to whether those controls are designed and operating effectively. These matters need to be completed prior to the effective date of the requirement to comply with the proposed standard.

We would be pleased to respond to any questions regarding our observations noted within this letter. If there are any other questions regarding this subject, please contact Kyle Owens at 630.575.4265 or kyle.owens@crowe.com or Linda Poeschel at 630.586.5268 or linda.poeschel@crowe.com.

Sincerely,



Crowe LLP



Deloitte & Touche LLP

30 Rockefeller Plaza

New York, NY 10112

USA

<https://www.deloitte.com>

February 17, 2023

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

Re: PCAOB Rulemaking Docket Matter No. 028

Deloitte & Touche LLP (“D&T,” “we,” or “our”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its Interim Analysis No. 2022-009, *The Auditors Use of Confirmation and Other Proposed Amendments to PCAOB Standards* (the “proposed standard” or “the Release”).

When properly designed and executed by the auditor, confirmations provide important audit evidence. We support the Board’s efforts to address the execution of audits when confirmation is a selected audit procedure and to update its existing confirmations standard to reflect changes in business practices, technology advances, and changes in communication methods since its original issuance. These changes include the increased use of electronic communications and use of third-party intermediaries by both companies (e.g., companies outsourcing treasury function activities) and by auditors.

Overall, we believe revisions to AS 2310, *The Confirmation Process*, should align with other PCAOB standards’ risk-based principles, maintain the concept of auditor judgment (specifically related to determining the appropriate responses to identified risks of material misstatement), and be written to evolve with future technologies (i.e., to “future proof” such that the standard will not need to be continually re-opened for data access and other technological advancements). In those respects, we have the following overall suggestions:

Audit Evidence

Auditors plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for their opinion, considering the identified and assessed risks of material misstatement (ROMM) and the quality (i.e., relevance and reliability) and quantity of the audit evidence necessary to appropriately respond to those ROMMs. The Release (e.g., pages 13, 18, 19 and 25 of Section III, and paragraphs 9 and 12 of the proposed standard) seems to infer that confirmation procedures would generally provide more persuasive audit evidence than any other procedure, even if the other procedure would involve obtaining and testing external (third-party) information. PCAOB standards, including AS 1105, *Audit Evidence*, indicate that evidence obtained needs to be sufficient and appropriate for the purpose for which it is intended, which is a significant judgement involving the evaluation of relevance, reliability, and other factors. Accordingly, different risk assessment conclusions reached for different account balances within an audit may lead the auditor to appropriately seek audit evidence with varying degrees of persuasiveness, however still sufficient and appropriate for its purposes.

Due to the facts and circumstances of every audit and the variety of sources of relevant and reliable evidence that are, or may be, available to the auditor, we do not believe a general conclusion can be reached in terms of the relative persuasiveness of audit evidence. We are therefore concerned that designating confirmations, as defined, as more persuasive, may inappropriately bias the auditor when other sources of audit evidence exist that may be more appropriate as well as sufficient for the circumstances, including evidence obtained from third parties using procedures other than confirmation.

Risk-Based Approach and Technology Considerations

We believe that the objective of the proposed standard should be to provide requirements and guidance when the auditor determines (through appropriate risk assessment procedures) that confirmation procedures provide an appropriate response to one or more assertions related to an identified risk of material misstatement. While a confirmation may in many circumstances provide high-quality evidence, what constitutes evidence that is sufficient and appropriate for the circumstances may include evidence obtained through other audit procedures contained in the PCAOB's standards, such as tests of controls, and other types of substantive procedures such as inspection, inquiry, observation, or analytical procedures, with information used in such procedures obtained from external or internal sources as appropriate.

It was unclear from the Release whether the Board feels that confirmations should be contemplated any time they can be used as evidence given the statements about persuasiveness (e.g. the various account balances, transactions, and risks discussed in paragraphs .06 and .07 of the proposed standard), or whether the Board's focus is on confirming cash and accounts receivable, with greater judgement available for other account balances and classes of transactions. We request the Board to clarify its position in the final standard if it is the Board's presumption or intention that auditors send confirmations, as defined, on any and all information that can be confirmed by external parties, as we are concerned this would lead to unnecessary cost and potential timing issues if confirmations were not received and alternative procedures sought. Further we are not sure there would be a commensurate benefit to audit quality. Additionally, it would not give consideration to current or future audit procedures, enabled by technological advancements, that allow for evidence to be obtained from external parties using procedures other than confirmation as defined. If it is not the Board's intent for auditors to always presume to send confirmations for those matters included in paragraphs .06 and .07, we recommend the removal of those paragraphs.

When auditing cash and accounts receivable, we believe auditors should be able to determine the audit procedure that they believe will be effective in providing relevant and reliable audit evidence without a default requirement to confirm in all cases when other evidence may be appropriately persuasive for the circumstances:

- As it relates to cash, auditors currently use audit procedures other than confirmations to obtain audit evidence, including obtaining evidence from third-party organizations to which banks have outsourced treasury functions or gaining direct access to the external information of a financial institution. Other innovations in obtaining access to information, such as obtaining direct feeds of information from a bank or lender, are currently being developed as reliable and appropriate alternatives to performing confirmation procedures, while still resulting in evidence being obtained from a third-party. As technology continues to evolve, we can expect that the ways that auditors can access reliable external information regarding cash balances that do not meet the definition of confirmation will continue to expand, consistent with the PCAOB's stated views in the Release that "...auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence". While the relative persuasiveness between alternative sources of relevant external evidence can be debated, strong arguments can be made that audit procedures such as direct access to third party banking information is more persuasive than confirming a cash balance, as defined in the proposed standard.
- For accounts receivable auditors have noted deteriorating trends in response rates to confirmation requests sent to customers, vendors, and other third parties in recent times. In some cases, confirming entities have instituted policies that they will not respond to confirmation requests. We have also observed increased trends by confirmation recipients to ignore requests due to suspicions of phishing and identity theft schemes. While we agree with the Board that receipt of an accounts receivable confirmation reply may be high-quality audit evidence, confirmation procedures may be ineffective due to expected high nonresponse rates, resulting in the need for alternative procedures to be planned and performed but only after the effort has been expended, unsuccessfully, in seeking to receive confirmation replies including sending multiple requests. Requiring, or adopting a presumptive requirement to confirm accounts receivable rather than enabling the auditor to use professional judgment in considering other relevant and reliable alternatives, for example, evidence of cash receipts subsequent to year end, may increase the cost of the audit without a substantial change in audit quality.

Therefore, we believe the final standard should not include prescriptive requirements (i.e., those in paragraphs 9 and 12 of the proposed standard) to perform confirmation procedures that would limit the auditor's judgment to assess and respond to risks or otherwise supersede the auditor's conclusion as to what constitutes sufficient and

appropriate evidence necessary in the circumstances having considered, among other matters, the assessed risk and expectations on the effectiveness of audit procedures. With the receipt of responses to accounts receivable confirmation continuing to decline leading to ineffective results, and the expanding technological options that allow direct access to banking information, confirmation should not be the presumed default and best audit procedure for cash and accounts receivable going forward.

If the Board proceeds with a prescriptive requirement to confirm cash, we ask that the Board expand paragraph .31 of the proposed standard to make it clear that alternative procedures can be performed for cash confirmations, provided the audit evidence obtained is sufficient and appropriate for its purposes (e.g., tests of controls, evaluation of service auditor's reports and other procedures related to service organizations to whom treasury function activities have been outsourced).

If the Board proceeds with a prescriptive requirement to confirm accounts receivable, we ask that the Board revise the criteria proposed that must be met when not sending confirmations for accounts receivables to be grounded in the concept of whether the confirmation process is expected to be effective in obtaining evidence.

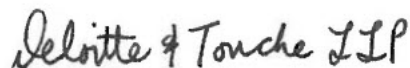
Communications with the Audit Committee

Absent the auditor identifying a significant risk related to accounts receivable, we do not believe that informing the Audit Committee when the auditor determines that an alternative to performing confirmation procedures is planned is relevant to the objectives described in paragraph .03 of AS 1301, *Communications with Audit Committees*. We believe that imposing such a requirement may cause unfounded concern by Audit Committee members because ordinarily the auditor is able to design and execute alternative audit procedures resulting in sufficient appropriate audit evidence, consistent with those procedures typically performed when confirmation replies are not returned. Therefore, we recommend that the Board modify the additional communication requirement in paragraph 14 from the proposed standard, to apply only when accounts receivable is a significant risk as the auditor would communicate to the Audit Committee the nature of the planned audit procedures.

We have also included more detailed observations and suggestions in the attached Appendix.

We would welcome the opportunity to engage with the Board in dialogue about these issues to provide deeper context about impacts and implications. If you have any questions, please contact Jennifer Haskell at 203-761-3394 or Dora Burzenski at 206-716-7881.

Yours sincerely,



Deloitte & Touche LLP

Appendix – Other Matters and Editorial Recommendations

The editorial recommendations are highlighted as follows: Additions are noted in **bold underline** and deletions are noted in ~~strikethrough~~ text. The markup of the paragraphs follows the same numerical sequence or ordering of sections as structured in the proposed standard.

Proposed AS 2310

Paragraph .06

We believe AS 1105, *Audit Evidence*, paragraph .08 adequately and appropriately draws a comparison between the relative reliability of evidence obtained from a knowledgeable source that is independent of the company, regardless of the means by which it was obtained, and that of evidence obtained only from internal sources. The inclusion of the language “through the confirmation process” in paragraph 6 does not recognize procedures that involve evidence obtained from knowledgeable, independent sources through means other than confirmations as defined in the standard, and is therefore unnecessarily limiting. We recommend deleting such phrase, as follows:

.06 Audit evidence obtained ~~through the confirmation process~~ from an external knowledgeable source is generally more reliable than evidence obtained only from internal company sources. The following are examples of financial statement assertions for which the confirmation process, when properly designed and executed, can provide relevant and reliable audit evidence:

- Existence (e.g., cash, accounts receivable, investments)
- Occurrence (e.g., revenue transactions)
- Completeness (e.g., accounts payable, debt)
- Rights and obligations (e.g., cash, assets pledged as collateral)

Paragraph .15

We believe the considerations included in Extant AS 2310, *The Confirmation Process*, paragraph 27 regarding heightened professional skepticism are important to maintain in the standard. This guidance allows auditors to make appropriate judgments in determining whether facts and circumstances indicate that confirmation procedures may not produce sufficient appropriate evidence to address the assessed risks. Therefore, we suggest the following additional wording:

.15 For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction. **In making this determination, the auditor should exercise a heightened degree of professional skepticism relative to the respondent, pursuant to paragraphs .18, .19, and .20. In these circumstances, the auditor should consider whether there is sufficient basis for concluding that the confirmation request is being sent to a respondent who is expected to be knowledgeable about the information to be confirmed and from whom the auditor can expect the response will provide relevant and reliable audit evidence.**

Paragraph .16 Note

There are a number of items the auditor considers when designing an effective confirmation process, including whether to use blank confirmation requests. As stated in Extant AS 2310 paragraph 19, blank confirmations may result in lower response rates because additional effort may be required of the recipient, which we think remains an important consideration; therefore we suggest the following:

Note: Some forms of positive confirmation requests ask the confirming party to indicate whether the confirming party agrees with the information stated on the request. Other forms of positive confirmation requests, referred to as blank forms, do not state the amount (or other information) to be confirmed, but request the confirming party to fill in the balance or furnish other information. Using a blank form confirmation request may provide more reliable audit evidence than using a confirmation request that

includes information the auditor is seeking to confirm (e.g., customer account balance). **However, blank confirmations may result in lower response rates because additional effort may be required of the recipient to respond.**

Paragraph .17

We suggest the following additions to paragraph .17 to be consistent with the text in AS 1105, *Audit Evidence*, paragraph 10:

.17 The auditor should **perform procedures to** test the accuracy and completeness of information ~~produced by the company,~~ **or test the controls over the accuracy and completeness, of information produced by the company** that the auditor uses in selecting the items to confirm.

Paragraph .18

We suggest the follow revisions to clarify that an appropriate confirming party is one that the auditor reasonably believes, based on the information available, should be expected to be knowledgeable about the information to be confirmed.

.18 The auditor should direct confirmation requests to confirming parties (individuals or organizations) who are **expected to be** knowledgeable about the information to be confirmed and determine that the confirmation requests are properly addressed.

Paragraph .24 and Appendix B paragraph .B2

In situations in which the evaluation of intermediaries is necessary, as described in certain paragraphs, we would expect these considerations would most often be evaluated at the firm level for intermediaries that are most commonly used for the auditor's confirmation procedures (including as part of processes and controls related to quality control). We therefore suggest the Board clarify (either in the Release or in paragraphs 24 and B2 of the proposal) that the evaluation may be performed and the documentation may be retained centrally as part of the firm's quality control system as opposed to a requirement that the auditor must include documentation of this assessment with their audit files. ____

Paragraph .26

We believe that the concepts in paragraph .26 are appropriate to link back to paragraph .25, and provide clarity that, presuming the confirmations were designed and performed appropriately with respect to evaluation of the appropriate confirming party, the auditor is not required to do an exhaustive search to obtain additional evidence that the confirmation response is reliable. Therefore, we suggest the following change:

.26 If the auditor **becomes aware of any factors pursuant to paragraph .25 and** is unable **to overcome these factors** to determine that the confirmation response is reliable, the auditor should perform alternative procedures as discussed in paragraph .31.

Paragraph .27

We suggest the following revisions to sequence the auditor's considerations, as confirmation exceptions would generally first be evaluated to determine if they are indicative of one or more misstatements, and, if so, the auditor would then determine whether there is a deficiency in internal control:

.27 The auditor should evaluate confirmation exceptions and determine whether the confirmation exceptions individually or in the aggregate indicate ~~(i) a deficiency in the company's internal control over financial reporting,~~ ⁹ ~~(ii)~~ (i) a misstatement that should be evaluated in accordance with AS 2810, *Evaluating Audit Results*, ~~or both.~~ **or (ii) a deficiency in the company's internal control over financial reporting.**

Proposed AS 2310, Appendix A

We suggest the following revisions to the definitions in Appendix A for improved clarity.

.A2 Confirmation exception – Information in a confirmation response that differs from information the auditor obtained from the company **and is seeking to confirm**.

.A3 Confirmation process – The process that involves sending (**which may include transmitting in electronic form through technological means**) a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions.

.A7 Negative confirmation request – A confirmation request in which the auditor requests a confirmation response only if the confirming party disagrees with the information provided in the **confirmation** request.

.A8 Nonresponse – A situation in which (i) after sending a confirmation request(s), the request is returned undelivered; (ii) the auditor does not receive a confirmation response to a positive confirmation request **directly** from the intended confirming party; (iii) the auditor receives correspondence from the intended confirming party indicating that the confirming party is unable or unwilling to respond to the confirmation request; or (iv) the auditor receives an oral response only.

Proposed AS 2310, Appendix B

We suggest the following revision to paragraph .B3 to conform the language to paragraphs .B1 and .B2, and to acknowledge that an indicator alone should not result in the inability for an auditor to use an intermediary, as there may be ways to overcome the indicator:

~~.B3 If information obtained by the auditor indicates that (i) the intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses, (ii) the necessary controls are not designed or operating effectively, or (iii) circumstances exist that give the company the ability to override the intermediary's controls~~ **confirmation requests and responses facilitated by the intermediary may not be reliable, the auditor should determine whether additional audit procedures may be performed that would result in reliable confirmation requests being sent and reliable confirmation responses being received by the auditor through the intermediary. If the auditor concludes that confirmation requests and responses would not be reliable,** the auditor should not use the intermediary to send confirmation requests or receive confirmation responses.



Ernst & Young LLP
One Manhattan West
401 9th Avenue
New York, NY 10001

Tel: +1 212 773 3000
ey.com

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

20 February 2023

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

Dear Ms. Brown:

Ernst & Young LLP is pleased to submit comments on the proposed standard on the auditor’s use of confirmations and related amendments issued by the Public Company Accounting Oversight Board (PCAOB or Board).

We support the Board’s efforts to modernize the requirements for the auditor’s confirmation process. As the Board noted in the proposing release, the manner in which auditors perform confirmation procedures to obtain audit evidence has changed significantly since 1991, when the American Institute of Certified Public Accountants (AICPA) issued the standard that the PCAOB subsequently adopted as interim auditing standard Accounting Update section 330, *The Confirmation Process*. Today, most audit confirmations are sent and received electronically, and new ways to perform confirmation procedures could emerge as technology evolves, creating both benefits and risks that were not contemplated by the interim auditing standard.

We also appreciate the Board’s efforts to solicit public comment and for its consideration of the feedback it already received on its initial 2010 proposal.¹ Below we discuss two areas where we encourage the Board to make adjustments in the final standard.

We agree with the Board that, when properly designed and executed, the confirmation process is an effective way for the auditor to obtain important third-party evidence to support certain financial statement assertions. The confirmation process is widely used in practice to obtain audit evidence for several financial statement accounts and to obtain information regarding the terms of certain transactions. We support the use of confirmations to obtain audit evidence in all circumstances where it is the best option to get sufficient, appropriate audit evidence. However, we believe it is also appropriate to retain the ability to obtain other forms of audit evidence directly from third parties (e.g., direct access) where possible and appropriate.

¹ See [Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards](#)



Ms. Phoebe W. Brown,
Public Company Accounting Oversight Board
Page 2

Generally, we recommend changes in two areas: (1) to provide further guidance regarding how the use of other forms of third-party audit evidence, not obtained through the confirmation process, may be sufficient and appropriate in the circumstances and (2) remove the proposed requirement to communicate to the audit committee when the auditor has not sent accounts receivable confirmations to be consistent with other communication requirements.

Persuasiveness of audit evidence

We agree that confirmation procedures that are properly designed and executed may provide more reliable audit evidence than audit evidence from internal company sources, as stated in the release.² However, we are concerned that the language in paragraphs .06 and .07 of the proposed standard could be interpreted to mean that other forms of audit evidence aren't sufficient and appropriate to address the assessed risks of material misstatement. Similarly, it is unclear what audit evidence would qualify as "at least as persuasive as the audit evidence that the auditor might expect to obtain through performing confirmation procedures."

We generally believe that auditors should follow the guidance in Auditing Standard (AS) 1105, *Audit Evidence*, and use their professional judgment to determine whether and to what extent confirmations should be used to obtain sufficient and appropriate audit evidence based on their assessment of risk. We support the Board's intention for the standard to be flexible enough to apply to new methods that may arise from future technological changes in auditing. However, we believe the proposal's emphasis on confirmations as the most reliable form of audit evidence in certain cases may have the unintended consequence of not supporting other techniques to gather evidence, such as appropriately designed direct access to third-party information.

While we agree that properly designed confirmations are an important form of third-party audit evidence, we believe that, without further clarifications on the evaluation of the persuasiveness of other forms of evidence, in certain situations the auditor could wind up expending significant effort to send confirmations, even when the auditor has determined that the confirmations are likely to not provide significant evidence in the audit. For example, this may be the case when an entity under audit operates in an industry where the auditor has observed a history of very low confirmation response rates (e.g., health care, hospitality, power and utilities, oil and gas industries) or when the auditor has concluded that the risks related to the existence of accounts receivable are minimal and persuasive evidence from external confirmations is not commensurate with the assessed risks.

Consider the audit of a utilities company, where accounts receivable are converted to cash quickly because the company will stop providing service promptly if the customer does not pay the company's invoices timely and whereby the accounts receivable balance is composed of many individually insignificant balances held by ordinary consumers. Based on these considerations and other factors, the auditor may have assessed the risk of material misstatement for the assertions related to accounts receivable as low. Let's also assume that the auditor has attempted to confirm accounts receivable historically and has consistently observed extremely low response rates. In this situation, the auditor may have elected to perform audit procedures other than confirmation to obtain sufficient and appropriate audit evidence that the receivables existed as of the testing date. Such procedures

² See Release page 4.



Ms. Phoebe W. Brown,
Public Company Accounting Oversight Board
Page 3

may have included obtaining third-party evidence that the receivables selected for testing were subsequently collected in cash and that the services were provided in the appropriate period. Under the proposed standard, the auditor would be required to send confirmations, despite knowing that this method of obtaining audit evidence is not effective and other forms of evidence will likely be needed for the auditor to conclude or assert that the evidence they obtained from other procedures is “at least as persuasive” as the evidence they would have obtained had they sent the confirmations, which may not be commensurate with the auditor’s risk assessment.

Audit committee communication

We understand the importance of and support the communication of key elements of the audit strategy, the timing of the audit and identified significant risks to the audit committee, as required by AS 1301, *Communications with Audit Committees*. Such communications form the foundation of the audit committee’s oversight of the auditor.

The auditor’s existing communication responsibilities require a discussion about the overall audit strategy, including significant risks identified during the risk assessment process. AS 1301 notes that the communication of the audit strategy is intended to provide information about key areas of the audit in such a way to not compromise the effectiveness of the audit procedures.

With respect to accounts receivable, we believe that the existing requirements would result in communications that accomplish the objective of sufficiently informing the audit committee when revenue and accounts receivable were identified as containing a significant risk, including fraud. In situations when the auditor concluded that the assertions related to accounts receivable have a lower risk of material misstatement, we believe the proposed requirement to communicate to the audit committee a determination that the presumption to confirm accounts receivable has been overcome could have the unintended consequence of shifting focus away from more meaningful issues given the volume of other required communications to the audit committee. Therefore, we believe that such requirement would not significantly enhance the audit committee’s oversight or have a positive impact on audit quality.

The attachment to this letter contains our responses to the questions the PCAOB posed in the release.

* * * * *

We want to again thank the Board and its staff for its consideration of this letter and the comments we previously submitted on this topic. We would be pleased to discuss our comments with members of the PCAOB or its staff at your convenience.

Sincerely,

Ernst & Young LLP



Ms. Phoebe W. Brown,
Public Company Accounting Oversight Board
Page 4

Copy to:

PCAOB

Erica Y. Williams, Chair
Duane M. DesParte, Board Member
Christina Ho, Board Member
Kara M. Stein, Board Member
Anthony C. Thompson, Board Member
Barbara Vanich, Chief Auditor

SEC

Gary Gensler, Chair
Hester M. Peirce, Commissioner
Caroline A. Crenshaw, Commissioner
Mark T. Uyeda, Commissioner
Jaime Lizárraga, Commissioner
Paul Munter, Chief Accountant
Diana Stoltzfus, Deputy Chief Accountant

Attachment

Attachment

Q6. Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?

We do not believe there are accounts other than those addressed in the proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures. Auditors should determine whether to use confirmation procedures to obtain sufficient and appropriate audit evidence based on their risk assessment for each account or disclosure.

Q7. As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?

Yes. The proposed approach would be appropriate for the reasons stated in the release.

Q10. Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

We agree that properly designed and executed confirmation procedures may provide audit evidence that is more reliable than that from internal company sources. However, we believe the emphasis on confirmations as the most reliable form of audit evidence in certain cases may not support the use of other techniques, such as appropriately designed direct access to third-party information, and the use of methods designed in the future that may provide sufficient appropriate audit evidence in the circumstances.

While we believe the proposed requirements related to confirming cash held by third parties would be sufficiently clear, we encourage the Board to add criteria to overcome the requirement to confirm cash in the final standard, consistent with the criteria in paragraph .34 of extant AS 2310, *The Confirmation Process*, on accounts receivable, to support the use of other techniques.

Q13. Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

Yes. We believe that the requirements in the proposed standard would be sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation.

Q14. Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?

Yes. The continued requirement to confirm accounts receivable is sufficiently clear and appropriate.

Q15. Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?

Yes. The provisions of the proposed standard would be sufficiently principles based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable. Paragraph 13 of the proposed standard would allow the auditor to make judgments regarding which accounts to select for confirmation, based on their understanding of the company's arrangements and transactions with third parties and the nature of items that make up the account balances.

Q16. Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?

Yes. The description of accounts receivable is sufficiently clear in the proposed standard, and we are not aware of a reason for the Board to broaden the description to include other types of receivables.

Q17. Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

While we understand the Board's objective, we do not believe that the proposed standard clearly explains when other substantive procedures would provide evidence that is at least as persuasive as performing confirmation procedures (i.e., when the presumption to confirm accounts receivable is overcome).

We recommend the Board retain the criteria to overcome the requirement to confirm accounts receivable in paragraph .34 of extant AS 2310. We are concerned that the proposal's emphasis on the persuasiveness of audit evidence obtained through confirmation procedures may unintentionally limit the auditor's ability to obtain other types of audit evidence that may be sufficient and appropriate, as required by PCAOB AS 1105.04. Further, we believe that it is unclear in the proposed standard how, and in what situations, an auditor would be able to obtain evidence that is "at least as persuasive" as performing confirmation procedures.

Q19. Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

No. While we understand the importance of and support the communication of key elements of the audit strategy, we do not believe the proposed requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm

accounts receivable has been overcome would be appropriate. The existing communication requirements in AS 1301 result in communications that achieve the objective of informing the audit committee when relevant. While we do not believe the proposed requirement is necessary, we are supportive of PCAOB's efforts to enhance auditor communications with audit committees given their important role.

Q20. Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?

While we support the Board's objectives related to confirming the terms of certain transactions that have a significant risk of material misstatement, we do not believe that the related provisions of the proposed standard would be sufficiently clear.

Paragraph .15 of the proposed standards states that "For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction." We believe that this proposed requirement, read alongside proposed paragraphs .06 and .07, could be interpreted to mean that auditors should perform confirmation procedures in such situations, even when other forms of sufficient appropriate audit evidence exist and may be more appropriate in certain cases.

Further, this proposed requirement would imply that the auditor should consider confirmation for all significant risks associated with a complex or significant unusual transaction, regardless of whether a confirmation procedure could adequately address the identified significant risk of material misstatement. We recommend that the Board revise proposed paragraph .15 as follows:

For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming the terms of the transaction with the counterparty to the transaction **when the assertions related to the significant risk of material misstatement can be adequately addressed through confirmation.**

Q22. Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

We do not believe the proposed provisions related to identifying information to confirm would be sufficiently clear and appropriate. Paragraph .17 of the proposed standard would require the auditor to "test the accuracy and completeness of information produced by the company that the auditor uses in selecting items to confirm." We believe the Board should consider narrowing this requirement to focus only on the attributes of the information produced by the company that are relevant to the account and/or disclosure that is to be confirmed.

Q26. 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 account when using an intermediary in the confirmation process?

We believe that the proposed requirements to evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses would be appropriate; however, additional clarity may be required to make sure that the proposed provisions would be practical, particularly as it relates to the auditor's response to a potential control failure at an intermediary.

Appendix B3 of the proposed standard states that an auditor should determine that the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively. We expect that auditors would generally rely on their review and evaluation of the intermediary's Service Organization Control (SOC) report to comply with this proposed requirement.

Consequently, if auditors are not able to obtain a SOC report from the intermediary stating that it has effective controls to mitigate the risk of interception and alteration of confirmation requests and responses, the auditor may not be able to use the audit evidence obtained from confirmation procedures because many confirming parties would only participate in the confirmation process through an intermediary. We believe that in these situations the auditor should have the flexibility to continue to use the intermediary to facilitate the confirmation process if the auditor is able to perform incremental audit procedures to mitigate any risks that arose as a result of the control failure(s).

Q28. Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?

Yes. The provisions of the proposed standard related to evaluating the reliability of confirmation responses are sufficiently clear and appropriate.

Q35. In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?

No. We believe that AS 2110, *Identifying and Assessing Risks of Material Misstatement*, and AS 2401, *Consideration of Fraud in a Financial Statement Audit*, provide sufficient guidance for the auditor's responsibilities in these situations.

Q49. Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?

Yes. Although we do not believe that significant effort would be required to implement the proposed standard considering current requirements and practices, we believe that intermediaries would need time to evaluate its impact on their operations with respect to the confirmation process, update their processes and controls, and effectively implement them so that they are prepared by the time the final standard becomes effective.

Therefore, we recommend that the final standard be effective for audits of fiscal years beginning no earlier than two years after approval by the Securities and Exchange Commission (SEC).

Denis Gorgemans, CIA
PO Box 6365
Denver, CO 80206

February 20, 2023

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

By email: comments@pcaobus.org

RE: Comments Regarding PCAOB Rulemaking Docket Matter No. 028

Dear Chair Williams and PCAOB Members DesParte, Ho, Stein, and Thompson:

As a practicing internal auditor and an active member of the Institute of Internal Auditors (IIA), I appreciate the opportunity to comment on the Public Accounting Oversight Board (PCAOB) proposed auditing standard AS 2310, *"The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards,"* and I wish to respectfully disagree with this proposal.

Starting on page 42 of the proposed standard, the PCAOB states that *"The new proposed standard identifies certain activities in the confirmation process where the auditor may not use the assistance of the company's internal audit function. Specifically, the auditor would not be permitted to use internal auditors for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses."* The PCAOB explains that *"using internal auditors for selecting items to be confirmed, or for sending or receiving responses, would not be consistent with the auditor's responsibility to maintain control over the confirmation process. Involving internal auditors or other company employees in these activities would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered. Accordingly, under the new proposed standard, using direct assistance from internal auditors for these activities would not be allowed."*

This seems to be a significant departure from PCAOB's Auditing Standard AS 2605, *"Consideration of the Internal Audit Function."* This standard essentially permits the external auditors to utilize an internal audit function to conduct certain audit procedures (direct assistance) on their behalf and under their supervision. This standard also requires the external auditor to *"assess the internal auditors' competence and objectivity and evaluate and test the work performed by internal auditors to the extent appropriate in the circumstances."*

From experience throughout my external auditing attestation work and, most recently, internal auditing career, this framework has been extremely successful and has created a stable and rigorous relationship between the external auditors and their internal audit partners. This relationship is ultimately beneficial to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. In my experience, the assiduity of our external auditors testing our competence and objectivity, confirming our credentials and knowledge, and reviewing our workpapers has been second to none.

As such, maintaining the current PCAOB AS 2605 as the basis for evaluating the internal auditors' involvement with direct assistance, including for the confirmation process, seems to provide the clearest, and most consistent, path forward. Therefore, I respectfully ask that you remove the exclusion of internal audit functions from your proposed auditing standard on the auditor's use of the confirmation process.

As you may know, the internal audit profession prides itself with the independence and objectivity fundamental to the risk assurance services we provide to our organizations. As a Certified Internal Auditor (CIA), I have an obligation to exercise due care and to conform with the globally recognized International Standards for the Professional Practice of Internal Auditing along with the requirements of the IIA's Code of Ethics. The PCAOB characterization of internal auditors as untrustworthy or incapable of exhibiting due care in the performance of their duties is deeply troubling and casts an unnecessary shadow on the long-standing history of collaboration and cooperation between external auditors and internal audit functions.

I thank you for your consideration.

Respectfully,

Denis Gorgemans

Denis Gorgemans, CIA
Internal Audit Practitioner
denis.gorgemans2@gmail.com



GRANT THORNTON LLP

Grant Thornton Tower
171 N. Clark Street, Suite 200
Chicago, IL 60601-3370

D +1 312 856 0200
S [linkd.in/grantthorntonus](https://www.linkedin.com/company/grantthorntonus)
twitter.com/grantthorntonus

February 20, 2023

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

Via Email to comments@pcaobus.org

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

Dear Board members and staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB’s or Board’s) Rulemaking Docket Matter No. 028, *Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*. We respectfully submit our comments and recommendations for the Board’s consideration.

We support the Board’s initiative to update and modernize AS 2310, *The Confirmation Process*, by clarifying the auditor’s responsibilities and addressing emerging areas, such as the use of electronic confirmations. Because there are currently other projects underway that may inform the appropriate direction of standard-setting in this area (for example, the Board’s midterm standard-setting project on fraud as well as its research project on emerging technology), we ask the Board to consider the timing of those projects within the context of the proposed standard on confirmations. We believe that the direction taken by the Board now with the confirmations project could possibly require adjustment or revision based on the outcome of those other projects.

We agree with the general direction of the proposed standard but have significant reservations as to the level of prescription with certain aspects of the proposal and its related operability. We provide further detail and recommendations below that could help ensure that the standard, as adopted, is appropriately risk-based and fit for its stated purpose for the foreseeable future.

Confirmation process

We support the proposed objective of the standard and believe it is sufficiently clear. We also support retaining the long-held principles related to the confirmation process, including the auditor being responsible for designing the confirmations and maintaining control of the confirmation process.



Role of technology

We appreciate the Board acknowledging the evolution of practice in this area with the use of electronic confirmations, such as email. We believe confirmations will continue to evolve as more efficient processes or technologies become available to the profession.

While we agree with specifically addressing electronic confirmations, we caution against being overly prescriptive in the proposed requirements, which might not allow the proposed standard to “age” effectively with time and innovation. Maintaining principles-based requirements and examples can enable flexibility for the future.

We are concerned that the examples provided in the note to proposed paragraph .25 could create onerous documentation for engagement teams in situations where plausible explanations are readily apparent and not necessarily indicative of inappropriate interception or alteration of the confirmation. For example, we are aware of instances where confirmation requests are emailed to a centralized mailbox at a vendor, which is monitored by multiple individuals. The completed response may be emailed back to the engagement team from a particular individual’s email address instead of the centralized mailbox, which may be reasonable and expected based on the engagement team’s understanding of the vendor’s process for responding to confirmation requests. We believe the principle of requiring the auditor to evaluate the reliability of the confirmation response would be sufficient to guide auditors, even as entities’ vendors, banks, and customers continue to innovate their approach to responding to confirmation requests to achieve greater efficiency and effectiveness.

Finally, we encourage the Board to consider the information gathered thus far from its emerging technology project to help inform areas where incorporating a more principles-based approach in this proposed standard could benefit audit quality.

Intermediaries

We commend the Board for addressing the role of intermediaries in the proposed standard. It has become common practice for certain entities, such as banks, to respond to confirmation requests only if they are submitted through an intermediary. However, we have significant concerns with the requirements for intermediaries proposed in paragraph .24 and Appendix B. As discussed in PCAOB Release No. 2022-006, *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, a confirmation intermediary would be considered a third-party provider and would, therefore, be subject to firm-level quality controls, including the assessment of quality risks associated with third parties and the firm’s response to the identified risks. Such responses could include annual due diligence procedures and follow-up procedures if or when a significant change in the intermediary’s operations, or a change in how the firm uses that intermediary, is identified. Depending on the identified quality risks, such procedures need not align with the financial statement period-end of each audit engagement performed by the firm, as implied by paragraph .B2b and its related note.

The requirements laid out in paragraph .24 and Appendix B are procedures that we would expect firms to perform at a national level, and the firm concludes whether the intermediary is appropriate for engagement teams to use. We do not believe it is the



Board's intent, nor is it practical, to require each engagement team to separately perform these procedures at the engagement level, which is what is implied by the proposed requirements in AS 2310. Since the PCAOB quality control proposal is still in process, we strongly recommend that the Board remove the proposed requirements from the proposed standard on confirmations and address intermediaries through the principles that would be included in the final quality control standard. Each engagement team would then be responsible for complying with the firm's policies and procedures for the appropriate use of such intermediaries on their respective engagements.

Confirmations as audit evidence

We are concerned about the tone of the proposal related to the presumption that confirmations always provide the most persuasive evidence in responding to identified risks of material misstatement, including significant risks. We understand the Board's intention to require the use of confirmation procedures to address the risk of material misstatement, primarily due to fraud; however, we believe that the proposed standard over-relies on the use of such procedures to reduce that risk to an acceptable level. This overreliance reduces the auditor's ability to exercise appropriate professional judgment and skepticism.

In certain situations, confirmation procedures may not be the most effective or efficient procedure to respond to the assessed risk, even those deemed to be significant risks. We are concerned that the potential costs of complying with certain proposed requirements would outweigh their benefits. For example, paragraph .14 would require the auditor to determine whether performing other procedures without confirmation provides audit evidence that is "at least as persuasive" as the evidence the auditor might expect to obtain through confirmation, which may create a documentation exercise that would not yield a commensurate benefit to audit quality. This can increase the overall cost of an audit because time and effort must be invested on performing confirmation procedures in areas when alternative procedures may be more effective. We believe the more appropriate approach would be to align with the terms contained in AS 1105 and then to direct the auditor to obtain sufficient appropriate audit evidence relative to the identified risks of material misstatement.

Alternative procedures

Similar to the views expressed above, we are concerned that the language used in proposed paragraph .31 perpetuates an inappropriate presumption that confirmations are the best evidence auditors can obtain in response to any risk of material misstatement. We fully support and agree that confirmations are an important and necessary procedure that auditors should use, but only when a confirmation procedure responds to the related risk of material misstatement. There are myriad instances where relevant and reliable audit evidence can be, and is currently being, obtained through other means. Currently, an auditor may observe company personnel use their credentials to log in directly to the bank's website, for example. While we do not believe this procedure would constitute a confirmation, we do believe it could constitute sufficient appropriate audit evidence. Including this scenario as a practical example that would be acceptable as an alternative procedure could be beneficial to auditors. We encourage the Board to reconsider the perceived value that



confirmations provide in an audit relative to other audit evidence that could be obtained by the auditor over the course of the audit.

We agree that performing other audit procedures as an alternative to confirmations may be necessary, as discussed in proposed paragraph .31. However, we are concerned that the note to such paragraph could be misapplied in practice. We ask the Board to consider incorporating elements of the guidance provided in paragraph .A26 of AU-C Section 505, *External Confirmations*, to clarify what we believe is the intent of the proposed note:

The auditor may determine that it is not necessary to perform additional alternative audit procedures beyond the evaluation of the confirmation results if such evaluation indicates that relevant and reliable audit evidence has already been obtained. This may be the case when testing for overstatement of amounts and (a) the nonresponses in the aggregate, projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated and (b) the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions.

Confirming accounts or transactions

Receivables

Presuming that an audit procedure should always be performed conflicts with the concept of identifying and responding to the assessed risks of material misstatement present in each audit. Nevertheless, we support retaining the presumptively mandatory responsibility to confirm receivables because such procedure is already common practice in obtaining persuasive audit evidence, considering historical events and experience.

However, we recommend adding to proposed paragraph .12 that this requirement applies when accounts receivable is a significant account or disclosure; as currently proposed, we feel this requirement does not clearly tie back to the proposed objective of the standard. Clarifying proposed paragraph .12 would appropriately focus auditors on confirming accounts receivable in response to a risk identified in a significant account or disclosure.

Cash

We do not believe the requirement to confirm cash is sufficiently risk-based, particularly when the proposed standard does not allow the auditor to overcome the presumption of performing confirmation procedures. We recommend adding to proposed paragraph .09 the stipulation that this requirement applies only when cash is a significant account or disclosure; as currently proposed, we feel this requirement does not clearly tie back to the proposed objective of the standard.

Additionally, we believe proposed paragraphs .09 and .10 are fraud-oriented and assume that there is always a heightened risk of fraud related to cash accounts in all audit engagements. We believe this assumption is further perpetuated by the proposed amendment to AS 2605.22, which edits out "cash" as an example of an



assertion that might have a low risk of material misstatement. However, we note that there may be circumstances in which the auditor appropriately assesses risk as low and can perform other more effective and efficient audit procedures, such as directly accessing or observing the company's bank account information via the bank's website. The prescription of the proposed requirements does not appear consistent with the Board's existing risk assessment standards. We recommend that the Board include the notion of assessed risks of material misstatement to proposed paragraphs .10 and .13, which discuss what the auditor takes into account when selecting the individual items of cash and receivables, respectively, to confirm. We also recommend that the Board reinstate cash as an example in paragraph .22 of AS 2605.

Additional observation

We found the proposed requirement in paragraph .17 to be confusing. In selecting items to confirm, we believe the risk is that the population is not complete, and not whether the population is accurate. Rather, in many cases, accuracy is addressed or tested through the confirmations themselves. Therefore, we ask the Board to reconsider the wording in paragraph .17 to focus instead on the risk or issue that this requirement is intended to address, which we believe is ensuring that the auditor is selecting items to confirm from a complete population.

Other topics

Definitions

Generally, we believe that the definitions in the proposed standard are sufficiently clear and reasonable.

Use of internal audit

The premise of AS 2605 is that if the auditor determines that the internal audit is sufficiently independent and objective, the auditor has the ability to use the work of internal audit or use internal audit to provide direct assistance to the auditor. While we don't disagree with the auditor maintaining control of the confirmation process, we are concerned about the implications of proposed paragraph .32, which is prescriptive in a manner that could imply that the principles provided in AS 2605 are not sufficient to enable auditors to arrive at the right approach in using internal audit. We believe internal audit can be a valuable resource to auditors and can assist in activities such as investigating exceptions or performing alternative procedures. We encourage the Board to clarify and reinforce how or where internal audit can provide direct assistance to the auditor relative to the confirmation process.

Audit committee communications

The requirements of AS 1301, *Communications with Audit Committees*, provide principles-based requirements that promote an appropriate level of communication of audit-related matters to an entity's audit committee. Since its implementation, AS 1301 has enhanced the two-way communication that takes place between auditors and audit committees and has effectively focused communications on the information that is most necessary for the audit committee to fulfill its duties in overseeing the audit and the company's financial reporting.



We do not believe that the proposed requirement in paragraph .14 aligns with the principles of AS 1301. We are unaware of issues in practice that imply auditors are inappropriately overcoming the presumption to confirm accounts receivable that would necessitate an audit committee communication as prescriptive as the requirement proposed in paragraph .14. If relevant or significant enough, the auditor's decision not to send confirmations would fall under AS 1301.09. We are concerned that by making this a mandatory communication requirement, the Board is implying that confirming accounts receivable is a vital audit procedure, rather than a presumed audit procedure, in every audit to which the communication is relevant. Instead of enhancing auditor accountability with regard to overcoming the presumption to send confirmations, this requirement might set a precedent that would mire audit committees in the minutiae of audit procedures instead of focusing on audit matters that are most relevant to their oversight responsibilities. Therefore, we ask the Board to remove this proposed requirement and allow the principles of AS 1301 to govern the level of detail about the audit strategy that the auditor communicates.

Amendments

Other than our concerns with the proposed amendments to AS 2605 outlined earlier in our letter, we do not have any additional concerns with the proposed amendments to the other auditing standards.

Effective date

Although confirmation procedures are generally performed at or near a company's year-end, engagement teams design those confirmation procedures as part of the planning and risk assessment process. While we believe audit firms currently are addressing the use of intermediaries in their systems of quality control, the proposed requirements related to intermediaries could have implications on those systems of quality control, which might require time to assess and respond appropriately. Therefore, we believe firms would benefit from additional time beyond what the Board proposes in order to appropriately implement the proposed standard. We recommend an effective date that is no sooner than fiscal years beginning two years after the year of SEC approval.

We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Hughes, National Managing Partner of Audit Quality and Risk, at 404-475-0130 or Jeff.Hughes@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP

From: timh@hvaudit.com
Sent: Thursday, February 16, 2023 1:25 PM
To: Michael.Downing@TheIIA.org
Cc: Comments
Subject: [EXT]: Comment on Restrictions on Internal Auditors Participation in the Confirmation Process

I have worked all sides of this profession (External Audit, Internal Audit, Fraud examiner, Controls/Audit Consultant). This proposal is just silly.

To think that Internal Audit would alter confirmations is an unprofessional accusation from a segment of the industry (Big 4/etc) that if they hadn't had issues in the first place, PCAOB wouldn't even have been needed.

This is the first step in trying to pull Internal Audit assistance out of the SOX picture just to rev up Big 4/etc revenues. This always seems to come around when there is a bit of a recession or resources require more for retention. Ironically, this segment continues to put newbies on many audits that need to be re-trained every year, which itself causes increased fees and increases liability of missing something during an audit.

This is just another example of why I get more disgusted about our profession. The real mission is lost in the money grab.

If you study fraud cases, Internal Audit is the least likely place to have issues. Please do not let this become official, as it is the tip of the iceberg of future changes designed to reduce Internal Audit and Increase Fees to Publicly traded companies by the Big 4/etc. I know our profession is arrogant enough to think that this would be a good thing, but it's only a good thing for those furthest from the actual audits and out of touch with the actual operations of the clients.

Thank you for hearing my concerns
Tim

Tim Hungerford, CPA, CIA, CMA, CFE, CISA



Virus-free. www.avg.com



PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

Issued 20 February 2023

ICAEW welcomes the opportunity to comment on the PCAOB's *Proposed Auditing Standard - The Auditor's Use of Confirmation and Other Proposed Amendments to PCAOB Standards* published by the PCAOB on 20 December 2022, a copy of which is available from this [link](#).

For questions on this response, please contact the ICAEW Audit and Assurance Faculty at tdaf@icaew.com quoting REP 14/23.

This response of 20 February 2023 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 18,000 members drawn from practising firms and organisations of all sizes in the private and public sectors.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of sustainable economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 165,000 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

© ICAEW 2023

All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context;
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

ICAEW

Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
icaew.com

The Institute of Chartered Accountants in England and Wales (ICAEW) incorporated by Royal Charter (RC000246)
Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS**GENERAL POINTS**

1. We welcome the PCAOB's proposal to revise its auditing standard related to an auditor's use of confirmation by updating AS 2310, 'The Confirmation Process', to AS 2310, 'The Auditor's Use of Confirmation'. The use of confirmation requests is a core audit procedure, and one which is often the focus of public and regulatory scrutiny after alleged instances of audit failure. It is critical that auditing standards in this area are clear and robust. We are therefore pleased that the Board is prioritising revisions to this standard.
2. In particular, we support the modernisation and enhancement of the existing standard through increased linkage to risk assessment guidance; the encouragement of auditors to consider using confirmations for complex transactions and significant unusual transactions; and the provision of more granular guidance and examples to assist auditors, especially where exceptions arise or the reliability of confirmation responses is uncertain.
3. We see a need for practical guidance from the PCAOB, outside the revised standard, on technological developments affecting the confirmations process. This could be issued in the form of Staff Guidance, tailored to specific situations, such as particular industries, and kept up to date as technology changes. In several places, the consultation document refers to changes in the business environment, the growing use of technology in the confirmation process and the increasing prevalence of newer and more complex asset types. Despite this, the revised standard does not cover these developments in detail except regarding the use of intermediaries. We understand the need to maintain auditing standards that are relevant and flexible enough to apply to any situation, and the consequent desire not to include reference to specific technologies given the pace of change in this area. By remaining principles-based, standards avoid becoming overly long and obsolete as older technologies are superseded.
4. However, as the use of technology evolves, auditors are seeking increased direction from regulators and standard-setters regarding the role of technology in performing audit procedures, as well as guidance on how to approach auditing new types of transaction and account balances. By avoiding the issue, standard setters make auditors responsible for developing their own approaches and methodologies, which are likely to be inconsistent across firms and may lead to further inspection findings and enforcement actions by the PCAOB.
5. Additionally, the Board should reconsider its proposed approach where intermediaries are assessed as unreliable. We are concerned that there is a risk of conflict between the requirement to perform confirmation procedures over cash, and the requirement not to use an intermediary if concerns are identified about their reliability. If a bank or financial institution will only accept confirmation requests via a specific intermediary, but the auditor has assessed the intermediary as unreliable, the auditor will be unable to perform confirmation procedures as required by AS 2310.09. The requirement to assess the intermediary will also result in significant additional work for auditors. It is not currently common practice to directly assess intermediaries in this manner.
6. It is essential for the PCAOB to effectively challenge the IAASB in areas in which it believes that ISAs should be improved. For that challenge to be effective, there is a need for it to be robust and detailed in its explanations of differences between PCAOB standards and ISAs. Challenge is an important part of the convergence process, which is not well-served by small differences in wording (noted below in our responses to questions 4, 28, and 37). We caution against the use of different words simply to express better what is required, as this can be misconstrued as needlessly adding a costly layer of complexity without commensurate benefit. The use of different words may distract firms from the key requirements of the

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

standard, cause needless concern about the distinctions between the two or discourage firms from conducting PCAOB audits.

7. The PCAOB should be clear about the nature and extent of changes in auditor behaviour it is seeking through the publication of the revised standard and introduction of further requirements. Adverse inspection findings generally focus on a failure to confirm at all, or to cover the gap between the response date and the period-end, both of which are existing requirements. We therefore remain unconvinced that the additional work proposed will result in any significant reduction in adverse inspection findings, and it is not clear that there will be an improvement to audit quality. In addition to carrying forward the pre-existing differences between the requirements of AS 2310 and ISA 505, the revised standard introduces new requirements which represent a further divergence from the ISAs.
8. We support the move towards a more principles-based framework which has eliminated some differences that we identified in our response to the Board's 2010 proposal, but other differences remain. Examples that concern us include new requirements to:
 - perform confirmation procedures over cash and cash equivalents held by third parties (see questions 10 and 11);
 - communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination (see question 19);
 - evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses (see question 26); and
 - send a second confirmation request if no response is received to a positive confirmation request (see question 30).
9. Questions on which we have no comment we omit from our response below. We have answered some groups of questions in aggregate.

ANSWERS TO SPECIFIC QUESTIONS

Question 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?

10. Although we agree with the PCAOB's analysis of the problems, we are not convinced that the proposed changes will effectively address them. Enforcement actions and inspection findings relating to confirmation arise due to failure to perform confirmation procedures in situations when using other substantive procedures will not provide sufficient appropriate evidence, or a failure to obtain evidence over gaps in time between the response date and the period-end. The current standard already speaks to these issues, suggesting that if the Board has identified consistent problems over a long period of time, there is a need for additional guidance rather than additional requirements. The incremental requirements of the revised standard may reduce the extent to which auditor judgement can be used to design a response proportionate to the risk assessed, without achieving a reduction in the number of adverse inspection findings and enforcement actions.

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? If so, what type of information would be useful to investors and how might it be provided?

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

11. We do not see value in re-instating the blanket requirement (last in effect in the early 1970s) to disclose in the auditor's report when confirmation of accounts receivable is not performed. If the auditor determines that the non-performance of this procedure is a critical audit matter, the explanation required by AS 3101.14(c) will explain the auditor's approach. Forcing auditors to disclose this, even where the risk is not considered significant, could have the unintended consequence of unnecessarily alarming investors in situations where the auditor has performed other substantive procedures providing audit evidence at least as persuasive as confirmation.
12. There is no equivalent requirement to disclose in the audit report when other substantive procedures have (justifiably) not been performed on specific account balances, and we therefore consider that the inclusion of additional information in the audit report about the auditor's use of confirmation would attach undue significance to the account balances about which the disclosure is made.

Question 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 confirmation process? If so, how?

13. We support the Board's proposal to include more principles-based requirements designed to apply to all methods of confirmation in the revised standard. However, the removal of the detailed guidance that was included in the 2010 proposal around the use of electronic communications deprives auditors of valuable insight into the specific risks and considerations associated with different confirmation methods. We see a need for practical guidance from the PCAOB to support auditors in navigating the use of technology in this area. This could be issued in the form of Staff Guidance.
14. The removal of information related to electronic confirmation procedures also moves the revised standard further away from ISA 505, which provides more guidance in this area. Where the PCAOB does not intend auditor behaviour to be different, we recommend maintaining consistency between the standards.

Question 4: Is the objective of the new proposed standard clear? If not, how should it be clarified?

15. We do not consider that the revision to the objective that has been made from the 2010 proposal has resulted in increased clarity, as there is now a wider gap between the revised standard and ISA 505. We understand that the change has been made in response to comments that the objective in the 2010 proposal was too generic but we do not see that the new phrasing provides additional value or how it will change behaviour. We are not convinced that the objectives in the two standards need to be different, and caution against the use of different words simply to clarify meanings where the divergence will have no impact on auditor methodology or behaviour.

Question 5: Does the new proposed standard provide for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard?

16. While we support the revised standard's emphasis on following the existing requirements of AS 2110 and AS 2301 to determine whether confirmation procedures should be performed, we note that the revised standard does not explicitly address the need for auditor judgment to be used.

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

Question 6: Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?

17. We do not consider that there are any further accounts or financial statement assertions for which the auditor should be required to perform confirmation procedures. We support a risk-based approach, as envisaged by the ISAs, rather than the introduction of prescriptive requirements for specific accounts or assertions. Mandatory procedures for specific accounts may shift the emphasis in audit planning away from the need to thoughtfully identify, assess and respond appropriately to risks.

Question 7: As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?

18. We support the proposed approach to remove the requirement in the 2010 proposal to send confirmation requests in response to significant risks. It is sufficient that the revised standard instead emphasises the need to follow the existing requirements of AS 2110 and AS 2301 to determine whether confirmation procedures should be performed.

Question 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?

19. The revised standard requires auditors to use judgment to determine when performing confirmation procedures is appropriate. We therefore consider it sufficiently flexible to accommodate different situations, and newer types of asset.
20. However, in the context of rapid technological advancement and the emergence of newer asset types, auditors are seeking enhanced guidance from regulators and standard-setters regarding suitable procedures and approaches. It would be helpful to auditors if the Board were to refer to newer types of asset, and when it might be appropriate to perform confirmation procedures over them either within, or as a note to, the revised standard.
21. As noted in our general points, and in our answer to question 3, above, we see a need for practical guidance from the PCAOB on technological developments outside the revised standard. This could take the form of staff guidance, could be tailored to specific situations, such as particular industries, and kept up to date as technology changes.

Question 9: Are there ways in which the new proposed standard should be changed to further align with the PCAOB's risk assessment standards? If so, how should the new proposed standard be changed?

22. None identified.

Question 10: Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

23. The blanket requirement to confirm cash held by third parties is not consistent with the PCAOB's auditing standards on risk assessment, nor is it required by ISA 505. It is important that the requirement to confirm cash is not seen as obviating the need for auditors to take a risk-based approach. However, we note that performing confirmation procedures over cash

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

is a long-standing requirement in the audit methodologies of many firms and is consistent with current audit practice. We therefore do not consider that the introduction of this requirement will lead to a significantly increased burden for auditors. Codifying this requirement has the benefit of increasing clarity and driving consistency in audit practice.

Question 11: Are there substantive audit procedures other than confirmation that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash? If so, please describe these procedures.

24. While we are not currently aware of audit procedures other than confirmation that would provide audit evidence over cash that is at least as persuasive as confirmation procedures, we recommend that the PCAOB keep this requirement under review. Increasingly sophisticated technology makes it unsafe to assume that performing confirmation procedures will always be the best method of obtaining audit evidence over cash and cash equivalents. As new technologies develop, new financial products and digital disruptor banks emerge, definitions of cash are becoming increasingly complex and mutable.

Question 12: For other financial relationships with the confirming party, is the requirement in the new proposed standard that the auditor should consider confirmation sufficiently clear and appropriate?

25. Yes.

Question 13: Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

26. Yes.

Question 14: Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?

27. Yes.

Question 15: Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?

28. Yes.

Question 16: Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?

29. We support the revisions to the description of accounts receivable in the revised standard to refer to balances that 'arise from the transfer of goods or services to a customer or a *financial institution's loans*'. This is more precise than that put forward in the 2010 proposal and therefore more likely to prevent confusion about whether confirmation procedures should be performed over complex financial instruments or other transactions.

Question 17: Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

30. The requirement for the auditor to determine that other substantive audit procedures would provide audit evidence at least as persuasive as confirmation procedures will, in practice, force auditors to send confirmations in all situations. Even now, to avoid regulatory challenge, confirmation requests are often sent by auditors even where there is a very poor expected response rate, with alternative procedures planned from the outset. This represents unnecessary additional work and higher costs. Determining that another procedure would provide better evidence than confirmation is a high bar to overcome, and the auditor's judgement would be even more vulnerable to regulatory challenge. Including this presumption in the revised standard is therefore unlikely to change auditor behaviour. It is not clear to us that this change will effectively address the problem where insufficient evidence is expected to be obtained from confirmations.

Question 18: Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?

31. The revised standard should not be prescriptive in defining the factors that should be present when determining that other substantive audit procedures would provide audit evidence at least as persuasive as the evidence expected to be obtained through confirmation. Requiring auditors to justify their approach, rather than follow a checklist of factors, will lead to more robust risk assessments and responses.

Question 19: Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

32. No, we do not consider this requirement appropriate. The requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome, regardless of the significance of the risk, is not consistent with other audit committee communication requirements under AS 1301, which are focused on significant risks. Audit committees are not usually involved in this level of granularity regarding which audit procedures have been carried out, and no justification has been provided for calling out this issue for specific consideration. Auditors should instead be required to consider reporting such instances to the audit committee. This would allow auditors to use judgment when determining what to report to audit committees, while still requiring audit documentation to evidence their consideration.

Question 20: Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?

33. Yes.

Question 21: Is the new proposed standard sufficiently clear that an auditor's use of confirmation is not limited to the circumstances discussed in paragraphs .09 through .15 of the new proposed standard? If not, how should it be clarified?

34. Yes. The list of example financial statement assertions for which confirmation procedures could provide relevant and reliable evidence in paragraph .06 is sufficiently clear.

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

Question 22: Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

35. Yes, although we note that the requirement to test the accuracy and completeness of information produced by the company that is intended to be used as audit evidence is already included in AS 1105.10. The proposed requirement in AS 2310.17 is duplicative, and represents a divergence from ISA 505, which does not include such a requirement as it is covered in ISA 500. We agree that auditors should test the accuracy and completeness of information produced by the company that is used to select items for confirmation, but it is unnecessary to include such a requirement in the revised standard as it is addressed elsewhere in the standards.

Question 23: Are the provisions of the new proposed standard related to identifying confirming parties sufficiently clear and appropriate?

36. Yes.

Question 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?

37. We agree that the requirement in the revised standard to send a confirmation request directly to the confirming party, and determine that the request is properly addressed, is sufficiently clear and appropriate.
38. Specific procedures requiring auditors to test information about the confirming party, such as addresses, would be overly prescriptive. We noted in our response to the 2010 proposal that checking addresses will not deter those intent on deceiving auditors, that PCAOB reports do not highlight problems in this area and that additional direction should therefore be kept to a minimum.

Question 25: Are the provisions of the new proposed standard related to the auditor's use of negative confirmation requests sufficiently clear and appropriate?

39. Our understanding is that there is limited use of negative confirmation requests in practice. We are therefore supportive of the revision clarifying that the use of negative confirmations requests alone does not provide sufficient appropriate audit evidence for addressing the risk of material misstatement for a financial statement assertion, even though this is inconsistent with ISA 505. We do not consider that the introduction of this requirement will lead to an increased burden for auditors, and codifying the requirement will increase clarity and drive consistency in audit practice.

Question 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 account when using an intermediary in the confirmation process?

40. No, because there is a risk of conflicting requirements. In situations where there are concerns about an intermediary's reliability, the standard requires that the auditor should not use that intermediary. However, as the Board has identified, a number of financial institutions and other companies have adopted a policy of only responding to confirmation requests via

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

intermediaries. We see the potential for a situation to arise in which the auditor has concerns about an intermediary's reliability and concludes that they should not therefore use that intermediary. In situations where a bank or financial institution will only accept confirmation requests via this specific intermediary, the auditor will then be unable to perform confirmation procedures as required by AS 2310.09. Since the same intermediary is likely to be used for all audits where balances are held at the bank in question, this has the potential to create problems in a large number of engagements simultaneously. The Board should provide additional guidance for auditors regarding the procedure to follow in such a situation.

41. The requirement to assess the intermediary will result in significant additional work for auditors. It is not common practice to directly assess intermediaries in this manner and auditors may be unable to assess the quality of the controls in place.

Question 27: Is the potential interaction between using an intermediary in the new proposed standard and the proposed requirements in QC 1000 related to third-party providers sufficiently clear?

42. The potential interaction between using an intermediary in the revised standard and the proposed requirements in QC 1000 are not directly addressed in the proposed revisions. It would be helpful for auditors for this link to be made explicit to ensure that intermediaries are consistently identified as third-party providers under QC 1000.

Question 28: Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?

43. Yes. We welcome the inclusion of additional guidance for auditors regarding potential indicators that confirmation responses may have been intercepted or altered, although we note minor differences between the wording in the key provisions of paragraphs .25 and .26 and the equivalent sections of ISA 505. We recommend that the Board considers whether these differences are sufficiently important to the meaning of this section to merit maintaining this divergence.

Question 29: Are the provisions of the new proposed standard related to confirmation exceptions and nonresponses sufficiently clear and appropriate?

and

Question 30: Are the provisions about when the auditor should send a second positive confirmation request sufficiently clear and appropriate? Would this provision be a change from current practice?

44. No, the requirement to send a second positive confirmation request is not appropriate. This requirement appears to date back to the era of physical confirmation requests being posted to third parties, and physical responses being posted back to the auditor. In the past, if no response was received, it would be reasonable to assume that either the request or the response may not have reached the intended recipient due to mail being incorrectly delivered, lost, or delayed. Sending a second confirmation request would therefore be appropriate. Confirmation requests are now largely sent by email or via third-party intermediaries and auditors can be almost certain that any confirmation requests sent out have been received by the intended party. Therefore, if no response has been received to an initial positive confirmation request, sending a second request would usually be of limited value. Auditors would be more likely to receive a response by directly following up on the status of the request with the confirming party, or asking management to escalate the request with the confirming party, as appropriate. We do not think that this requirement is consistent with the PCAOB's stated desire to *'modify the standard to further support the*

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS

auditor's use of electronic forms of communication between the auditor and the confirming party.'

45. Additionally, as discussed above, in practice, many auditors send confirmation requests by default, even in situations where low response rates are expected. While auditors may not be aware of any new information indicating that the confirming party is unlikely to respond, the likelihood of receiving a response to a second request will also be low. Auditors should instead be required to use their judgment to determine whether sending a second request is appropriate.

Question 31: Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?

and

Question 32: Are there any additional examples of alternative procedures that we should consider for inclusion as examples in the new proposed standard?

46. The inclusion of additional guidance on alternative procedures that may be performed is welcome. We have not identified any additional examples of alternative procedures that should be considered for inclusion.

Question 33: Are the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses sufficiently clear and appropriate? If not, what changes should be considered?

and

Question 34: Based upon information available, we understand auditors' use of internal audit in a direct assistance capacity to send confirmation requests or receive confirmation responses to be infrequent. Are commenters aware of information to the contrary?

47. Yes. Our understanding is that it is not common for auditors to use internal audit in a direct assistance role when designing and executing the confirmation process, but clarity regarding the requirements in this area is welcome to drive quality and consistency in audit practice.

Question 35: In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?

and

Question 36: Based upon information available, we understand management requests not to confirm certain items or accounts to be infrequent. Are commenters aware of information to the contrary? If so, in what circumstances do management requests not to confirm commonly arise in practice?

48. No, we are not aware of information to the contrary. Our understanding is that it is not common for management to request auditors not to obtain confirmations over certain items or accounts.
49. We welcome the Board's decision not to carry forward the proposed requirements related to management requests, in line with our previous comments on the 2010 proposal. The requirements of other PCAOB standards appropriately address the procedures that an auditor should perform.

ICAEW REPRESENTATION 14/23 PROPOSED AUDITING STANDARD - THE AUDITOR'S USE OF CONFIRMATION AND OTHER PROPOSED AMENDMENTS TO PCAOB STANDARDS***Question 37: Are the definitions included in the new proposed standard sufficiently clear and appropriate? If not, what changes should be made to the definitions?***

50. No. We find the differences between the wording of the PCAOB's definitions of positive confirmation requests, negative confirmation requests, non-responses and exceptions, and the wording of the IAASB's definitions, to be so small as to be trivial. We see no difference of substance in these definitions, and we urge the PCAOB to consider the merits of aligning the definitions with that of the ISA. The PCAOB should not use different wording where no difference in the underlying meaning is intended.



January 31, 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 No. 028

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is 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. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated, or the ICPAS Board.

GENERAL COMMENTS:

As a Committee, we agree with efforts made by the PCAOB and believe the proposed standard and replacement of extant AS 2310 are examples of the PCAOB’s continued efforts to modernize and revisit existing auditing standards as a means of driving audit quality. We believe the proposal scope, objective, and guidance is generally clear and reflects an appropriate perspective of both current practice and industry trends. We also feel that it is sufficiently responsive to recent changes in audit technology and incorporates certain practical enhancements such as recognizing the use of intermediaries and providing additional guidance in those situations. As such, we believe the proposed standard is appropriate and explains the use of a risk-based approach in planning and performing audit confirmations. Our direct response is limited to the following questions.

PCAOB QUESTIONS AND COMMITTEE RESPONSES:

Question 10: Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

Response: Yes, we believe that the general messaging surrounding the requirement to confirm cash and cash equivalents, as well as other financial relationships, is clear. However, the Committee questions the appropriateness of mandating cash confirmations in all cases. The Committee acknowledges that while confirmations represent a persuasive form of audit evidence, there are instances whereby an auditor may be able to obtain sufficient appropriate audit evidence over the accuracy and existence of lower risk cash and cash equivalents accounts without the need for a confirmation. For example, an auditor may be able to observe individuals from the company who have appropriate access to a financial institution’s online portal login to access or download the bank statements for the requested date or period. Please also refer to the



ILLINOIS CPA SOCIETY.

Committee's response to Questions 13 relating to the risk-based approach as currently written in the proposed standard.

In explicitly identifying cash and cash equivalents as a financial statement account where an auditor should confirm the balances directly, the Committee questioned why such guidance does not extend to other financial statement accounts typically confirmed by auditors. For instance, external debt is often confirmed by the auditor to address risks of material misstatement identified to assess the existence, accuracy and completeness assertions.

Question 13: Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

Response: The proposed standard is clear in that the auditor should obtain an understanding of the entity's cash accounts and that should drive the nature, timing, and extent of confirmation procedures over cash accounts and other relationships. However, it would be beneficial for the PCAOB to provide guidance regarding how an auditor could use the results of its risk assessment over cash from paragraph .10 in the auditor's implementation and application of the provisions. It is not clear to the Committee how the auditor may make its selections when not testing 100% of cash and cash equivalents. For example, if the auditor is allowed to use sampling or scoping in its selection process, or if the auditor may use its judgment in determining that there are certain classes of cash or cash equivalents that would not require confirmation based on risks relative to other cash and cash equivalent accounts. It is not uncommon for companies to have multiple operating accounts with the same financial institution that are used for different purposes (receipts, disbursements, operating, payroll, sundry expenses, foreign, subsidiary / branches, etc.) that are swept nightly into one account. While the volume and nature of transactions in each account may differ, the internal control environment is often similar, such that it is not clear how auditors would be able to make informed risk assessment decisions for which accounts within cash and cash equivalents are required to be selected under the proposed standard. The background on page 21 describes certain examples of how the auditor may use its understandings in designing its confirmation procedures, and we feel that the proposed standard would benefit from incorporating that into the primary provisions or the explanatory material/appendices.

We acknowledge that such additional application guidance does not exist for accounts receivable in the extant and proposed standard, and that auditors have been able to apply the guidance and sample accounts receivable for many years. However, with the addition of a requirement for cash that may be new for auditors, we suggest that similar examples be included for accounts receivable. These could be unique to accounts receivable or could be generalized to address both cash and accounts receivable.

Question 17: Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

Response: The ability to overcome the presumption to confirm accounts receivable is clear and appropriate, but the Committee questions why such a similar provision does not exist for cash and cash equivalents. The Discussion of the Proposed Standard notes that the PCAOB did not identify any other substantive audit procedures as persuasive as direct confirmation. In practice, we have encountered situations where the



ILLINOIS CPA SOCIETY

auditor is able to sit with the client and observe them logging directly into an online banking portal to show balances and recent activity to an auditor. We feel that such a substantive procedure may be just as effective (persuasive) in addressing the assessed risks of material misstatements and may be more efficient for certain cash and cash equivalent accounts, and that the presence of such a procedure should be considered when concluding that a presumption cannot be overcome for cash and cash equivalents.

If the PCAOB does not change the standard, the Committee seeks additional guidance on what may constitute appropriate alternative procedures for cash, similar to examples provided for other types of accounts and transactions in paragraph 31.

Question 19: Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

The Committee finds a direct requirement as part of proposed AS 2310 to be unnecessary. AS 1301 exists and contains provisions for the communication of other audit matters (paragraph .24) that would address this. We believe that auditors should be able to use judgment in determining if the decision to not send confirmations warrants communication to those charged with governance as opposed to being rules based, and such judgment would be captured in AS 1301.24.

Further, AS 3101 discusses critical audit matters, which is yet another form of communication between the audit committee and users over areas of the audit that are particularly challenging, subjective, or subject to complex auditor judgment. Should accounts receivable fall into that category, we feel that is an appropriate means of communication. The Committee also noted that auditors are currently not required to communicate when they overcome the presumption of fraudulent revenue recognition as a significant risk of material misstatement, and question why the accounts receivable confirmations are any different, particularly when the accounts receivable may not represent a significant risk of material misstatement. We propose that the PCAOB, at a minimum, consider requiring disclosure only in the event that the accounts receivable not subject to confirmation represent a significant risk.

The Committee appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

Michael Ploskonka, CPA

Chair, Audit and Assurance Services Committee

Amber Sarb, CPA

Vice Chair, Audit and Assurance Services Committee



ILLINOIS CPA SOCIETY

APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2022 – 2023

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:**National:**

Scott Cosentine, CPA
Timothy Delany, CPA
Michael R. Hartley, CPA
Emily Hoaglund, CPA
James R. Javorcic, CPA
Michael Potoczak, CPA
Jon Roberts, CPA
Amber Sarb, CPA

Ashland Partners & Company LLP
RSM US LLP
Crowe LLP
KPMG LLP
Mayer Hoffman McCann P.C.
Marcum LLP
BDO USA, LLP
RSM US LLP

Regional:

Elda Arriola, CPA
Genevra D. Knight, CPA
Matthew Osiol, CPA
Michael Ploskonka, CPA

Roth & Co., LLP
Porte Brown LLC
Topel Forman LLC
Selden Fox, Ltd.

Local:

Arthur Gunn, CPA
Lorena C. Engelman, CPA
Mary Laidman, CPA
Carmen F. Mugnolo, CPA
Jodi Seelye, CPA

Arthur S. Gunn, Ltd.
CJBS LLC
DiGiovine, Hnilo, Jordan & Johnson, Ltd.
Mugnolo & Associates, Ltd.
Mueller & Company LLP

Industry/Consulting:

Sean Kruskol, CPA

Cornerstone Research

Educators:

Meghann Cefaratti, PhD

Northern Illinois University

Staff Representative:

Heather Lindquist, CPA

Illinois CPA Society



17 February 2023

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

submitted via email to comments@pcaobus.org

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0) 211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0) 211 / 4 54 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
IBAN: DE53 3007 0010 0748 0213 00
BIC: DEUTDE33XXX
UST-ID Nummer: DE119353203

**Re.: PCAOB Rulemaking Docket Matter No. 028
PCAOB Release No.2022-009 of December 20, 2022 “Proposed Auditing
Standard – The Auditor’s Use of Confirmation, and Other Proposed
Amendments to PCAOB Standards”**

Dear Madam, dear Sir,

Following the submission of our comments on the Rulemaking Docket Matter No.028 PCAOB Release No. 2010-003 “Proposed Auditing Standard related to Confirmation and Related Amendments to PCAOB Standards” in a letter dated 13 September 2010 and PCAOB Release No. 2009-002 “Concept Release on Possible Revisions to the PCAOB’s Standard on Audit Confirmations” in a letter dated 29 May 2009, we would like to thank you for the opportunity to provide the PCAOB with comments on the PCAOB Release No. 2022-006 (hereinafter “the Release”).

In this letter, we address the key issues with which our members have concerns. We have chosen not to respond to specific questions; however, we have indicated where our comments are relevant to specific questions.

Alignment of the PCAOB’s Auditing Standards with corresponding ISAs (No question)

The IDW has repeatedly commented to the PCAOB in previous correspondence, that, in the interests of global comparability, differences of substance between the PCAOB’s auditing standards and those of the IAASB should be minimised where possible, deriving solely from U.S.-specific legal

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Melanie Sack, WP StB,
stv. Sprecherin des Vorstands;
Dr. Torsten Moser, WP

Amtsgericht Düsseldorf
Vereinsregister VR 3850



Page 2/4 to the letter to the PCAOB of 17 February 2023

requirements. We refer to the aforementioned letter dated 13 September 2010 in which we explain the reasons behind this stance, which include concerns that the standards issued by the PCAOB are overly rules-based (i.e., our concern is that the exercise of professional judgement by an auditor is increasingly restricted, leading auditors to adopt a “checklist” approach rather than use the “thinking mentality” essential in exercising appropriate professional judgment and thus potentially detrimental to audit quality).

Proposed Retention of the Presumption in the Board’s Interim Standards and Requirements to Perform Confirmation Procedures (Questions 2, 5, 7, 14, 15, 17, 19, 20 and 21)

We refer to our aforementioned letters in which we expressed concerns about the retention of the presumption that the auditor’s confirmation procedures will apply to accounts receivable. In our letter dated 29 May 2009, we had specifically noted our agreement with the comments of those members of the PCAOB’s SAG who had indicated that auditors should determine which procedures to perform based on the assessed level of risk for the relevant assertions for each account. We are still of the opinion that the more principles-based ISA requirement in ISA 330, which follows the audit risk approach, whereby the auditor has to “... consider whether confirmation procedures are to be performed...” has the advantage that an auditor must give due consideration to a comprehensive range of possible confirmations relevant in the particular engagement circumstances, and their consideration will not be biased by presumptions or lack of presumptions, respectively, but constitutes instead a response to the assessed risk of material misstatement. The application of an auditor’s professional judgment in determining the appropriateness and scope of confirmations to be sought, when applied properly, will enhance audit quality more than the “tick the box” approach likely to result from a widening of the extant presumption on the part of the PCAOB and the proposed requirement to perform confirmation procedures.

Although we appreciate that in the vast majority of audit circumstances confirmations may well be the most effective audit procedure, and their extensive use would be common in many jurisdictions and in many industries, our concern is that this aspect of the PCAOB’s proposal not only fosters the checklist approach mentioned above, but will also require audit resources to be expended for the sake of compliance without any attaching enhancement of audit quality. Notwithstanding the acknowledgement proposed in para. 14 that an auditor may overcome the presumption to confirm accounts receivable, the



Page 3/4 to the letter to the PCAOB of 17 February 2023

work effort to “prove” the required basis for the auditor’s determination is a wasted use of resources; communicating instances of where the auditor has overcome the presumption to the audit committee together with this basis serves no purpose in terms of a tangible improvement to audit quality. Similarly, when the auditor is able to obtain relevant and reliable audit evidence by performing alternative audit procedures, we see no benefit in terms of audit quality of explaining such instances of overcoming the presumption as a Critical Audit Matter in the auditor’s report. Indeed, we remain concerned that if, and to the extent that, the proposals could result in auditors seeking to be seen to comply with the letter of the standard rather than focussing on performing those alternative procedures that would be the most effective ones in the particular audit circumstances, this lack of flexibility may be detrimental to audit quality.

The Auditor Lacks Power to Obtain Responses (Question 1)

As we have previously noted, neither auditor confirmation procedures nor rules-based auditing standards can compel external parties to respond to confirmation requests or to verify the information therein before responding.

The proposals in this Release will solve neither the practical problems that in some industries responses are generally not forthcoming nor will they be effective when collusion is at play (The note below para. 18 would not help; indeed it would exacerbate the problem in the event of collusion if management supplies the name of a contact with whom management is in collusion).

As previously suggested, we would like to suggest the Board consider whether, in future, legislative or regulatory measures might be taken to improve third party cooperation with requesting auditors. For example, we wonder whether consideration ought to be given to the possibility that the SEC could specifically require all registrants to cooperate with auditor requests for confirmations.

Possible Validity of Oral Responses (Questions 3, 28, 29 and 37)

The proposals specifically classify all oral confirmations as nonresponses. This seems inappropriate given that – provided relevant legal requirements governing consent are adhered to – recordings of oral confirmations could be made. We suggest that a (video) recording of a call between an auditor and a named individual working for the party asked to reply to a confirmation request ought not to be considered less reliable audit evidence than a written response from an unknown individual from a confirming party. A call with a representative



Page 4/4 to the letter to the PCAOB of 17 February 2023

from the confirming party may facilitate a thorough reconciliation between the records of the audit client and the confirming party that would satisfy the auditor's need for sufficient audit evidence that confirmation has been given. If the confirming party neglects to follow up in writing or for other reasons no written response reaches the auditor, it would be counterproductive for AS 2310 to negate the reliability of a successful reconciliation leading to the oral confirmation.

We therefore suggest the PCAOB consider amending the proposed definitions of "confirmation response" and "nonresponse" so as not to specifically exclude oral responses that can be properly recorded in accordance with prevailing consent legislation. Similarly, in this context, the proposed amendments to AS 1105 should be reconsidered.

Effective Date (Questions 48 and 49)

As confirmation procedures may be used during the period subject to audit or to confirm period end balances and transactions, we are concerned that the proposed approach to setting an effective date may be overly tight.

We would be pleased to provide you with further information if you have any additional questions about our response, and would be pleased to be able to discuss our views with you.

Yours truly,

Melanie Sack
Executive Director

Gillian Waldbauer
Head of International Affairs

February 20, 2023

Ms. Phoebe Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K St, NW
Washington, DC 20006-2803

Dear Secretary Brown and PCAOB Board Members:

Johnson Global Accountancy is pleased to submit its comments on the new proposed standard AS 2310, *The Auditor's Use of Confirmations*.

Johnson Global Accountancy's mission is to be the most innovative and technically excellent advisory firm at the intersection of companies, auditors, and regulators, that improves investor decision-making confidence. We serve a diverse group of audit firms ranging from single office firms to more complex regional firms and the top 20 firms. We help firms interpret, respond, and comply with global auditing and financial reporting standards and regulatory requirements, including those standards set by the PCAOB. Our team of financial reporting quality advisors help prepare firms to perform high quality audits using innovative tools with a shared commitment to implement effective policies, procedures, and controls. We also provide firms with integrated software and service solutions to help them comply with audit quality standards.

Overall, we support the PCAOB's objective to strengthen and modernize the requirements for the confirmation process. Reflecting changes in business practices since the standard was initially issued and clarifying the auditor's responsibilities would enhance the performance of quality engagements and overall firm audit quality.

The proposal's scope and guidance are generally clear, and it lays out the requirements in a detailed step-by-step manner. We also appreciate the Board including a reference to intermediaries reflecting current practices.

We have carefully considered the Board's questions and are providing our comments based on our experience and our work with PCAOB-registered firms worldwide.

Principles-Based Requirements

The Executive Summary states that the proposed standard describes "principles-based requirements that apply to all methods of confirmation, including paper-based and electronic means of communication" and would be "more expressly integrated with the Board's risk assessment standards....". However, the proposal provides prescriptive requirements primarily focused on cash held by third parties and accounts receivable.

While we agree that confirmations generally provide more reliable evidence to support assertions, we suggest revising the proposal to focus on the use of confirmations as a tool that may apply to many components of the audit and to provide guidance on how to execute confirmations regardless of the nature of the account being tested.

Rather than setting requirements to confirm cash and accounts receivable within the *Confirming Certain Accounts and Terms of Transactions* section early in the proposed standard, we suggest moving these specific requirements to application guidance. Cash and accounts receivable are examples that illustrate the application of the objective of the principles-based proposal.

We also suggest that the Board add other illustrations to guide the application of these principles to other areas, such as inventories, digital assets, loans, etc. Using practice aids or other explanatory material would also support scaling the requirements to varying-sized audits and audit practices. Finally, as noted above, we encourage the Board to lead off the standard with the general principles followed by the more specific application guidance and illustrations.

Confirming Cash Held by Third Parties

The proposed standard requires auditors to perform confirmation procedures over cash held by third parties and indicates that the Board is not aware of other types of substantive procedures that would provide audit evidence that is as persuasive as audit evidence obtained through confirmations. However, from the proposal, the extent of work expected from auditors regarding the confirmation process is unclear.

Section D, 1. i. Confirming cash on page 20 of the proposal indicates that “an auditor need not necessarily confirm all cash accounts in all cases. Under PCAOB standards, the alternative means of selecting items for testing are selecting all items, selecting specific items, and audit sampling.” However, paragraph 9 of the proposed standard’s text requires the auditor to perform confirmation procedures for cash and cash equivalents held by third parties. Since most cash balances are held by third parties, this requirement implies that auditors must confirm all balances regardless of the auditors’ identification, assessment, and response to the risk of material misstatement. However, selecting specific items or conducting audit sampling under AS 2315 will often result in not all items being subject to confirmation procedures. We encourage the Board to clarify the requirements and how paragraph 9 interacts with the risk assessment standards.

The proposal does not appear to provide any room for auditors to determine or identify other procedures that could provide audit evidence that is as persuasive as that obtained through confirmations. This does not provide flexibility for future evolution in practice. In addition, this seems inconsistent with the approach proposed for confirming accounts receivable, whereby the auditor can overcome the presumption to confirm accounts receivable.

Confirming Accounts Receivable

Presumption to confirm accounts receivable may be overcome

The proposal follows the existing guidance and practice generally to confirm accounts receivable. It also includes a presumption that must be overcome if accounts receivable is not confirmed. As noted above, it is not clear why this option is provided for accounts receivable but not for cash.

Communicate with audit committee when presumption to confirm accounts receivable has been overcome

The proposal requires auditors to communicate with the audit committee when they have overcome the presumption to confirm accounts receivable. This requirement appears inconsistent with the approach used for other audit areas. In addition, it is not clear why the proposed standard expressly includes this

requirement, as existing standards for auditors to communicate with audit committees appear adequate. If this area is viewed as significant as a stand-alone item, it should be covered by those existing standards.

Maintaining Control over the Confirmation Process – Use of Intermediaries

We support including guidance over the use of intermediaries in the confirmation proposal and the requirement for auditors to address certain aspects of the intermediary's controls that address the risk of interception and alteration of communication between the auditor and the confirming party.

The proposal allows auditors to customize their approach based on the facts and circumstances of their audit firm and the audit engagement. However, we have observed several practical issues through our work with auditors. We encourage the Board to provide additional guidance on using intermediaries. Specifically, it would be helpful to address the following questions to guide auditors:

- Is an auditor expected to follow the principles and rigor of procedures used to evaluate internal control over financial reporting in evaluating intermediaries? Alternatively, is it appropriate to view these processes akin to software audit tools whereby the auditor would consider different risks around the software tools?
- What is a reasonable gap period or bridge period between the receipt of an independent service auditor's report on service organization controls at the intermediary and the auditor's report on an issuer and the issuer's year-end? For example, when an intermediary receives its annual independent service auditor's report in November, audits with a June 30 or September 30 year-end might be challenged using this intermediary due to the length of the gap period. We also understand that, generally, a bridge letter covering an interim period greater than three months has typically not been acceptable when used in the audit of internal controls over financial reporting.
- What alternative procedures are acceptable for the auditor when the length of the gap period or bridge period between the date of the independent service auditor's report and the issuer's year-end is too long to address the risk of material misstatement?

Addressing Nonresponses and Incomplete Responses

Paragraph .28 of the proposed standard requires an auditor to send a second positive confirmation request to the confirming party unless the auditor has become aware of information that indicates that the confirming party is unlikely to respond. We believe that this prescriptive requirement is very limiting and appears unnecessary to the objective of the proposal. If this is retained, we encourage the Board to provide additional clarification regarding the extent of information an auditor would need to support not sending a second request and the length of time an auditor should allow for the first responses to return.

Appendix 2 – Proposed Amendments to the Related PCAOB standards

The Board proposes to amend AS 2510, *Auditing Inventories*, to refer to the requirements set out in the proposed AS 2310, *The Auditor's Use of Confirmation*. It leaves intact the existing guidance in AS 2510 regarding confirming inventories held in public warehouses and adds the reference to AS 2310. There is no further discussion of the addition, and the guidance here appears vague. We propose that the Board clarify and illustrate the work an auditor should do when an entity holds inventory in a public warehouse and more directly address applying proposed AS 2310 principles to inventory.

We appreciate the opportunity to provide our comments and support the PCAOB's efforts to modernize these standards. We would be pleased to discuss our comments with you at your convenience. Please direct any questions to Jackson Johnson, President (jjohnson@jgacpa.com) or Geoffrey Dingle, Managing Director (gdingle@jgacpa.com). They may be reached at (702) 848-7084.

Sincerely,

A handwritten signature in black ink that reads "Johnson Global Accountancy". The signature is written in a cursive, flowing style.

Johnson Global Accountancy

February 15, 2023
Public Company Accounting Oversight Board
Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

RE: IIA Comments Regarding PCAOB Rulemaking Docket Matter No. 028

Dear Chair Williams and PCAOB Members DesParte, Ho, Stein, and Thompson:

It has recently come to my attention via the Institute of Internal Auditors' (IIA) Global Advocacy, Policy, and Government Affairs Team, that there is a proposed auditing standard entitled, "The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards", which appears to have undesirable implications for the internal audit profession. Additionally, the language used in the proposed standard falsely portrays a poor relationship between external auditors and internal auditors in that it makes internal auditors seem to be categorically untrustworthy. The specific language to which I am referring is as follows:

"Having considered the comments, we believe that using internal auditors for selecting items to be confirmed, or for sending or receiving responses, would not be consistent with the auditor's responsibility to maintain control over the confirmation process. Involving **internal auditors** or other company employees in these activities would **create a risk** that information exchanged between the auditor and the confirming party is **intercepted** and **altered** (emphases added). Accordingly, under the new proposed standard, using direct assistance from internal auditors for these activities would not be allowed."¹

The mission of the Internal Audit Profession is to, "enhance and protect organizational value by providing risk based and objective assurance, advice and insight"², and to carry out that mission effectively, internal auditors – not dissimilar to our external audit counterparts – are required to adhere to a strict set of standards, core principles and a code of ethics. The code of ethics is what makes us who we are. Without an emphasis on integrity, objectivity, confidentiality, and competency, there would simply not be as strong of a case to push back on your proposed auditing standard. However, this code of ethics is **mandatory**, and we take great pride in upholding these values in our personal and professional lives.

In summary, I believe that the proposed standard is unnecessarily divisive and counterproductive to the goal of having internal and external auditors working together to achieve great results for their stakeholders. Internal and external auditors, in fact, must report to the same audit committee of the auditee organization which only further supports the need to recall the portion of this standard that falsely mischaracterizes the internal audit function as being non-independent and objective.

Finally, in direct contrast with the proposed standard, we strongly urge the PCAOB to continue with its existing standard, **AS 2605**, which allows external auditors to assess internal auditors for objectivity and competence and then decide whether to seek the assistance of the internal audit function³. **AS 2065** correctly puts the burden back on the external auditor to make an informed decision on a case-by-case basis, rather than casting unreasonable and unnecessary doubt about an entire group of professionals without any evidence for the need to take away an external auditors' ability to make such a decision.

Thank you for your time and consideration in this matter.

Respectfully,

Joshua R. Kirby, CIA



¹PCAOB Release No. 2022-009 December 20, 2022, Page 43

² <https://www.theiia.org/en/standards/mission-of-internal-audit/>

³ https://pcaobus.org/oversight/standards/auditing-standards/details/as-2605-consideration-of-the-internal-audit-function_1528



KPMG LLP
345 Park Avenue
New York, N.Y. 10154-0102

Telephone +1 212 758 9700
Fax +1 212 758 9819
Internet www.us.kpmg.com

February 17, 2023

By email: comments@pcaobus.org

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

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

Dear Office of the Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2022-009, *Proposed Auditing Standard - The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards* (the "Release"). We would like to acknowledge the considerable effort and thoughtfulness that went into the creation of the Release, which includes the proposed replacement of AS 2310, *The Confirmation Process*, with a new standard AS 2310, *The Auditor's Use of Confirmation* (the "Proposed Standard"). We commend the Board for taking significant steps towards modernizing the extant PCAOB confirmation process standards. We recognize and agree that this is an important standard for audit quality and investor protection as the confirmation process may provide relevant and reliable external audit evidence obtained as part of an audit. We also commend the PCAOB for thoughtfully considering and addressing in the Proposed Release the many comments communicated as part of the 2010 Proposed Standard.

We support further alignment of the Proposed Standard with the existing risk assessment standards to enable the level of risk to drive the necessary audit response, including the nature of evidence necessary when using confirmations. Further, advances in information technology and the increased use of electronic forms of confirmations have had a significant impact on the confirmation process and, when properly used, have the potential of further increasing the effectiveness of the confirmation process. In addition, since the prior Proposed Standard release issued by the Board in 2010, there has been increased usage of third-party intermediaries within the confirmation process. We support the Board including specific considerations related to the use of intermediaries in the confirmation process, but suggest those considerations be sufficiently principles-based to prevent the new standard from becoming quickly outdated due to future advances in technology.

The remainder of this letter provides our specific comments on the Proposed Standard and other matters.

Risk Assessment

We support the Proposed Standard's overall relationship with the auditor's identification and assessment of and response to risks of material misstatement. Risk assessment and response underly the entire audit process, and confirmation procedures are one of many procedures through which auditors can obtain audit evidence to address the identified risks. In general, the Proposed Standard provides for an appropriate amount of auditor judgment on whether to perform confirmation procedures outside those addressed in the Proposed Standard and allows for an auditor to focus on obtaining sufficient appropriate audit evidence in these areas. However, we have concerns related to the ability to design an audit response commensurate with the assessed level of risk of material misstatement. Specifically, the inability

Office of the Secretary
Public Company Accounting Oversight Board
February 17, 2023
Page 2 of 4

to overcome confirming cash and cash equivalents and the lack of available alternative procedures as well as the need for the most persuasive evidence for accounts receivable are two areas where we believe the Proposed Standard is inconsistent with the existing risk assessment standards.

Confirmation of cash and cash equivalents

As noted, while we are supportive of the Board's efforts to improve the extant confirmation standard, we have the following concerns related to the aspects of the Proposed Standard that outline the presumption that the auditor will request confirmation of cash and cash equivalents.

We acknowledge the importance of cash confirmations as an audit procedure and note the Board's view that cash confirmations provide the most persuasive audit evidence. We also acknowledge that a confirmation is a common procedure to respond to an assessed level of risk over cash and cash equivalents under AS 2301, *The Auditor's Responses to the Risks of Material Misstatement* (AS 2301). However, the proposed standard's requirements to always confirm cash and cash equivalents appears inconsistent with AS 2301 requirements to vary the nature of audit procedures based on the degree of risk. While we believe confirming cash will usually be the most appropriate procedure to respond to risks of material misstatement related to cash and cash equivalents, we respectfully suggest that the Board considers permitting the presumption to confirm cash and cash equivalents to be overcome, similar to the provisions over accounts receivable, such that the audit response is commensurate with the assessed level of risk as required under AS 2301.

Further, we are concerned that the Proposed Standard's requirements to confirm cash and cash equivalents without an ability to obtain alternative evidence sets a performance requirement that may result in an inability to obtain sufficient appropriate audit evidence in the event of a nonresponse or incomplete response to a request for confirmation. The Release states that, "In general, the Board is not aware of other types of substantive procedures that would provide audit evidence that is as persuasive as audit evidence obtained through confirmation of cash". Further, the alternative procedure examples included in paragraph 31 of the Proposed Standard are intended to illustrate audit procedures that may satisfy an auditor's responsibilities when relevant and reliable evidence is not obtained through confirmation. However, paragraph 31 does not include examples relative to cash and cash equivalents. Therefore, the language in the Release and the Proposed Standard suggests that the most persuasive audit evidence (confirmation) is the only way to obtain sufficient appropriate evidence. If the Board believes a confirmation is necessary to provide sufficient audit evidence over cash and cash equivalents, then situations where confirming parties do not respond to confirmation requests for cash and cash equivalents or return incomplete confirmation responses would result in an inability to obtain sufficient appropriate audit evidence because an auditor would never be able to obtain a level of persuasive evidence the Board believes is necessary. In this situation, while alternative procedures may provide relevant and reliable evidence, that evidence would appear to fall short of the Board's expectation of the level of evidence necessary.

Therefore, we respectfully suggest that the Board clarifies the type of evidence it believes is necessary to obtain sufficient evidence over cash and cash equivalents in the event of incomplete or nonresponses. Should alternative procedures be required, we suggest the Board clarifies that the auditor should obtain relevant and reliable audit evidence and may not require audit evidence that is as persuasive as confirmation. We also suggest that the Board provides examples of alternative procedures that may provide relevant and reliable audit evidence for cash and cash equivalents. For example, obtaining the bank statement for the period-end as well as the period following and examining subsequent cash activity or obtaining direct online view-only access to an entity's bank accounts are procedures that could provide relevant and reliable evidence about cash and cash equivalent balances held with third parties.

Office of the Secretary
Public Company Accounting Oversight Board
February 17, 2023
Page 3 of 4

We are also concerned that future changes in the technology or process used by confirming parties or enhanced technology-enabled audit techniques may enable auditors to obtain equally persuasive audit evidence without using a confirmation. We believe our suggestion above that the Board considers permitting the presumption to confirm cash and cash equivalents to be overcome will have an added benefit of future-proofing the Proposed Standard.

Overcoming the presumption to confirm accounts receivable

We agree that the provisions of the new Proposed Standard allow auditors to determine the extent of confirmation of accounts receivable and that the Proposed Standard should allow for the presumption to confirm accounts receivable to be overcome. However, we believe the Proposed Standard is unclear as to how the presumption can be overcome. Paragraphs 6 and 7 state that audit evidence obtained through confirmation is generally more reliable and persuasive than other evidence. To overcome the presumption to confirm, paragraph 14 requires the auditor to perform procedures that “would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures.” If evidence from confirmations is the most persuasive form of evidence, it is unclear in the Proposed Standard as to what evidence could be obtained that would be at least as persuasive as a confirmation. We observe that ‘persuasive’ is not defined in AS 1105, *Audit Evidence*, which contributes to the lack of clarity of the Board’s expectations about the procedures that would be necessary if the presumption to confirm accounts receivable is overcome.

The Release includes an example of procedures that may meet the requirement; however, the Proposed Standard lacks clarification as to how to measure persuasiveness, and it is unclear as to what combination of evidence would then rise to that level. The Release also states that “as the risk increases, the auditor could increase the number of individual transactions for which the auditor examines third-party evidence. Further, the auditor may determine that to obtain audit evidence that is at least as persuasive as evidence from a confirmation, the auditor may need to apply the other procedures to a greater number of items than the auditor would otherwise address through confirmation.” The weight an auditor is to put on the quality (i.e. appropriateness) of evidence compared to the quantity (i.e. sufficiency) of evidence in the determination of persuasiveness under the Proposed Standard is not clear. If an auditor is required to obtain evidence that is equally persuasive as a confirmation and confirmations are viewed to provide the most persuasive evidence, then obtaining a larger quantity of lower quality evidence would seem to contradict AS 1105.05, which states “Obtaining more of the same type of audit evidence, however, cannot compensate for the poor quality of that evidence.” We recommend the PCAOB further clarify their intent and provide guidance on how to evaluate persuasiveness in such circumstances.

Similar to our comment on cash and cash equivalents above, since the Proposed Standard requires the most persuasive audit evidence for accounts receivable, it suggests that accounts receivable are presumed to contain a higher risk. We do not believe this level of risk exists for all accounts receivable balances. When accounts receivable has been determined to contain a lower risk, while confirmations may provide the most persuasive audit evidence when returned, other substantive audit procedures may provide audit evidence that is sufficiently persuasive to address the risk.

The Release acknowledges there are situations where a confirmation for accounts receivable may not provide sufficient appropriate audit evidence, indicating “an auditor may have determined from firsthand experience that sending positive confirmation requests to a company’s customers has not resulted in obtaining relevant and reliable audit evidence, because of poor rates of response, as well as unreliable responses, from the customers contacted by the auditor.” However, this does not appear to be included in the Proposed Standard. The extant standard more explicitly considers and acknowledges these situations. We agree with the language in the Release that sending confirmations in certain situations would not be necessary, including certain industries (for example telecommunications where balances between providers are in dispute or in retail where almost all receivables are from credit card companies

Office of the Secretary
Public Company Accounting Oversight Board
February 17, 2023
Page 4 of 4

that are settled within a few days of year-end). However, the Proposed Standard suggests that in such situations where the rates of response are low, auditors should still send confirmations unless they can obtain audit evidence at least as persuasive as a confirmation. We respectfully recommend that the Board includes specific criteria for when to overcome the requirement to confirm accounts receivable, consistent with that of the extant standard and example substantive procedures to perform when the presumption to use confirmations is overcome.

Further, we believe the continued development of technology utilized throughout audits, including when applied to provide substantive audit evidence, is an important consideration for the Proposed Standard. For accounts receivable, there is potential opportunity to utilize technology and data and analytics routines to provide evidence across entire populations to sufficiently address the relevant risks. However, the requirement in the Proposed Standard to perform procedures that provide equally persuasive evidence may limit the ability to utilize these future technologies depending on how persuasiveness is measured.

Other considerations

We included in the appendix detailed responses to certain questions on which the Board requested feedback.

We appreciate the Board's consideration of our comments and observations in support of revising the auditing standards to enhance audit quality and would be pleased to discuss our comments with the Board and its staff at your convenience. We look forward to continuing our engagement with the Board and its staff in support of our shared commitment of investor protection and audit quality.

Sincerely,

A handwritten signature in black ink that reads "KPMG LLP". The letters are stylized and connected, with a cursive-like flow.

KPMG LLP



Appendix

Below are responses to select questions outlined in the Release for which we had specific input.

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?

The Proposed Standard offers sufficient flexibility to accommodate situations where an auditor confirms information about newer types of assets. While such assets would be outside the categories of cash or accounts receivable, the application of the remainder of the Proposed Standard would not be hindered in these cases.

14. Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?

The continued requirement to confirm accounts receivable is sufficiently appropriate. However, we suggest that the Proposed Standard carry forward the provisions addressing materiality or a combination of risk assessment to overcome the presumption to confirm accounts receivable in the extant standard to provide more clarity on the matter.

17. Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

As discussed in *Overcoming the presumption to confirm accounts receivable* above, because the evidence obtained through confirmation is generally more reliable and persuasive than other evidence, consideration should be given to whether auditors would be able to obtain evidence that is equally persuasive. In addition, it is not sufficiently clear as to how an auditor would measure the persuasiveness of evidence to comply with the Proposed Standard. We also believe that the requirement to obtain evidence that is equally persuasive to a confirmation, which the Proposed Standard regards as the most persuasive audit evidence, is not necessary when the risk is low. We respectfully recommend that the Board include specific criteria for when to overcome the presumption to confirm, consistent with that of the extant standard.

19. Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

We believe that AS 1301, *Communications with Audit Committees*, sufficiently addresses circumstances requiring the auditor to communicate to the audit committee. Specifically, Paragraph 3 of AS 1301 states the auditor's objectives, which include to, "(c) communicate to the audit committee an overview of the overall audit strategy and timing of the audit; and (d) provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process". Under AS 1301, we believe there are circumstances when the auditor will communicate that the presumption to confirm accounts receivable has been overcome; such circumstances could include, for example, when there is a significant risk over accounts receivable, if the auditing of accounts receivable has a significant impact on the audit strategy or timing and/or if there is a critical audit matter related to the auditing of accounts receivable. However, we do not believe that such communication is relevant in all circumstances, and particularly when accounts receivable has been determined to have a lower risk of material misstatement. We are concerned that in such circumstances, the requirements outlined in Paragraph 14 of the Proposed Standard may result in a disproportionate amount of the audit committee's agenda being focused on lower risk areas, contrary to the principles outlined in AS 1301. We suggest the Board replace

the requirement for communication to the audit committee of the auditor's determination that the presumption to confirm accounts receivable has been overcome with an acknowledgement that such communication is something an auditor may find appropriate under AS 1301.

22. Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

We believe that the provisions of the Proposed Standard related to identifying information to confirm are, in most aspects, sufficiently clear and appropriate. However, Paragraph 17 states, "the auditor should test the accuracy and completeness of information produced by the company that the auditor uses in selecting the items to confirm". We agree that the completeness of the information produced by the company and used by the auditor in selecting the items to confirm, should be tested. However, we are concerned that the proposed language will require the auditor to test the accuracy of the information used by the auditor to select the items to confirm as a procedure separate from sending the confirmations. We believe the results of the confirmation procedures (or alternative procedures) provide relevant and reliable audit evidence to address the accuracy of the information provided by the company. We suggest that the Board clarify that the population of information produced by the company and used by the auditor in selecting the items to confirm, should be tested for completeness. The requirement to test the accuracy of the information used by the auditor in selecting the items to confirm should be removed or further clarified.

48. How much time following SEC approval would audit firms need to implement the proposed requirements?

While the Proposed Standard would result in changes to methodologies, guidance and related tools, the overall impact of the Proposed Standard would likely not take considerable time to implement. However, we believe that the Proposed Standard may have a more pervasive impact on intermediaries utilized in the confirmation process. This may include modified processes and controls and changes in the preparation of SOC reports, including additional and/or more timely release of SOC reports. Firms will likely need time to coordinate with intermediaries and implement changes to processes necessary to address the new requirements in the Proposed Standard. We recommend the PCAOB consider responses from intermediaries, if any, as to the impact of the Proposed Standard and the time needed to implement the requirements of the Proposed Standard.

From: Kristin Kruse <krusek@verizon.net>
Sent: Sunday, February 19, 2023 6:12 PM
To: Comments
Subject: [EXT]: About Docket 28

Having spent decades as an internal auditor in financial services, I am confounded as to why there is a need for this proposed standard. From my perspective, external audit reliance on internal audit for confirmations has worked well for both sides without concerns of mishandling by internal audit. I am not aware of any examples of why there is a need for external audit to no longer rely on internal audit for work when it is considered appropriate. Accounting Standard 2605 already provides external audit the opportunity to assess whether internal audit can be relied upon for work. It does not seem that an additional standard is needed, especially when it is one that mischaracterizes internal audit.

Thank you for the opportunity to comment.



1200 W. Century Ave.
Bismarck, ND 58503
Mailing address:
P.O. Box 5650
Bismarck, ND 58506-5650
(701) 530-1000
www.MDU.com

February 14, 2023

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

RE: PCAOB Rulemaking Docket Matter No. 028 and Internal Auditing

Dear PCAOB & Board Members Vanich, Andriynko, Busedu, and Hardison:

I am writing in response to the open comment period for Docket 028: Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards. I represent the Internal Auditing group at MDU Resources Group, Inc., providing essential products and services through our regulated energy delivery and construction materials and services businesses. We are the largest publicly traded company headquartered in North Dakota and conduct business in nearly every state in the United States.

The purpose of my letter is to voice our concern on the language used in the above-referenced proposed auditing standard. Specifically, Section III. – I. of Proposed Rule filing 2022-009 states: “Involving internal auditors or other company employees in these activities would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered.” While this language is used in reference to the Confirmation Process, the precedence it is setting would be detrimental to our Internal Auditing (IA) function and the profession as a whole. This language is incorrect and indicates internal audit is the same as “other company employees” when in fact, IA functions independently from management and prides themselves on providing an objective perspective to our company. Our Internal Auditing department reports directly to our Audit Committee, no different than our external auditors.

Additionally, in a Wall Street Journal article on the proposed changes published December 20, 2022, PCAOB officials are referenced as stating that the “goal is to make sure that internal auditors don’t manipulate the confirmation requests before they go out or the responses after they come back.” This statement sends the overarching message that internal auditors are inherently untrustworthy. Our Internal Audit department is anything but untrustworthy. Our company and Board of Directors looks to our IA team to be the independent and objective voice in our corporation.

Internal Audit is an important, vital function of our company that generates value by bringing a defined, systematic approach to assessing and improving how effective our risk management, control and governance processes are. IA provides an independent and objective perspective, separate from management. The value of IA is not always overtly evident or quantifiable however, as one of our board members once said, “we will never know all the land mines we would have stepped on without Internal Auditing.” Our IA team also allows the corporation to spend dollars in ways that provides value to our shareholders, by performing high quality work that our external auditors rely on. By saving on external audit fees, our company can use this money in other ways to move our business forward and to give back to our stockholders. If the message remains ‘as-is’ in the proposed auditing standard, this casts an unwarranted negative light on the IA profession and IA function that brings value to our company.



1200 W. Century Ave.
Bismarck, ND 58503
Mailing address:
P.O. Box 5650
Bismarck, ND 58506-5650
(701) 530-1000
www.MDU.com

Today, as it has been in the past, our Internal Audit team and external auditors work closely in coordination to ensure appropriate coverage in audit engagements and avoid duplication of efforts. This proposed change would alter the collaborative relationship that has historically existed between internal and external audit. It seems that if the language remains unchanged from the proposal, the next question would be, "If external audit can't rely on IA for Confirms, why should they rely on IA for anything?" This proposed change could damage the perception of the Internal Audit profession and be an unfair characterization. Our Internal Audit team is required to adhere to mandatory professional standards, and a code of ethics and takes pride in doing so.

Currently the existing PCAOB Account Standard 2605 (AS2605 - "Consideration of the Internal Audit Function") acknowledges "internal auditors maintain objectivity with respect to the activity being audited." Why now, in the case of the Confirmation Process, would internal auditors not be able to maintain objectivity to be relied upon by external audit? To our knowledge, there have been no specific examples of IA failure with regards to confirms, which would have warranted the proposed change. Additionally, AS2605 allows external auditors to assess the objectivity and competence of internal auditors and then decide whether or not to rely on a specific internal audit function. Within AS2605.11 it states that external auditors may "also use professional internal auditing standards as criteria in making the assessment" of an internal auditors' competence and objectivity. These are the same professional internal auditing standards that our Internal Audit function complies with.

Due to the points made in this letter, I respectfully encourage the PCAOB to remove this damaging language from Proposed Rule filing 2022-009 with regards to the characterization of Internal Auditing, while still expecting external auditors to assess the objectivity and competence of internal auditors. Doing this would not take ultimate responsibility off external auditors with regards to the Confirmation Process.

If you would like to discuss this matter further, please reach out to me at 701-530-1037, or Dawn.Belohlavek@MDUResources.com.

Thank you for your consideration,

A handwritten signature in black ink that reads "Dawn Belohlavek". The signature is written in a cursive style with a large, looping initial "D".

Dawn Belohlavek
Chief Audit Executive & Director of Internal Auditing
MDU Resources Group, Inc.



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)¹ 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).² 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.”³

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.⁴

¹ 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>.

² 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.

³ 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>.

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

Page 2 of 8
February 16, 2023

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.”⁵ 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”:⁶

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 standards⁷

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.⁸ 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.⁹
- 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

⁵ 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>.

⁶ 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/%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.

⁷ 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.

⁸ 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.”).

⁹ 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.¹⁰ 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.¹¹
- 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.¹²
- The auditor must maintain control over the confirmation, including over the transmission and receipt of the confirmation directly to and from the third party.¹³
- 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.¹⁴ We believe the other audit procedures should be designed to result in persuasive, sufficient and competent evidence.¹⁵

¹⁰ 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.”).

¹¹ 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 (“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.’”).

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

¹³ 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”).

¹⁴ 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 . . .”).

¹⁵ 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.¹⁶ 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.¹⁷ However, in light of the various enforcement actions discussed in the Proposal,¹⁸ 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.¹⁹
- 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.”²⁰ 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.²¹ **We also note that overcoming the presumption could result in what would be considered a critical audit matter.**

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.”).

¹⁶ 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”).

¹⁷ 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.”).

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

¹⁹ 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?”).

²⁰ *Id.* at 15.

²¹ 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.²²
 - 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.²³
- The Proposal refers to the use of “professional judgment” by the auditor.²⁴ 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,”²⁵ 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.

²² 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.”).

²³ 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!”).

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

²⁵ 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.²⁶ 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.²⁷ 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.”²⁸ However, no such language is included in the proposed auditing standard. We believe the Board should include this language in any final standard.
- Paragraph .05.²⁹ 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 .15.³⁰ This paragraph discusses a “complex” or an “unusual” transaction that involves “significant risks of ‘material’ misstatement.”³¹ 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.³² As a result, we believe the word “consider” should be struck.
- Paragraph .19.³³ 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.

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

²⁷ See PCAOB Release No. 2022-009 at 26.

²⁸ *Id.*

²⁹ See *id.* at A1-1.

³⁰ See *id.* at A1-4.

³¹ *Id.*

³² *Id.*

³³ See *id.* at A1-5.

- Paragraph .21.³⁴ We believe the word “Generally” should be struck.³⁵ 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 .26.³⁶ 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 .31.³⁷ 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 .31.³⁸ The Proposal discusses the need for evidence the auditor considers and evaluates to be both sufficient and competent as well as persuasive.³⁹ Accordingly, footnote 10 of this paragraph should be modified by inserting the words “that is persuasive” after the words “. . . sufficient appropriate audit evidence”⁴⁰
- Paragraph .31(b).⁴¹ The phrase “. . . or (iii) . . . ” should be replaced with “. . . and (iii)”⁴² 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.⁴³ We believe the word “documented” should be inserted after the word “has.”⁴⁴
- Paragraph .B2b.⁴⁵ We believe the phrase “and document” should be inserted after the word “Determine.”

³⁴ *See id.*

³⁵ *Id.*

³⁶ *See id.* at A1-6.

³⁷ *See id.* at A1-6-7

³⁸ *See id.* at A1-7.

³⁹ *See AS 1015.*

⁴⁰ *See PCAOB Release No. 2022-009 at A1-7 n.10.*

⁴¹ *See id.* at A1-8.

⁴² *Id.*

⁴³ *See id.* at A1-10.

⁴⁴ *Id.*

⁴⁵ *See id.*

Page 8 of 8
February 16, 2023

- Page A2-1, paragraph .18.⁴⁶ We believe the word “~~third~~” should not be struck.⁴⁷ We note that throughout the Proposal there are references to a “third party”.⁴⁸ We recommend the term “third” be retained as it may provide clarity with respect to a confirming party.

Thank you for carefully considering the comments of the MIAG and other investors—the primary customers of audited financial reports.⁴⁹ 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.

Sincerely,

Members of the Investor Advisory Group

Members of the Investor Advisory Group

⁴⁶ See *id.* at A2-1.

⁴⁷ *Id.*

⁴⁸ 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.”).

⁴⁹ 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 (“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”).

2191 Lemay Ferry Road, St. Louis, MO 63125
(800) 894-1350 | (314) 631-5500



February 16, 2023

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

RE: 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 December 20, 2022

Dear Board members and staff:

On behalf of Midwest BankCentre, I appreciate the opportunity to comment on the PCAOB Rulemaking Docket Matter No. 028 *Proposed Auditing Standard – The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*. I am grateful for the efforts the PCAOB has made to consider the feedback, concerns, and viewpoints from various stakeholders about the proposed change that will bar the use of Internal Audit in the Confirmation process.

I am concerned with and object to the proposed change which is presented without any clear explanation or examples for why the change is necessary. Also, it is a significant departure from the current regulatory guidance between internal and external auditors.

My Internal Audit department abides by the Institute of Internal Audit Standards and Code of Ethics which require objective assurance, independent from management. Specifically Standard 1100 – Independence and Objectivity states “The internal audit activity must be independent, and internal auditors must be objective in performing their work”. Our independence and objectivity is required in all audits and would include any role in the confirmation process. With Section III(I) of the PCAOB proposal stating:

Involving internal auditors or other company employees in these activities would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered. Accordingly, under the new proposed standard, using direct assistance from internal auditors for these activities would not be allowed.

With this proposed change, The PCAOB is disregarding the standards internal auditors adhere to and implies that we are not trustworthy or capable of exhibiting independence and due care in the performance of our duties.

Prior to this new proposal, the PCAOB’s standard for using and evaluating internal auditors has been Accounting Standard 2605 (AS 2605) entitled, “Consideration of the Internal Audit Function.” In that standard, the PCAOB grants the external auditors authority to utilize an internal audit function, as needed, to provide direct assistance during any audit. It provides guidance to the external auditors on assessing

the internal auditors' competence and objectivity. Further, it specifically states that "internal auditors maintain objectivity with respect to the activity being audited".

Currently, our external auditors provide direction and oversight to my internal audit team assisting with the confirmation process. Additionally, our external auditors rely on some of our control testing. A change to the confirmation guidance would impact our annual audit on both sides. It would increase the number of external audit procedures and the cost of the audit. Our external auditors have not expressed any concerns with our independence and objectivity within the process. We have a strong working relationship with our external auditors to provide objective testing to aid in the external audit process.

Thank you for your time and consideration of my view on the proposed change. It is important to my profession to have constructive and collaborative relationship with the PCAOB, external auditing firms, and other governing bodies to ensure that we have the best interest of the general public, customers, investors, corporations, and auditors taken into consideration.

Thank you,
Krista Rowe, CPA, CIA
Internal Audit Supervisor
Midwest BankCentre
krowe@midwestbankcentre.com



National Association of State Boards of Accountancy

150 Fourth Avenue North ♦ Suite 700 ♦ Nashville, TN 37219-2417 ♦ Tel 615/880-4200 ♦ Fax 615/880-4290 ♦ Web www.nasba.org

February 13, 2023

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

Via email: comments@pcaobus.org

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

Dear Members of the Public Company Accounting Oversight Board (PCAOB):

The National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to comment on the PCAOB’s Proposed Auditing Standard, *The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards* (Proposal).

Founded in 1908, NASBA serves as a forum for the nation’s Boards of Accountancy (State Boards), representing fifty-five jurisdictions. NASBA’s mission is to enhance the effectiveness and advance the common interests of the State Boards that regulate all Certified Public Accountants (CPAs) and their firms in the United States and its territories, which includes all audit, attest and other services provided by CPAs. State Boards are charged by law with protecting the public.

In furtherance of that objective, NASBA offers the following comments.

Risk-Based/Principles-Based

NASBA commends the PCAOB for their continued efforts in modernizing the standards. We are supportive of a risk-based approach designed to focus firms’ attention on proactively identifying and responding to risks that may affect their engagements. We recognize that risk-based standards can be more challenging to enforce by regulators due to the greater level of judgment that can be implicit in their implementation.

In the preamble to the Proposal, there is discussion and reference to risk-based or principles-based standard setting; however, we noted several instances throughout the Proposal in which there were fairly prescriptive requirements. We respectfully request the PCAOB’s consideration as to whether or not those areas are in conflict before a final standard is issued.

Negative Confirmations

The Proposal sets a high bar for the use of negative confirmations and, in our opinion, appropriately emphasizes the relatively insignificant amount of audit evidence obtained from using negative confirmation requests. We support the approach with negative confirmations and believe placing the burden on the auditor to justify their use is appropriate.

Communication with the Audit Committee

The Proposal includes a requirement for the auditor to communicate to the audit committee instances where the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination. We believe that other standards and existing communication requirements such as communication about the overall audit strategy, significant changes to the planned audit strategy and significant difficulties experienced during the audit are sufficient and that this requirement should apply only if receivables represent a significant risk area.

Confirmation with Intermediaries

The Proposal permits the auditor or confirming party to engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. If an intermediary is used, then the auditor should evaluate detailed information about the intermediary and the design and operating effectiveness of the intermediary's controls.

The Proposal does not address situations in which intermediaries receive a Service Organization Control Type 1 report (SOC1), which evaluates service organization controls that are applicable to a user entity's internal control over financial reporting, and how the auditor might use the SOC1 report to fulfill the requirements of the standard.

The use of intermediaries is a common practice. We recognize that, in addition to the proposed standard, there is additional non-authoritative guidance provided in the Spotlight document referenced in footnote 10 on page 7 of the Proposal. Nevertheless, we believe more robust guidance is needed in considering intermediaries and the expectations around required procedures and documentation to better enable auditors to comply with the standard.

Disclosure of Confirmation Strategy to Investors

Question 2 on page 16 of the Proposal asks if investors would 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.

We do not support the disclosing of the auditor's confirmation strategy to investors. There is concern about the notion of over-emphasizing one element of the audit strategy with respect to one discrete

item of the financial statements. From a regulatory perspective, it could possibly create more confusion with differing understandings and expectations of the information that has been disclosed.

Internal Audit Involvement

The Proposal identifies certain activities in the confirmation process where the auditor may not use the assistance of the company's internal audit function. Specifically, the auditor would not be permitted to use internal auditors for selecting items to be confirmed, sending confirmation requests and receiving confirmation responses.

We do not support the proposed prohibition. The PCAOB did not provide an evidence-based rationale for this prohibition. The prohibition could potentially undermine the valid and helpful relationship that exists between external and internal audit functions and the very positive audit work that can be accomplished when auditors work with internal audit in the context of AS 2605, *Consideration of the Internal Audit Function*.

Additionally, in many instances, internal audit performs confirmation procedures on its own (not in the form of direct auditor assistance). In such instances, it is possible, even likely, that external auditors may want to review evidence provided by such internal auditor-issued confirmations for a variety of reasons. The proposed ban may cause confusion as to whether the external auditors could continue to review (and react to) such internal auditor-generated confirmations.

Guidance on New Asset Categories

Given that new asset categories, such as blockchain, cryptocurrency and digital assets, have emerged as an area of concern and likely to be one of audit focus and inspection focus, we believe additional guidance is needed on these asset categories and the procedures and documentation to be considered.

Integration with QC 1000

The Proposal makes reference to integration with QC 1000, which we understand has not yet been finalized. As QC 1000 is currently still under consideration, reference to QC 1000 may need to be revisited upon finalization.

Use of Email

We would recommend more guidance around the area of use of email for confirmation. The Proposal included minimal guidance – to verify the email domain. Given the common use of email in the confirmation process, additional guidance would be advisable.

Definitions

We would also recommend including a definition of the term “confirmation” in the Appendix. Definitions provided in the Appendix include a confirmation response and mentions that an oral response equates to a non-response. However, there is not much guidance on what other form of response is evidence of confirmation. For example, are screen shots from a confirming party’s system an acceptable form of evidence? Can the auditor observe the client accessing the company’s account at a confirming party’s system as a form of confirmation?

Effective Date

We are concerned that, given some of the more substantial changes contained in the Proposal, the effective date beginning in the year after approval by the SEC approval may be too soon.

We would recommend the effective date to begin two years after the year of SEC approval (regardless of the timing of when approval is granted). Many audits utilize confirmations throughout the auditee’s fiscal year, and requiring implementation in the year after approval would be premature and likely not allow effective implementation and training. Effective implementation of standards is in the public interest.

Robust Guidance for Implementation

Given the breadth of the changes in the Proposal, we believe there will be a need for robust guidance and perhaps training from the PCAOB staff, to communicate expectations from an inspection standpoint to better enable firms to comply with the standard and better enable regulators to provide the required oversight.

Special Consideration for Emerging Growth Companies (EGC)

While the risk profile of an EGC is different from more mature entities, we believe that the Proposal should apply to EGCs, to the extent that such applicability is determined to be statutorily permissible. To exclude EGCs from the Proposal would be inconsistent with protecting the public interest.

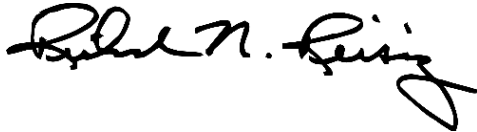
* * * * *

Public Company Accounting Oversight Board
February 13, 2023

Page 5

Again, we appreciate the opportunity to comment on the Proposal.

Very truly yours,

Handwritten signature of Richard N. Reising in black ink.

Richard N. Reising, CPA
NASBA Chair

Handwritten signature of Ken L. Bishop in black ink.

Ken L. Bishop
NASBA President and CEO

3604 W Iowa Ave.
Tampa, FL 33611

February 16, 2023

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

Re: **PCAOB Rulemaking Docket Matter No. 28**

To whom it may concern:

I'm writing to express my concerns regarding **PCAOB Rulemaking Docket Matter No. 28.**, The Auditors Use of Confirmation and Other Proposed Amendments to PCAOB Standards specifically related to the proposal and statements on **page 43 of the PCAOB Release No. 2022-009, dated December 20, 2022** which reads "....*Involving internal auditors or other company employees in these activities would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered. Accordingly, under the new proposed standard, using direct assistance from internal auditors for these activities would not be allowed.*".

The mischaracterization of Internal Auditors working on behalf of external auditors would alter confirmations is offensive and conflicts with the long-standing relationship between the professions outlined in **PCAOB AS 2605. PCAOB AS 2605 allows external auditors to assess the specific internal auditor for their objectivity and competence and then decide whether or not to seek the assistance of the internal audit function.** The elimination of use of internal auditors in the confirmation processes removes the external auditors' professional judgement and vilifies the profession of Internal Auditors as a whole without consideration to our backgrounds, skillset, required independence from management, and reporting relationships to Boards/Audit Committees.

As internal audit professionals, we are required to comply with mandatory professional standards and a code of ethics. The language used by the PCOAB disparages Internal Auditors and thus I ask the PCOAB to examine closely this generalization and mischaracterization and its long-term impact on our collective professions working together.

Sincerely,



Karen Percent, MHA, CPA, CIA

As a member of the Board of Governors for the Florida West Coast Chapter of the Institute of Internal Auditors Association, other professional Internal Auditors also shared my concerns as follows:

Monica Moyer-Kessel

Monica Moyer-Kessel, MBA, CIA, CFE, CRMA, CCEP, CICA

Gary Jordan

Gary Jordan



Laura Tatem, CPA, CIA, CGAP, CRMA

Mark Nash

Mark Nash, CFE

Kristina Simmons

Kristina Simmons, CIA

February 20, 2023

Sent via e-mail: comments@pcaobus.org

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

**Re: The Auditor's Use of Confirmation, and Other Proposed Amendments to
PCAOB Standards; PCAOB Rulemaking Docket Matter No. 028**

Dear Office of the Secretary:

Plante & Moran, PLLC ("PM," "the Firm," or "we") appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") proposed Auditor's Use of Confirmation standard and related amendments (the "proposed standard"). We are committed to performing high-quality audits in accordance with professional standards, and we agree that when properly designed and executed by the auditor the confirmation process may provide relevant, reliable third-party evidence that auditors obtain as part of an audit of a company's financial statements as stated in the release text accompanying the proposed standard (the "Release").¹

We support the Board's objective of updating its interim standard related to the confirmation process as the confirmation process has continued to evolve since adoption. We appreciate the Board's consideration of public comments on both the 2009 Concept Release² and 2010 proposed standard,³ as well as ISA 505 (Revised and Redrafted), *External Confirmations*, finalized by the International Auditing and Assurance Standards Board (IAASB).⁴

General Observations

We generally support the objectives of the proposal as set forth by the Board. However, we have some concerns about specific proposed requirements that we encourage the Board to address in the final standard. Our specific concerns are included in the responses to the questions below. Specifically, we are concerned about (1) the auditor's ability to apply professional judgment consistent with their risk assessment and response determinations and (2) the emphasis the proposed standard places on the persuasiveness of audit evidence obtained through confirmation procedures over other forms of audit evidence.

¹ See Release page 4.

² See [Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations](#)

³ See [Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards](#)

⁴ See <https://www.iaasb.org/projects/external-confirmations>.

Risk Assessment and Auditor Judgment

In an audit performed in accordance with PCAOB standards, the auditor's risk assessment is the basis for designing and implementing responses to the risks of material misstatement. Auditors are required to identify and assess audit risks and perform audit procedures to address those risks.⁵ Auditors apply professional judgment to determine which audit procedures will produce sufficient appropriate audit evidence to provide a reasonable basis for their audit opinions.⁶

We support the integration of the Board's risk assessment standards with the proposed standard through incorporating certain risk-based considerations. However, we are concerned that some portions of the proposed standard remove or limit the auditor's judgment to design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for a particular audit engagement. Instead, the proposed standard includes certain prescriptive requirements for the confirmation process, regardless of the assessed level of risk.

Specifically, the proposed standard:

- Continues to require the auditor to use confirmations regardless of the assessed risk of material misstatement, which is inconsistent with the Board's risk assessment standard;
- Creates a new requirement for the auditor to confirm cash with no ability to overcome the presumption to confirm cash; and
- Modifies the auditor's ability to overcome the presumption to confirm accounts receivable to a much higher threshold (see discussion of *Persuasiveness of Audit Evidence* below).

Certain new proposed provisions may hinder the auditor's ability to apply professional judgment to risk and response determinations. Auditors develop and perform audit procedures based on their risk assessment given the facts and circumstances of each engagement. In certain circumstances, confirmation procedures may be appropriate to address risks associated with accounts and disclosures specified in the proposed standard, but they can also be appropriate responses for other accounts and disclosures not specified in the proposed standard. Further, confirmations may be more appropriate to use when relevant accounts and assertions have a higher risk, rather than required to be used regardless of the risk assessment, which may promote a checklist mentality that does not contribute to audit quality and an audit approach that may be less efficient and effective. Further, we believe auditors may view this as counterproductive to the spirit of the risk assessment standard, which builds the foundation of the audit approach. To truly execute a risk-based audit approach that promotes audit quality, as well as an effective and efficient audit, the standard should allow auditors to make the determination of when and how confirmations should be used in an audit.

Persuasiveness of Audit Evidence

Paragraph .09(a) of AS 2301 states, "[i]n designing the audit procedures to be performed, the auditor should obtain more persuasive audit evidence the higher the auditor's assessment of risk."

⁵ For example, see various provisions in AS 2110, *Identifying and Assessing Risks of Material Misstatement*, and AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.

⁶ See paragraph .04 of AS 1105, *Audit Evidence*.

Paragraph .06 of the proposed standard states, “[a]udit evidence obtained through the confirmation process from an external knowledgeable source is generally more reliable than evidence obtained only from internal company sources.” While the proposed standard itself does not explicitly state that confirmations are the most persuasive form of audit evidence, discussions in the Release imply this may be the Board’s view. Persuasiveness of audit evidence should be commensurate with the risks identified. For example, in situations where inherent risk is high, fraud risks exist, and control risk is at maximum, confirmations may be warranted along with other appropriate procedures. However, the proposed standard does not contemplate situations where inherent risk may be less than high and controls are operating effectively, which reduces the risk of material misstatement and the need for the most persuasive audit evidence. Pursuant to an auditor’s risk assessment (and in accordance with AS 2301 and paragraphs .04 - .06 of AS 1105, *Audit Evidence*), as risk increases, so must the amount of audit evidence that the auditor obtains to address the risk. Conversely, accounts and assertions with lower risk require less persuasive evidence. Requirements to use confirmations for these lower risk accounts and assertions increase the level of effort and documentation required without a corresponding benefit to audit quality. Further, confirmations, in some cases may not provide the most persuasive audit evidence as further described below.

As discussed above, we believe the final standard should be risk based and allow for auditor judgment in determining the appropriate audit response. However, given that the proposed standard contemplates including a provision for the auditor to overcome the presumption to confirm accounts receivable, we have additional concerns with the statement “...would provide audit evidence that is at least as persuasive as...” in paragraph .14 of the proposed standard. Given the emphasis placed on the persuasiveness of audit evidence provided by confirmations in paragraph .06 of the proposed standard, the auditor may be challenged to identify other substantive procedures that would provide audit evidence at least as persuasive as that obtained from confirmations. Further, if there are procedures that are “as persuasive as” confirmations, then this statement may imply that confirmations are not the most persuasive audit evidence. In either case, this statement may result in obtaining more evidence than necessary. Further clarification may be necessary to understand the Boards intent for this requirement. We believe there are various sources of audit evidence that in combination may provide sufficient audit evidence to address the risks identified. Further, with increasing concerns around cybersecurity which has affected confirmation response rates and raised concerns as to the reliability of confirmations, other forms and sources of audit evidence driven by technological advancements may become more important and achievable. We ask that the Board consider this in determining whether confirmations are, in fact, the most persuasive form of audit evidence.

Fraud Identification

The Release also highlights various PCAOB and SEC enforcement cases alleging auditor failures to execute effective confirmation procedures to address fraud.⁷ We do not dispute the results of these proceedings; however, we are concerned that the Release may inadvertently set an unrealistic expectation that confirmation procedures would uncover most frauds or that confirmations are an appropriate audit response to fraud risks. When appropriately designed and

⁷ See Release pages 11 and 12.

executed, confirmation procedures may adequately address certain risks of material misstatement, including those due to fraud; however, we also believe other procedures could accomplish the same objective or may be more appropriate to address risk of material misstatement due to fraud. Further, when third parties collude with auditees, detection of the fraud, under any circumstance, is much more difficult.⁸

Key Recommendations

Given the above, we highlight our key recommendations for the Board to consider in order to promote consistency in application and operability of the final standard.

We recommend that the Board revise the final standard to:

- Eliminate the presumption to confirm cash and accounts receivable to align the proposed standard with the Board's risk assessment standards.
- If elimination of the presumption is not feasible, then:
 - Include criteria to overcome the required confirmation of cash, and
 - Consider the implications of promoting confirmations as the most persuasive form of audit evidence. Specifically, the implication on the auditor's inability to identify sufficient alternative procedures to overcome the presumption and the inconsistency with the ability to perform other procedures, as suggested in paragraph .31, that suggest there are alternative procedures that would be acceptable in place of a confirmation under certain circumstances described in paragraphs .20 (inability to identify a confirming party), .26 (unreliable response), and .30 (nonresponse or incomplete response).

See below for responses to specific questions outlined in the Release and further recommendations.

Specific Feedback

Q5. Does the new proposed standard provide for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard?

We believe the proposed standard generally provides for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations *other than those specifically addressed* in the new proposed standard. As discussed in our General Observations above, we believe it is important for an auditor to apply professional judgment in determining whether the use of confirmations is appropriate and effective based on their risk assessment for each audit.

⁸ See, e.g., Paul Caster, Randal J. Elder, and Diane J. Janvrin, A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness, 27 Auditing: A Journal of Practice & Theory, 5 (2008).

Q6. Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?

We do not believe there are accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures. The use of confirmation procedures to obtain audit evidence should be based on the auditor's risk assessment given the facts and circumstances of each audit.

Q7. As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?

Yes. The proposed approach is appropriate as it is consistent, as it relates to this matter, with PCAOB standards on risk assessment and allows for the use of professional judgment in determining the most effective approach to obtain audit evidence in response to the assessed risk.

Q9. Are there ways in which the new proposed standard should be changed to further align with the PCAOB's risk assessment standards? If so, how should the new proposed standard be changed?

Yes. We believe the Board should consider eliminating the requirement to confirm cash and presumption to confirm accounts receivable and rather allow auditors to determine an appropriate response to address risks identified. Paragraph .09 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, states that "in designing the audit procedures to be performed, the auditor should obtain more persuasive evidence the higher the auditor's assessment of risk". The proposed standard requires auditors to confirm cash and accounts receivable regardless of the assessed risk of material misstatement and places the burden on auditors to rebut the presumption (relative to accounts receivable). We believe this is inherently included in the risk assessment process and would more effectively identify appropriate procedures and audit evidence commensurate with the risks identified for the relevant account and assertion. As it relates to cash, there is no ability to overcome such presumption, which could result in performing confirmations and obtaining the most persuasive evidence for risks that are less than high. This could result in expending unnecessary time and effort to either rebut the presumption or address issues identified later in the audit as a result of non-responses and exceptions. Further, we believe by requiring confirmations regardless of assessed risk, the messaging is inconsistent with the spirit of the risk assessment standard and could promote a checklist mentality.

Q10. Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

We do not believe the requirements in the proposed standard regarding confirming cash held by third parties, as well as other financial relationships, are sufficiently clear and appropriate, as detailed in our response to this question and Q11, as well as our General Observations above. First and foremost, we encourage the Board to consider eliminating the requirement to confirm

cash. Second, we have concerns with regard to certain proposed requirements and suggest the Board provide further clarification to enable the application of auditor judgment.

Paragraph .02 of the proposed standard indicates that “the objective of the auditor in designing and executing the confirmation process is to obtain relevant and reliable audit evidence about one or more relevant financial statement assertions of a *significant account or disclosure*” (*emphasis added*). Therefore, it appears that when cash is determined to be a significant account confirmation is required for at least a selection of cash items pursuant to proposed paragraphs .09 and .10. We do not believe this is appropriate in all cases where cash is determined to be a significant account, for example where an auditor determines that assessed levels of risks are less than high or confirmations would not be effective due to the likelihood of receiving incomplete responses or nonresponses. Auditors should have the ability to use professional judgment in determining whether confirmations are an appropriate procedure based on the assessed level of risk. If the Board decides that eliminating the presumption to confirm cash is not feasible, we suggest the Board at least add the ability to overcome the presumption to confirm cash as well as consideration of AS 1105, *Audit Evidence*, in determining how to overcome such presumption.

Q11. Are there substantive audit procedures other than confirmation that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash? If so, please describe these procedures.

Yes. A combination of audit procedures, including test of controls in some cases, could provide evidence as persuasive as confirmations. Further, audit evidence should be sufficient and appropriate in response to the assessed risk of material misstatement. In instances where risk is high and there is no controls reliance, the highest level of evidence may be necessary. In other instances, the combination of various audit procedures could provide both internal and external audit evidence to address the identified risks sufficiently and appropriately.

Q13. Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

Although the proposed standard appears to allow for judgment in selecting which accounts should be confirmed, we encourage the Board to consider allowing auditors judgment in determining the extent of confirmations used as well as other procedures over cash accounts based on the assessed level of risk.

Q14. Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?

No. We believe the proposed standard should align more closely to the risk assessment standards and allow for auditor judgment in determining whether confirmations are the most appropriate audit response. See response to Q9 above. If the Board decides that eliminating the presumption to confirm accounts receivable is not feasible, we suggest the Board at least consider incorporating more of the concepts included in AS 1105, *Audit Evidence*, in determining how to overcome such presumption, rather than highlighting certain paragraphs that may imply a higher bar for determining what procedures would be “as persuasive as” confirmations. We have highlighted some concerns related to the auditor’s ability to overcome the presumption to confirm

accounts receivable in our General Observations and response to Q17 below. Further, we note that auditors have observed the trend in declining confirmation response rates referenced in the Release. Factors like increased skepticism related to cybersecurity may escalate that trend, which makes it important that auditors are able to perform procedures other than confirmation to obtain audit evidence for accounts receivable and other accounts or disclosures.

Q17. Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

No. As written, it is unclear how an auditor would be able to obtain evidence that is at least as persuasive as performing confirmation procedures under the proposed standard. While the proposed standard itself does not explicitly state that confirmations are the most persuasive form of audit evidence, discussions in the Release imply this may be the Board's view. Thus, while the standard includes a provision to overcome the presumption to confirm accounts receivable, it does not appear to be an actionable opportunity given the high bar of evidence to overcome.

Page 25 of the Release states, "[t]he new proposed standard would not carry forward the provisions addressing materiality or a combination of risk assessments that are currently available to overcome the presumption to confirm accounts receivable, as these matters would be considered by the auditor as part of identifying and assessing the risks of material misstatement and designing and implementing an audit response under PCAOB risk assessment standards." Therefore, we do not believe it is the intent of the Board that, for example, the auditor would be required to confirm accounts receivable when the combined level of control and inherent risk are at a sufficiently low level (combined with other evidence obtained as part of the audit). However, we do not believe this is reflected in the proposed standard and should be clarified. Similarly, we believe the process of identifying risks and designing responses includes consideration of whether confirmations are an effective procedure, which supports eliminating the presumption to confirm accounts.

Q18. Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?

As discussed in our General Observations and in various questions above, we suggest eliminating the presumption to confirm accounts receivable and focus on risk assessment procedures and designing appropriate audit responses. However, if such a presumption is required, we do not agree that the ability for an auditor to overcome the presumption to confirm accounts receivable should be dependent on obtaining audit evidence that is at least as persuasive as the evidence that which the auditor might expect to obtain through performing confirmation procedures. Further, confirmations may not be reliable or otherwise effective, such as in instances where there is a higher risk of errors in the responses or where historically low response rates have been observed. Audit evidence obtained by an auditor should be sufficient and appropriate in responding to the assessed risk associated with a given account or disclosure.

Q19. Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

We do not believe the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome is appropriate in all cases. Auditors may communicate the determination to overcome the confirmation of accounts receivable when it presents a significant risk of material misstatement or a fraud risk. However, it may not be beneficial for auditors to communicate that the presumption has been overcome when accounts receivable was assessed as a lower risk.

Requirements within PCAOB auditing standards focus audit committee communications on key judgments made throughout the audit and other matters that may be relevant to their oversight responsibilities. In some cases, the auditor's determination to overcome the confirmation of accounts receivable may be insignificant in the context of the overall audit (e.g., in lower risks). Existing standards already address instances where audit committee communication would be appropriate.

Q20. Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?

We believe the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement require additional clarity to ensure the proposed provisions are operational.

Under paragraph .09 and .12 of the proposed standard, it is clear that an auditor is required to perform confirmation procedures over cash and accounts receivable, however, additional clarification is needed to understand the Board's expectations for "should consider confirming" as it relates to complex or significant unusual transactions under paragraph .15. Although the Release states the new proposed standard does not require the auditor to send confirmation requests in response to significant risks and allows for the exercise of professional judgment by the auditor, "should consider" implies the auditor would be required to document their consideration for why they did not perform such procedures. Further, when taken in context of the preceding provisions in the proposed standard (e.g., the emphasis on persuasiveness of audit evidence provided by confirmations), the new proposed provision appears to add an increased burden of documentation in instances where an auditor may conclude that confirmation procedures are not necessary to obtain sufficient appropriate audit evidence to address a significant risk of material misstatement associated with either a complex transaction or a significant unusual transaction.

We recommend that the Board revise proposed paragraph .15 to indicate that an auditor "may consider" confirming terms of complex or significant unusual transactions connected to a significant risk. Pursuant to PCAOB Rule 3101(a)(3), the auditor would have a responsibility to

consider performing confirmation procedures over such terms and exercise professional judgment in the circumstances consistent with the objectives of the standard.

Q22. Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

We believe that modification of the proposed requirements related to identifying information to confirm will aid auditor execution of the new proposed standard.

Based on the Release text, it appears that the intent of proposed paragraph .17 is that the auditor should test the accuracy and completeness of information produced by the company that the auditor uses as audit evidence.⁹ However, the text of the proposed provision requires an auditor “test the accuracy and completeness of information produced by the company that *the auditor uses in selecting items to confirm*” (*emphasis added*). We agree that making selections from a complete and accurate population is important. However, in many cases, confirmations may be designed to address the risk of accuracy for a given account balance or disclosure (and sometimes completeness). As such, we believe that requiring the auditor to test information produced by the company for accuracy (or completeness) before selecting items for confirmation may be duplicative if the confirmation is designed to test that assertion. We believe that paragraph .10 of AS 1105 appropriately addresses this concept and that proposed paragraph .17 is not necessary.

Q26. 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 account when using an intermediary in the confirmation process?

We believe that the requirements in the new proposed standard to evaluate the use of an intermediary to facilitate direct electronic transmission of confirmation requests and responses are appropriate; however, additional clarity may be required to ensure the proposed provisions are operational.

Appendix .B3 of the proposed standard states that an auditor should not use an intermediary to send confirmation requests or receive confirmation responses if there are indicators the necessary controls at the intermediary are not designed or operating effectively, among other indicators. Clarification is required as to the definition of “indicators,” which can be different than a deficiency in relevant controls. Such indicators may warrant additional investigation, which may result in identification of compensating controls, or a means to overcome the “indicator” or conclude no impact to the reliability of the intermediary.

For operational or other reasons, many confirming parties will only participate in the confirmation process through an intermediary, such as in the financial services industry. If a highly concentrated intermediary received a qualified SOC report with a negative indicator regarding its reliability, and the standard did not permit auditors to perform additional procedures to address the negative indicator, this could have severe and pervasive effects on how auditors across the

⁹ See Release page 29.

profession perform confirmation procedures. Further, the proposed standard does not provide an opportunity to overcome the presumption to confirm cash, even in situations where the ability to confirm is out of their control. Additional clarity is needed to understand alternatives under circumstances such as these.

Q28. Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?

Yes. The provisions of the new proposed standard related to evaluating the reliability of confirmation responses are sufficiently clear and appropriate for the reasons stated in the Release.

Q31. Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?

We believe the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures are sufficiently clear and appropriate, however, it is uncertain whether the procedures the Board describes in paragraph .31 in the proposed standard as being acceptable alternative procedures when the auditor is unable to obtain relevant and reliable audit evidence through confirmation would also be considered acceptable procedures to use which would provide evidence “as persuasive as” confirmations when overcoming the presumption to confirm.

Q33. Are the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses sufficiently clear and appropriate? If not, what changes should be considered?

Yes. The requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses are sufficiently clear and appropriate.

Q35. In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?

We do not believe that there are procedures that the auditor should perform in the event of a management request not to confirm a certain item which are not currently required by other PCAOB standards as discussed on pages 44 and 45 of the Release.

Q49. Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?

Yes. We believe that requiring compliance for fiscal years beginning after the year of SEC approval would present challenges for auditors if the final standard is relatively consistent with what is currently reflected in the proposed standard. Based on the responses provided above, the final standard would significantly affect firm methodologies, related tools, and guidance, which will need to be fully updated prior to the beginning of the audit year in which the final standard becomes effective. We will also need to develop and implement training and effective quality

control processes and procedures to support and facilitate effective implementation of the final standard.

Additionally, the confirmation process often involves intermediaries that will need time to evaluate the impact of the standard on their operations with respect to the confirmation process, update their processes and controls, and effectively implement them so they are prepared by the time the final standard becomes effective. A longer implementation period will enable the firms, intermediaries, and staff/Board to discuss potential implementation issues and inform additional guidance.

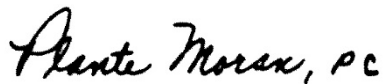
In order for firms and intermediaries to sufficiently prepare, we strongly recommend that the final standard be effective for audits of fiscal years beginning on or after December 15, 2024.

We appreciate the opportunity to comment on the proposed auditor's use of confirmations standard and related amendments. As the Board gathers feedback from other interested parties, we would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Steve Neiheisel (steve.neiheisel@plantemoran.com) or Bora Brock (bora.brock@plantemoran.com).

Sincerely,



Plante & Moran, PLLC



Plante Moran, P.C.

cc: **PCAOB**

Erica Y. Williams, Chair
Duane M. DesParte, Board member
Christina Ho, Board member
Kara M. Stein, Board member
Anthony C. Thompson, Board member
Barbara Vanich, Chief Auditor

SEC

Paul Munter, Chief Accountant
Diana Stoltzfus, Deputy Chief Accountant



February 20, 2023

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

RE: PCAOB Rulemaking Docket Matter No. 028

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the "Board") proposed auditing standard, *The Auditor's Use of Confirmation*, and other proposed amendments to PCAOB standards included in PCAOB Release No. 2022-009 ("the proposed standard" or "the proposing release"). We support the Board's updating of its standard on confirmations to consider the changing landscape and advancements in technology related to the confirmation process. We also appreciate the PCAOB's intent to expressly align the proposed standard with the risk assessment standards. We agree with the PCAOB's view that "[t]he auditor's assessment of the risk of material misstatement is an important consideration when designing audit procedures, including the use of confirmation."¹

We also are encouraged by the PCAOB's acknowledgement in the proposing release that auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence,² and that the standard should include more principles-based requirements that are designed to apply to all methods of confirmation,³ including new methods that may arise from technological changes in auditing in the future.

Notwithstanding this support, certain of the proposed requirements are prescriptive to the point that they may add unnecessary costs without commensurate benefits to audit quality. For example, certain requirements may require unnecessary incremental documentation or may create inefficiencies in the audit process, and may inhibit future auditor innovation, undermining the PCAOB's intent. The final standard should be more principles-based, and more risk-based, to allow for auditors to tailor the nature, timing, and extent of their audit procedures to appropriately address the assessed risk of material misstatement and to obtain sufficient appropriate evidence in relation to relevant assertions. We offer recommendations on how to enhance the proposed standard that we believe address these issues. Additional commentary on these and other matters that may be of interest to the Board are included in the appendix.

Acknowledging the increasing use of technology, including the involvement of intermediaries in the confirmation process

For operational or other reasons, many confirming parties, including many large financial institutions, will only participate in the confirmation process through an intermediary. In the absence of standard-setting, practice has already been evolving through discussions between firms and intermediaries to enable sound methods of confirmation when an intermediary is used. We therefore support the proposed standard,

¹ PCAOB Release No. 2022-009, page 58

² PCAOB Release No. 2022-009, page 13

³ PCAOB Release No. 2022-009, page 14



including specific requirements when the auditor or confirming party uses an intermediary in the confirmation process.

As discussed in the appendix, we are concerned, however, that practical challenges may arise as a result of how the requirements are drafted, and that intermediaries may need to make enhancements to their processes in order for auditors to comply with the proposed standard. While we are supportive of enhancements in the interest of continuous improvement, we are not aware of evidence that suggests that auditors should be precluded from continuing to use common intermediaries that have been viewed to have sufficient controls in the interim.

Need to acknowledge how technology can be used to obtain persuasive evidence

In issuing the proposed standard, the PCAOB decided not to define direct access to information in a third party's information system concerning the third party's transactions or balances with the company under audit as a confirmation procedure. This circumstance is addressed in the AICPA's confirmation standard, and we believe information obtained directly may become more prevalent as a source of relevant and reliable audit evidence from financial institutions and in certain industries. We recommend that the PCAOB consider aligning with the AICPA and acknowledge that the auditor's direct access to information held by a third party (the confirming party) may meet the definition of an external confirmation when, for example, the confirming party provides the auditor with the electronic access codes or information necessary to access a secure website where data that addresses the subject matter of the confirmation is held.⁴ At a minimum, we believe it is necessary to acknowledge that this direct access to information from third parties can provide audit evidence that is as persuasive as a confirmation, and consider how such evidence would be considered in accordance with AS 1105.⁵

The proposing release asks whether "the new proposed standard [is] 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)?" Auditors may or may not be able to confirm information about digital assets, however, additional considerations may affect the auditor's judgment about how best to obtain sufficient appropriate evidence related to digital assets. For example, the auditor may be able to interrogate the blockchain rather than sending a confirmation request to a third party (as a confirming party may not be readily identifiable). Accordingly, we recommend that the PCAOB more holistically consider whether changes to PCAOB standards are necessary to address the auditing of digital assets. In this regard, the work of the AICPA's Digital Assets Working Group, including their practice aid, *Accounting for and auditing of digital assets*, may be relevant.

Concerns with how the concept of evidence being "at least as persuasive" is articulated

We agree with the PCAOB's view that, when properly designed and executed, the confirmation process can be an effective and efficient way of obtaining relevant and reliable evidence about certain financial statement assertions. However, confirmations are often used *in combination with* other substantive procedures, as well as tests of controls, to provide sufficient appropriate evidence to respond to the assessed risk of material misstatement relating to a significant account or disclosure. Accordingly, we recommend that the Board take care to ensure that the proposed standard is not interpreted as removing the auditor's ability to determine what is the most effective response to the assessed risk of material misstatement.

⁴ AU-C section 505, *External Confirmations*

⁵ AS 1105, *Audit Evidence*



For example, the proposing release describes how, in many situations, confirmation could provide audit evidence that is more persuasive than evidence obtained solely through other substantive procedures.⁶ Because the proposed standard and proposing release therefore may be read as positioning confirmation responses as the preferred form of audit evidence, we are concerned that there could be unintended consequences that could negatively affect audit quality if certain language (described further in the appendix) is not revisited, including the following:

- Auditors may default to performing confirmation procedures when other procedures would be *more* effective, including procedures that are technology-enabled. This consequence may be exacerbated if auditors believe their professional judgment would be unnecessarily questioned, including, for example, as a result of proposed new reporting to audit committees when the auditor seeks to overcome the presumption to confirm accounts receivable.
- Auditors may unduly limit their efforts to confirmations, where other procedures may also be necessary or appropriate in the circumstances to respond to assessed risks of material misstatement.
- The expectation gap could be exacerbated in relation to fraud. For example, the proposing release states that “an audit confirmation process designed and executed under the new proposed standard should benefit investors and other users of a company’s financial statements by *reducing the likelihood that the financial statements are materially misstated, whether due to fraud or error*” (emphasis added). When appropriately designed and executed, confirmation procedures may adequately address certain risks of material misstatement due to fraud; however, when third parties collude with auditees, detection of the fraud is much more difficult.⁷

Finally, consistent with AS 2301, we believe the proposed standard should focus on requiring the auditor to design and perform procedures to address the assessed risk of material misstatement. However, we do not believe it is appropriate for the standard to suggest auditors are able to, or need to, comparatively measure the nature, timing, and extent of other substantive procedures against the evidence provided by confirmation in order to be able to conclude on a level of persuasiveness. Rather than requiring auditors to determine (and possibly document) whether evidence from other substantive procedures would be *as persuasive as* evidence from confirmation procedures, we believe the PCAOB should either:

- Revert to the construct in paragraph .34 of extant AS 2310 that set out factors for the auditor to consider in determining whether the presumption to confirm accounts receivable could be overcome, as this language is more clear and appropriate. Additional factors could be articulated in relation to overcoming the presumption to confirm cash; or
- Use an alternative construct of requiring auditors *to consider whether to confirm cash and accounts receivable*, similar to the requirements in paragraphs .11 and .15.

Either of these approaches would give appropriate emphasis to the potential for confirmations to be a persuasive source of audit evidence, while allowing for appropriate auditor judgment if other types of procedures are sufficient, and potentially more effective, to respond to the assessed risks of material misstatement.

⁶ PCAOB Release No. 2022-009, page 18

⁷ See, e.g., Paul Caster, Randal J. Elder, and Diane J. Janvrin, A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness, 27 *Auditing: A Journal of Practice & Theory*, 5 (2008).



Effective date

The proposed standard introduces requirements that, if finalized, are likely to require changes to firms' methodologies, tools, and guidance, as well as incremental training. In addition, intermediaries will need time to adequately assess the impact of new requirements on their controls and processes, as well as potential deliverables (e.g., SOC reports) and implement any needed changes. Assuming the SEC approves the final standard before early 2024, we recommend a final standard be effective for audits of financial statements for periods beginning on or after December 15, 2024.

* * * * *

We appreciate the opportunity to provide input and would be pleased to continue a dialogue with the Board and its staff. Please contact Brian Croteau at brian.t.croteau@pwc.com regarding our submission.

Sincerely,

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP



Appendix

Concerns with the presumption to confirm accounts receivable and cash

As noted in the cover letter, we are concerned that certain of the proposed requirements are prescriptive to the point that they may add unnecessary costs without commensurate benefits to audit quality. We support the Board's intent to strengthen and clarify certain requirements related to the confirmation process. However, the final standard should be more principles-based and more risk-based to allow for auditors to develop an audit response that is efficient and effective - tailoring the nature, timing, and extent of their audit procedures to appropriately address the assessed risks of material misstatement and obtain sufficient appropriate evidence in relation to relevant assertions.

AS 2310 requires the auditor, in designing the audit procedures to be performed, to obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁸ This is in the context of the overarching requirement in paragraph .08 of AS 2310 for the auditor to design and perform audit procedures in a manner that *addresses the assessed risk of material misstatements* for each relevant assertion of each significant account and disclosure.

While paragraph .05 of the proposed standard aligns with paragraph .37 of AS 2301, it does not include the concept articulated in the last sentence of that paragraph, underlined below:

As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.

Suggesting that audit evidence obtained from confirmation is the most persuasive evidence, and therefore presuming confirmations should ordinarily be obtained in relation to cash and accounts receivable, may detract from audit quality, result in increased costs without commensurate benefits, and limit innovation or "date" the standard as both the environment in which audits are conducted and the data and technology available to auditors continues to evolve.

Concerns specific to accounts receivable

Our concerns related to accounts receivable relate to (1) the changes in how the presumption to confirm accounts receivable can be overcome and (2) the new requirement to communicate with the audit committee when the auditor decides not to confirm accounts receivable.

The PCAOB states that the changes to the requirement on overcoming the presumption to confirm accounts receivable "would allow for the use or development of more sophisticated and effective audit procedures, which might include the use of technology-based auditing tools, subject to the requirement that they provide the same or increased level of audit evidence about the relevant financial statement assertion. Accordingly, this change could potentially improve the efficiency and effectiveness of the audit."⁹ We continue to agree that auditors should be permitted to overcome the presumption to confirm accounts receivable. However, we do not support the requirement that an auditor may only overcome the presumptively mandatory responsibility regarding confirming accounts receivable if the auditor

⁸ AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph .09(a)

⁹ PCAOB Release No. 2022-009, page 61



determines that other procedures performed in lieu of confirmation would provide audit evidence that is “at least as persuasive” as the evidence the auditor might expect to obtain through confirmation. For example, in some situations auditors might reasonably determine confirmation not to be an effective audit procedure. This may occur when the auditor has an expectation of inadequate response rates (which is not within the auditor’s control). Or the auditor may believe other substantive procedures, including those that are technology-enabled, represent a more effective and efficient audit approach.

We believe the construct in paragraph .34 of extant AS 2310 that set out factors for the auditor to consider in doing so is more clear and appropriate than paragraph .14 of the proposed standard. Neither existing PCAOB standards nor the proposed standard explain how the auditor could measure the persuasiveness of evidence obtained from other substantive procedures against the evidence provided by confirmation. Under existing standards, the auditor performs the risk assessment and considers the results of that risk assessment when designing audit procedures to be performed to respond to the assessed risk - a foundational principle that we believe must be retained. For example, the proposing release notes “the auditor may determine that to obtain audit evidence that is *at least as persuasive as evidence from confirmation*, the auditor may need to apply the other procedures to a greater number of items than the auditor would otherwise address through confirmation”¹⁰ (emphasis added). In practice, the amount of items selected for testing when executing a sampling approach is the outcome of a formula derived with consideration of the assessed levels of inherent risk, control risk, and detection risk for a particular account. The proposing release notes that more items may need to be tested if confirmations are not performed in order to meet the bar of “at least as persuasive;” however, since this is not tied to the level of risk, this is not contemplated in the way that sample sizes are calculated today based on the concepts in AS 2315.¹¹

As written, it is not clear if the words “at least as persuasive as the evidence the auditor might expect to obtain through confirmation” refers to the level of persuasiveness expected from a confirmation returned with no exceptions, or to the level of persuasiveness expected after considering the facts and circumstances unique to a particular account. For example, if the auditor knows from prior experience that a counterparty is unlikely to respond to a confirmation request due to company policy, and therefore confirmations might be determined to be an ineffective strategy, it is unclear if this can be considered in the auditor’s determination of the level of persuasiveness expected to be obtained from confirmation. In other words, in this scenario, the auditor already has a view that confirmations would not be expected to provide persuasive evidence due to the likely ineffectiveness and would decide it would be more appropriate to plan and perform other procedures to respond to the assessed risks of material misstatement.

Accordingly, deciding whether or not to confirm accounts receivable (and cash, as discussed below) should be tied to the auditor’s assessment of risk for that account and allow for consideration of what procedures would address the risk, rather than an assessment of the level of persuasiveness of those procedures when compared to confirmations. Should the PCAOB decide not to revert to paragraph .34 of extant AS 2310, we believe an alternative construct of requiring auditors *to consider whether to confirm accounts receivable* would give appropriate emphasis to the potential to obtain confirmations as audit evidence, while allowing for appropriate auditor judgment if other types of procedures are likely to be more effective to respond to the assessed risks of material misstatement.

¹⁰ PCAOB Release No. 2022-009, page 24

¹¹ AS 2315, *Audit Sampling*



Required communication to audit committees

AS 1301¹² provides a framework for required communications to the audit committee about the overall audit strategy and significant risks. AS 1301 also requires the auditor to communicate other matters arising from the audit that are significant to the oversight of the company's financial reporting process. Matters in relation to accounts receivable may - or may not - warrant a discussion with audit committees. For example, when accounts receivable has been identified as a significant risk of material misstatement or fraud risk or the auditing of accounts receivable (or related accounts and disclosures) was considered as a potential critical audit matter, discussion with the audit committee would already be required. In other circumstances, the discussion proposed to be required by the standard may not be relevant to the audit committee given the size of the account, the risks associated with it (i.e., if there is not an elevated risk of material misstatement), when compared to other engagement-specific matters (including other significant accounts with higher identified risks of material misstatement).

We therefore question whether the new requirement to communicate with the audit committee in paragraph .14 of the proposed standard is appropriate. We are concerned that a required communication about one specific element of the auditor's overall audit strategy could detract from more important matters relevant to the audit committee's oversight. In addition, as the presumption to confirm accounts receivable is often overcome year after year when engagement circumstances have not changed, this may result in boilerplate communications with no incremental information presented to the audit committee.

The proposing release notes "there may be some expectation by audit committees that the auditor would use confirmation as part of a planned audit response."¹³ We encourage the Board to perform outreach with audit committees on this matter to understand whether this expectation is widespread and determine whether the proposed communication requirement would always be relevant and meaningful.

Lack of ability to overcome the presumption to confirm cash and cash equivalents and the need for the auditor to perform alternative procedures

We generally support the Board's proposal to require the auditor to confirm cash and cash equivalents when cash is determined to be a significant account. However, in our experience, there are circumstances when auditors have a reasonable basis to conclude that confirmations will not be effective (e.g., based on prior experience and inquiries performed, the auditor may be aware that counterparties have a pre-established policy not to respond to confirmation requests). Without any provision that allows the auditor to initially overcome the presumption to confirm cash, auditors may be required to send confirmation requests that will ultimately be ineffective - and will also need to perform other audit procedures to obtain sufficient appropriate evidence.

Auditors may also be able to obtain persuasive evidence through other audit procedures more efficiently and effectively. For example, some auditors are employing auditing techniques that involve obtaining direct view-only access to client banking information. An auditor may (1) assess the risk of material misstatement related to cash as low, (2) test the design and operating effectiveness of relevant controls, and (3) test bank reconciliations and inspect bank statements through direct access to this external information. Regardless of whether the PCAOB believes this meets the definition of a confirmation, such procedures provide the auditor with evidence that is responsive to the assessed risks of material misstatement.

Similar to accounts receivable, we believe either setting out factors for the auditor to consider in determining that the presumption to confirm cash can be overcome or an alternative construct of

¹² AS 1301, *Communications with Audit Committees*

¹³ PCAOB Release No. 2022-009, page 25



requiring auditors *to consider whether to confirm cash* would give appropriate emphasis to the potential to obtain confirmations as audit evidence, while allowing for appropriate auditor judgment if other types of procedures are likely to be more effective to respond to the assessed risks of material misstatement.

Further, the proposed standard does not provide examples of alternative procedures that may be performed for cash and cash equivalents (unlike other areas described in paragraph .34). The proposing release also notes that, in general, the Board is not aware of other types of substantive procedures that would provide audit evidence that is as persuasive as audit evidence obtained through confirmation of cash.¹⁴ Taken together, this could create an untenable situation in which auditors send confirmations but receive no response, and therefore may view the proposed standard as implying the auditor has no path forward but to determine there is a limitation on the scope of the audit.

Like all other significant accounts and disclosures, the auditor should be able to exercise professional judgment in determining what (alternative) procedures appropriately respond to the assessed risks of material misstatement related to cash and cash equivalents. The following represent procedures the PCAOB could provide as examples that may provide relevant and reliable audit evidence:

- Agreeing the bank balance per the reconciliation to the bank statement
- Testing the design and operating effectiveness of controls relating to the treasury function, including the opening and closing of bank accounts, authorization levels, access to online banking facilities, approval of new facilities, capturing all facilities and arrangements, and monitoring of compliance with terms and arrangements
- Observing authorized personnel access online banking and assessing completeness and accuracy of recorded bank balances and arrangements with details shown online
- Performing inquiries with individuals responsible for banking relationships to identify changes in banking arrangements during the period and to assist with assessment of completeness of facilities and arrangements
- Reviewing reconciling items in the bank reconciliation to identify facilities and other arrangements
- In addition to a combination of the above procedures, obtaining representations specific to banking facilities from management in the representation letter to corroborate conclusions reached through the alternative procedures performed

Considering whether to confirm other financial relationships

We appreciate the PCAOB's emphasis on the need to consider confirming other financial relationships. Our approach to confirming cash is part of a broader focus on understanding the company's banking relationships and considering them in our risk assessment, including considering risks of material misstatement related to liabilities such as lines of credit, other indebtedness, compensating balance arrangements, or contingent liabilities, including guarantees. In practice, we often find it necessary to confirm facilities and other banking arrangements separately from cash and cash equivalents balances, as the party to which the confirmation is addressed for cash may not be the most knowledgeable person at the confirming party with regard to other financial relationships.

¹⁴ PCAOB Release No. 2022-009, page 21



We recommend that the Board revise proposed paragraph .11 to indicate that an auditor "may consider" confirming other financial relationships when confirming cash. Pursuant to PCAOB Rule 3101(a)(3),¹⁵ the auditor would have a responsibility to consider performing confirmation procedures over such terms and exercise professional judgment in the circumstances consistent with the objectives of the standard. This would allow auditors to exercise appropriate judgment in determining an appropriate audit response, without a burden of additional documentation.

Acknowledging the increasing use of technology, including the involvement of intermediaries in the confirmation process

Implications of using an intermediary

We support the intent of the requirements in paragraph .B2 relating to the auditor obtaining an understanding of the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses, and determining that the controls used by the intermediary to address these risks are designed and operating effectively. In practice, obtaining and reviewing System and Organization Controls (SOC) reports may often be necessary in order to evaluate the reliability of evidence obtained through an intermediary, and firms may establish central processes to obtain and evaluate these reports, rather than having individual engagement teams make such an evaluation.

In accordance with paragraph .B2(c), engagement teams would also need to perform procedures to assess the relationship of the intermediary with the company being audited. We question whether this requirement would be necessary in all cases, as the company's engagement with the intermediary is ordinarily limited to providing authorization to the intermediary. Rather than establishing a requirement for the auditor to "assess" the relationship of the intermediary with the company, we recommend that the proposed standard require auditors to consider any information of which they become aware that may suggest there is a reasonable possibility that the company being audited has the ability to override the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses.

Considering when it is not appropriate to use an intermediary

Appendix .B3 of the proposed standard states that an auditor should not use an intermediary to send confirmation requests or receive confirmation responses if certain indicators are present, including indicators that the necessary controls at the intermediary are not designed or operating effectively. Indicators, in and of themselves, do not necessarily reflect that an intermediary is not fit for use. Depending on the circumstances, an auditor (or the firm, on behalf of engagement teams) can perform additional procedures to evaluate the implications on the reliability of confirmation requests and responses. For example, an auditor (or the firm) may be able to obtain an understanding of how a specific control failure impacts (or does not impact) the confirmation process and perform additional procedures to overcome the issue. Accordingly, it may be possible for auditors to conclude there is a remote risk of interception and alteration, such that the intermediary can still be used to facilitate direct electronic transmission of confirmation request and responses.

¹⁵ PCAOB Rule 3101(a)(3) states, "The words "may," "might," "could," and other terms and phrases describe actions and procedures that auditors have a responsibility to consider. Matters described in this fashion require the auditor's attention and understanding. How and whether the auditor implements these matters in the audit will depend on the exercise of professional judgment in the circumstances consistent with the objectives of the standard."



We recommend revising the requirement in paragraph .B3 to enable auditors to exercise judgment to determine if the intermediary's controls and processes are appropriate for the auditor's purposes, taking into account the auditor's judgment about the risk of interception and alteration as follows:

If information obtained by the auditor indicates that (i) the intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses, (ii) the necessary controls are not designed or operating effectively, or (iii) circumstances exist that give the company the ability to override the intermediary's controls, the auditor may consider performing additional audit procedures to address these indicators. If, after performing additional audit procedures, the auditor concludes that the indicators cannot be resolved, the auditor should not use the intermediary to send confirmation requests or receive confirmation responses.

Anecdotally, we have observed a concentration of intermediaries used in the marketplace. If an intermediary receives a qualified SOC report with a negative indicator about its controls, and the proposed standard does not permit auditors to perform additional procedures to address the negative indicator, this could have severe and pervasive effects on the ability of auditors to perform confirmation procedures in accordance with the proposed standard.

How confirmations are used to respond to assessed risks of material misstatement due to fraud

We are concerned that the proposed standard could exacerbate the expectation gap in relation to fraud. For example, the proposing release states that "an audit confirmation process designed and executed under the new proposed standard should benefit investors and other users of a company's financial statements by *reducing the likelihood that the financial statements are materially misstated, whether due to fraud or error*" (emphasis added). The proposing release also highlights various PCAOB and SEC enforcement cases alleging auditor failures to execute effective confirmation procedures to address fraud.¹⁶ Finally, paragraph .07 of the proposed standard states that, "[i]n situations involving fraud risks and significant unusual transactions, audit evidence obtained through the confirmation process generally is more persuasive than audit evidence obtained solely through other procedures."

Confirmations may be one type of procedure, often used in combination with other procedures, to respond to certain elevated risks of material misstatement due to fraud, depending on the nature of the fraud risk. However, the proposing release, whether intended or inadvertent, may set an unrealistic expectation that performing confirmation procedures consistent with the proposed standard could prevent frauds from going undetected. When appropriately designed and executed, confirmation procedures may adequately address certain risks of material misstatement due to fraud; however, when third parties collude with auditees, detection of the fraud is much more difficult.¹⁷

We agree (in line with AS 1105) that evidence obtained from a knowledgeable source independent of the company is *generally* more reliable than evidence obtained only from internal company sources. However, we are concerned that the suggestion that confirmations should be used as the primary way of addressing fraud risks may undermine the need for professional judgment in designing and performing audit procedures to address the assessed risk and result in auditors defaulting to confirmations in situations when confirmations may not be effective or efficient.

¹⁶ PCAOB Release No. 2022-009, pages 11-12

¹⁷ See, e.g., Paul Caster, Randal J. Elder, and Diane J. Janvrin, A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness, 27 *Auditing: A Journal of Practice & Theory*, 5 (2008).



We note that the PCAOB has a project on its standard-setting agenda to consider how AS 2401¹⁸ should be revised to better align an auditor's responsibilities for addressing intentional acts that result in material misstatements in financial statements with the auditor's risk assessment, including addressing matters that may arise from developments in the use of technology. That project would provide the PCAOB with a better opportunity to more holistically consider how confirmations, as well as other procedures (including those that are technology-enabled), may be an appropriate response to certain fraud risks. Accordingly, we recommend that the PCAOB remove the language in paragraph .07 of the proposed standard, and consider whether it is appropriate to develop additional requirements or guidance in relation to confirmations in the context of its fraud project.

Practical challenges related to how certain proposed requirements are drafted

We are concerned that certain of the proposed requirements could create practical challenges in implementation as follows.

Identifying information to confirm and designing confirmation requests

Paragraph .17 of the proposed standard notes that the auditor should test the accuracy and completeness of information produced by the company that the auditor uses in selecting the items to confirm, and refers to paragraph .10 of AS 1105. However, AS 1105 requires auditors to test *either* the accuracy and completeness of the information produced by the company as audit evidence, or the controls over the accuracy and completeness of that information. We believe paragraph .17 should be amended to align with AS 1105 and enable auditors to also test controls over the accuracy and completeness of information produced by the company.

Additionally, as it relates to designing confirmation requests more broadly, we recommend that the Board retain a requirement similar to paragraph .23 in extant AS 2310 that allows for consideration of prior experience when designing confirmations. In practice, auditors often consider prior experience when designing their audit strategy and determining the expected efficiency and effectiveness of confirmation procedures, such as past response rates.

Lastly, we suggest the Board add the following language from extant AS 2310 in the note to proposed paragraph 16:

“However, blank forms might result in lower response rates because additional effort may be required of the recipients; consequently, the auditor may have to perform more alternative procedures.”

We believe that this is an important consideration when designing effective confirmations.

Addressing nonresponses

Paragraph .28 of the proposed standard would require auditors to send a second positive confirmation request to the confirming party if the auditor does not receive a response, unless the auditor has become aware of information that indicates that the confirming party would be unlikely to respond to the auditor. While we believe that following up is an important part of the confirmation process, requiring the auditor to send a second request is unduly prescriptive, and may result in an unnecessary and potentially ineffective administrative effort or put pressure on resources that may ultimately need to perform alternative procedures. We recommend the Board revert to language similar to paragraph .30 of extant AS 2310.30 that “the auditor should generally follow up with a second and sometimes a third

¹⁸ AS 2401, *Consideration of Fraud in a Financial Statement Audit*



request to those parties from whom replies have not been received.” This follow up may not involve sending a second request, but rather contacting the confirming party to request a response to the initial confirmation request.

From: Hieger, Tim <Tim.Hieger@usaa.com>
Sent: Thursday, February 23, 2023 2:44 PM
To: Comments
Cc: michael.downing@theiia.org; membership@sanantonioiia.org
Subject: [EXT]: [Public] PCAOB Rulemaking Docket Matter No. 028

Good Morning

The PCAOB should keep current standards for external auditors while adding emphasis that reliance on internal auditors, even acting as intermediaries, does not minimize or remove external auditors' accountability to ensure the confirmation process meets professional standards.

Thank You

Tim Hieger, BCM Testing COE Director, CPA, CIA
Property & Casualty Insurance Group, USAA
Cell: (210) 560-5067
Tim.hieger@usaa.com

USAA Classification: Public

Disclaimer: This email and any attachments are the property of USAA and may contain confidential and/or privileged material. If you are not the intended recipient, any use, disclosure or copying of this email or any attachments is unauthorized. If you received this email in error, please immediately notify the sender and delete the email and any attachments from your computer.

From: Shine, Jami <jshine@quiktrip.com>
Sent: Tuesday, February 7, 2023 12:21 PM
To: Comments
Subject: [EXT]: PCAOB Rulemaking Docket Matter No. 028

I would like to voice my concerns regarding proposed Auditing Standard “The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards.”

The proposed standard would prevent external auditors from using their clients’ internal audit functions to provide direct assistance in the confirmation process under the implication that internal auditors are less independent. This language is biased and unfair to the internal audit profession. Just like external auditors, internal auditors report directly to the Board of Directors and not to management. Our mandatory global standards require us to maintain independence. Having served as an external auditor for five years and as an internal auditor for almost eleven years, it’s been my observation that internal auditors tend to have an even higher level of independence and objectivity than external auditors. External auditors rely upon client satisfaction to maintain the engagement in the future, and organizations frequently change their external auditor, incentivizing external auditors to suppress valid findings to promote a strong client relationship. While an ethical external auditor will not yield to such pressure, neither will an ethical internal auditor fraudulently modify audit confirmation or other test results.

I recommend that the PCAOB continue with existing standard AS 2605, which allows external auditors to assess internal auditors for objectivity and competence and then decide whether to seek their assistance during an engagement.

Thank you for considering my feedback and concerns.

Kind Regards,

Jami Shine, CIA, CRMA, CISA, CRISC

Corporate and IT Audit Manager

QuikTrip Corporation

918-615-7929

jshine@quiktrip.com



RSM US LLP

30 South Wacker Drive
Suite 3300
Chicago, IL 60606www.rsmus.com

February 20, 2023

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington, D.C. 20006By e-mail: comments@pcaobus.org**Re: Proposed Auditing Standard – The Auditor’s Use of Confirmation**

Dear Office of the Secretary:

RSM US LLP (RSM) values the opportunity to offer our comments on the Public Company Accounting Oversight Board’s (PCAOB) Proposed Auditing Standard, *The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards* (the proposed standard). We are generally supportive of many of the proposals to update the standard, recognizing the importance of the standard to audit quality and investor protection. RSM is a registered public accounting firm serving middle-market issuers, brokers and dealers.

Overall Comments on the Proposed Standard

We recognize the need to update this standard – the confirmation process has significantly evolved with changes in technology and electronic communications since the standard was written. Current practice by firms and others involved in the confirmation process has also evolved to incorporate these changes in technologies and electronic communications, and we acknowledge the efforts of the PCAOB in advancing the standard to capture some of these changes. However, we don’t believe that the standard has gone far enough to enable the standard to remain fit-for-purpose into the future, recognizing that technologies and communication methods will continue to evolve, as well as practices to undertake the confirmation process. We therefore encourage the PCAOB to broadly reconsider what more can be done to ‘future-proof’ the standard before it is finalized.

The structure of the standard is largely focused on the confirmation process itself. While we agree that there are unique aspects to undertaking the confirmation process that need to be addressed by the standard, we are of the view that the standard does not adequately address when confirmations are the most appropriate form of audit evidence based on risk identification and assessment, and the unique circumstances of each entity. We therefore encourage the PCAOB to further consider how the risk identification and assessment model, with appropriate responses thereto, can be better incorporated into this proposed standard, which will provide greater clarity around when confirmations are the most appropriate form of audit evidence or when other substantive procedures are appropriate, given the circumstances. For example, the proposed standard focuses on specific requirements for cash and accounts receivable confirmation, with an explanation of why confirmation is commonly seen as an appropriate substantive test. In practice, confirmation is also often used by auditors for several other significant accounts. While examples of other balances are referred to in paragraph .06, we suggest that the proposed standard go further in assisting auditors in determining when confirmation may or may not be the most appropriate test.

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

Office of the Secretary
 Public Company Accounting Oversight Board
 February 20, 2023
 Page 2

With regard to the specific proposals within the proposed standard, we are generally supportive and believe that the proposals are workable, subject to the specific concerns we have detailed in this letter. We also support the PCAOB's objective of including more principles-based requirements that are designed to apply to all methods of confirmations, using risk-based considerations for obtaining relevant and reliable audit evidence through confirmation, which allows for the auditor's judgment to be used for the unique circumstances applicable to the entity and its circumstances. However, in some circumstances, the requirements appear less principles (and risk) based, which detracts from the scalability of the proposed standard. In particular, one of our main concerns relates to the requirement to confirm cash balances without consideration to the risk associated with the balance, the effectiveness of the confirmations or the standard providing for the presumption to confirm cash to be overcome. While in many situations, confirmations related to cash and cash equivalents provide sufficient and appropriate audit evidence, we strongly believe that a more risk-based approach to the requirement to confirm any balances, including cash, would be more consistent with the overall risk-based approach to audits.

We provide further detail on these broader points, as well as other comments, in our responses to the specific questions as set out below.

Comments on the Specific Aspects of the Proposals

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?

While we agree that obtaining evidence from third parties is generally the most reliable form of audit evidence, in many instances, third parties do not return the confirmations, even after follow-up. Alternative procedures on the balance are then performed to obtain the evidence necessary to support the audit opinion. We do not believe that the standard amply recognizes that, in some cases, the confirmation process may not be the most effective audit procedure and we encourage that further consideration be given to leaving the decision to confirm with a third party to the auditor's judgment, which would allow the auditor to plan the most effective audit procedure to obtain audit evidence and would include consideration of prior experience with confirmations from the prior year's audit. This would avoid wasted effort and cost in trying to obtain confirmations that the auditor initially knows will be difficult to obtain and the likelihood is greater that other procedures will still need to be performed.

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? If so, what type of information would be useful to investors and how might it be provided?

Without speaking on behalf of investors, we would like to provide our perspective on this matter. A mechanism within the auditor's report to communicate matters of interest to investors through the disclosure of critical audit matters already exists within an audit.

The auditor's approach to obtaining sufficient and appropriate audit evidence, including determining when confirmations are undertaken, is an intricate balance of what is needed within the context of that particular audit.

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 confirmation process? If so, how?

As noted in our introductory comments, we believe the standard should more explicitly allow for current and future technologies and practices for obtaining confirmations. To allow for continuously evolving

Office of the Secretary
 Public Company Accounting Oversight Board
 February 20, 2023
 Page 3

technology and different types of electronic communications (including how electronic confirmations may be sent today), further consideration could be given to clarifying the required elements of an electronic confirmation to explain the basis for obtaining the necessary evidence (i.e., explain the nature of the evidence that would be relevant and reliable), as this would allow auditors to ensure that these underlying characteristics are met, regardless of the technology used or the practices undertaken to obtain the confirmation. For example, it would be helpful if the proposed standard clarified what more needs to be done with regard to the reliability of the information in a confirmation when it is received electronically, or if the auditor verifies the information directly in the third party's system.

4. Is the objective of the new proposed standard clear? If not, how should it be clarified?

We believe that the objective of the standard is clear and that no further clarification is needed.

5. Does the new proposed standard provide for an appropriate amount of auditor judgment in determining whether to perform confirmation procedures in situations other than those specifically addressed in the new proposed standard?

We agree that the proposed standard allows for auditor judgment (outside of those areas specifically addressed by the proposed standard) when determining whether to use confirmations to obtain audit evidence using a risk-based approach. However, we believe additional guidance would be beneficial regarding when procedures alternative to the confirmation process may provide sufficient appropriate audit evidence. We believe that there should be sufficient judgment for the auditor to determine which procedures they will use to collect the evidence they need.

6. Are there accounts other than those addressed in the new proposed standard or financial statement assertions for which the auditor should be required to perform confirmation procedures? Why or why not?

We do not believe there are any other specific accounts or financial statement assertions for which confirmation procedures should be required. However, we believe that further clarification is needed about those areas where more persuasive evidence through the use of confirmations is required to be obtained or considered (and thus such consideration documented). Paragraph .07 of the proposed standard briefly explains that for certain areas, such as where there are fraud risks and significant unusual transactions, confirmations are generally more persuasive than audit evidence obtained through other procedures. There is not an explicit requirement and, therefore, it is difficult to understand the intent of the paragraph and assess whether the confirmation process is required for all fraud risks and significant unusual transactions, the confirmation process is required to be considered for all fraud risks and significant unusual transactions, or this is simply guidance to be considered as part of the auditor's overall determination of procedures to be performed. Paragraph .15 of the proposed standard does require the auditor to 'consider confirming' certain aspects of significant unusual transactions that are determined to be significant risks, but it is not clear how that is linked to paragraph .07, and therefore there may be confusion as to when confirmation is required. As noted previously in our letter, we suggest that the proposed standard be more broadly revised to better incorporate a risk-based approach to determining the most appropriate audit procedures to address the risks that have been identified, for example in a similar way to how an auditor considers the risks of fraud, and responses thereto, as set out in AS 2401, *Consideration of Fraud in a Financial Statement Audit* and AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*.

Paragraph .15 also addresses 'complex transactions that are significant risks,' but fraud risks are not addressed. We believe that the standard should be clear when confirmation is required, or when it is left

Office of the Secretary
 Public Company Accounting Oversight Board
 February 20, 2023
 Page 4

to the auditor's judgment based on the persuasiveness of evidence needed. The PCAOB's explanations about the requirements of the standard provide more clarity for which areas confirmations are required or are required to be considered, and we encourage that this clarity is reflected in the final standard. We also believe that 'general principles' for determining when confirmations are required should have more prominence than the requirements addressing specific areas, and therefore we have the view that paragraph .15 should be elevated above the more specific requirements.

7. As discussed above, the new proposed standard would not include a requirement to send confirmation requests in response to significant risks related to assertions that could be adequately addressed through confirmation. Is the proposed approach appropriate? Why or why not?

We support that the decision to not include a requirement to send confirmation requests for significant risks and rather allow the auditor to use judgment as to the most appropriate way to obtain sufficient appropriate audit evidence about the balance or disclosure. We believe that the decisions about how the auditor chooses to obtain evidence should be left to the auditor's judgment based on the identified and assessed risks of material misstatement.

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?

Taking into account our comments about the proposed standard more broadly addressing a risk-based approach to confirmations rather than addressing specific balances to be confirmed, we believe that the proposed standard is sufficiently flexible and scalable to allow for these areas that are evolving and other new emerging areas to be appropriately addressed by the auditor based on the identified and assessed risks of material misstatement.

9. Are there ways in which the new proposed standard should be changed to further align with the PCAOB's risk assessment standards? If so, how should the new proposed standard be changed?

Other than our response to question 5 above regarding the prescriptive nature of some requirements, we do not believe that there are further changes needed.

10. Are the requirements in the new proposed standard regarding confirming cash held by third parties, as well as other financial relationships, sufficiently clear and appropriate? If not, what changes should be considered?

The requirements in the proposed standard related to confirming other financial relationships are clear and appropriate (also, please see our response to question 12 below). However, we have concerns about the requirements regarding cash held by third parties.

As previously noted in this letter, we strongly encourage a broader risk-based approach to determining when confirmations are needed. In particular, we do not believe the proposed requirements relating to confirming cash and cash equivalents are appropriate. We believe that in certain circumstances it is not necessary to confirm cash and cash equivalents with a third party (e.g., there may be cash balances that are clearly trivial), which was also recognized by the PCAOB in the explanatory material. We therefore encourage the PCAOB to revise the requirements to achieve a more risk-based approach to determining when confirmation for cash and cash equivalents is required. This could be achieved through allowing a rebuttal if there is an alternative procedure that will provide the persuasive evidence that is needed, or

Office of the Secretary
 Public Company Accounting Oversight Board
 February 20, 2023
 Page 5

there is no or low risk of material misstatement. Such an approach would be consistent with the requirement for confirming accounts receivable, which can be rebutted, and therefore allows the auditor to exercise judgment about how to respond to the auditor's risk assessment and the entity's unique circumstances (as set out in paragraphs .12 and .14 of the proposed standard).

It is also not clear from the proposed standard which cash and cash equivalents held by third parties are required to be confirmed. Paragraph .10 of the proposed standard explains, "When confirming individual items of cash and cash equivalents, the auditor should take into account the auditor's understanding of the company's cash management system and treasury function, and the substance of the company's arrangements and transactions with third parties." It is not clear what the intent of that paragraph is. The explanatory part of the exposure draft explains that the PCAOB, "...notes that an auditor need not necessarily confirm all cash accounts in all cases, that there may be other means of testing (selecting all items, selecting specific items and audit sampling)." It goes on to explain that the auditor would, "... select individual cash items to confirm following relevant PCAOB standards, including identifying and assessing the risks of material misstatement." This suggests that the selection of individual cash items to be confirmed would depend on the evidence necessary to address the assessed risks of material misstatement. This in turn may suggest that if there is no or a low risk of material misstatement (i.e., there is not a significant amount of persuasive evidence needed), there may be limited or no confirmation with a third party of cash and cash equivalents balances. We therefore encourage that if the intent is that not all cash and cash equivalents are required to be confirmed, explicit clarification be added to the standard to align the determination about the cash and cash equivalents that need to be confirmed with the response to the auditor's risk assessment.

11. Are there substantive audit procedures other than confirmation that would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through confirming cash? If so, please describe these procedures.

As noted previously, the way that confirmations are being sent and received, and the technologies involved, continue to evolve. The standard should allow for other types of persuasive evidence to be obtained, where appropriate. For example, an auditor may obtain a read-only access log-in from a third party that permits direct access to verify and validate information for an entity being audited. This validation procedure would provide substantially the same evidence as a confirmation from the third party of the same information. We believe that the standard should allow for other types of persuasive evidence such as this to be obtained where appropriate.

12. For other financial relationships with the confirming party, is the requirement in the new proposed standard that the auditor should consider confirmation sufficiently clear and appropriate?

Yes, the requirement in the new proposed standard relating to other financial relationships with the third party that the auditor should consider confirming is appropriate.

13. Are the requirements in the new proposed standard sufficiently risk-based to enable the auditor to use professional judgment in selecting which cash accounts and other relationships would be subject to confirmation?

No, please see our response to question 10 above.

14. Is the continued requirement to confirm accounts receivable sufficiently clear and appropriate? Are there other approaches that we should consider instead?

Office of the Secretary
 Public Company Accounting Oversight Board
 February 20, 2023
 Page 6

Yes, the requirement to confirm accounts receivable is sufficiently clear and appropriate. Also, please see our response to question 17 below.

15. Are the provisions of the new proposed standard sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable?

Yes, the provisions of the new proposed standard are sufficiently principles-based to allow auditors to use professional judgment to determine the extent of confirmation of accounts receivable (i.e., through the ability to rebut the requirement for a confirmation and use other procedures).

16. Is the description of accounts receivable sufficiently clear? Is there any reason to broaden the description to include other types of receivables, and if so, which ones?

Yes, the description of accounts receivable is sufficiently clear, and we do not believe the description should be broadened.

17. Is the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive as performing confirmation procedures sufficiently clear and appropriate?

Yes, we strongly support maintaining the ability to overcome the presumption to confirm accounts receivable when another substantive audit procedure would provide evidence that is at least as persuasive, as set out in the proposed standard. The ability to overcome the presumption to confirm allows for a risk-based approach.

However, we believe the PCAOB should clarify in the standard when it would be appropriate to perform alternative procedures in place of confirmations, possibly through the use of examples to explain circumstances when alternative procedures would be appropriate.

The PCAOB's explanatory material in the proposed standard provides guidance relating to the expected extent of testing for confirmation or other substantive procedures related to accounts receivable, such as:

"...the necessary nature, timing, and extent of audit procedures performed in lieu of confirmation would depend on the facts and circumstances of the company and the audit. Under PCAOB standards, as the risk of material misstatement increases, the amount of evidence that the auditor should obtain also increases. In the above example, as the risk increases, the auditor could increase the number of individual transactions for which the auditor examines third-party evidence. Further, the auditor may determine that to obtain audit evidence that is at least as persuasive as evidence from confirmation, the auditor may need to apply the other procedures to a greater number of items than the auditor would otherwise address through confirmation. The auditor's determinations (including the basis for the determinations) would be required to be documented in the working papers..."

As written, this states that even when an auditor determined that other substantive procedures provided evidence at least as persuasive as evidence from confirmation, nonetheless the extent of procedures would need to be increased. It is not clear why the extent of tests of details would need to be expanded based upon different procedures being applied that provide equally persuasive evidence. From a practical perspective, this would then require the auditor to design a test based on a confirmation procedure that was not determined to be appropriate for the engagement simply to have a baseline upon which to select a greater number of items for testing or for firms' audit methodologies to have separate sampling factors for accounts where confirmation could have been selected, but was not. This seems overly burdensome and not aligned with the application of auditor judgment in response to risks of material misstatement.

Office of the Secretary
Public Company Accounting Oversight Board
February 20, 2023
Page 7

18. Are there certain factors that should be present when determining that other substantive audit procedures would provide audit evidence that is at least as persuasive as the evidence that the auditor might expect to obtain through performing confirmation procedures for accounts receivable? If so, what are those factors?

We believe that the auditing standards should focus on the assessed risks of material misstatement and the nature of the evidence to be obtained. The auditor should be allowed to use their judgment to apply the concepts of other existing standards to design the appropriate audit procedures in response to the assessed risks of material misstatement. For example, AS 1105 describes many considerations when determining how to obtain sufficient appropriate audit evidence. Further, AS 2301 provides the concept that the quantity and persuasiveness of audit evidence needed depends on the auditor's assessment of risk.

Factors to consider when evaluating the persuasiveness of evidence for accounts receivable may include the nature of the entity's customer base and the auditor's experience in performing confirmation procedures in past audits. For example, there may be instances where an entity's customers have historically not provided persuasive evidence as a result of low confirmation response rates.

19. Is the requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor's determination sufficiently clear and appropriate? Why or why not?

We do not believe this requirement is appropriate. We believe that communications to the audit committee should be based on the auditor's assessment of risks of material misstatement and the existing requirements in AS 1301 when making such communications. Current standards already require auditors to communicate other matters to the audit committee when those matters arise from the audit that are significant to the oversight of the company's financial reporting and include concerns regarding accounting or audit matters. Including the requirement for the auditor to communicate all instances in which the auditor has determined to not confirm accounts receivable is not aligned with the framework set out in AS 1301 and runs the risk of providing information that is not decision-useful and obviates the ability of auditor and audit committee communications to be focused on the risks identified in the audit.

20. Are the provisions of the new proposed standard related to confirming the terms of certain transactions that have a significant risk of material misstatement sufficiently clear and appropriate?

We agree that the auditor "should consider" (i.e., exercise their professional judgment) whether to confirm terms for transactions that are considered significant risks, and the decision to do so should be based upon the assessed risks of material misstatement and the persuasiveness of other evidence to support the balance or disclosures. However, it is not clear what the term "complex transaction" means because it is not defined in the PCAOB's literature. We therefore believe the references to "complex transaction" should be removed or that it should be clarified whether a "complex transaction" is a transaction that is determined to be a significant risk.

21. Is the new proposed standard sufficiently clear that an auditor's use of confirmation is not limited to the circumstances discussed in paragraphs .09 through .15 of the new proposed standard? If not, how should it be clarified?

Although we have specific concerns about the requirement for confirmations as set out in paragraphs .09-.15 as detailed above, it is clear that there may be other circumstances where confirmations are the appropriate audit procedure to obtain audit evidence.

Office of the Secretary
Public Company Accounting Oversight Board
February 20, 2023
Page 8

22. Are the provisions of the new proposed standard related to identifying information to confirm sufficiently clear and appropriate?

While we believe that the provisions of the new proposed standard related to identifying information to confirm are clear and appropriate, we believe that there should be consistency in how the accuracy and completeness of the information can be tested (in paragraph .17 of the proposed standard) with paragraph .10 of AS 1105, *Audit Evidence*, which also allows the testing of controls over the accuracy and completeness of the information.

23. Are the provisions of the new proposed standard related to identifying confirming parties sufficiently clear and appropriate?

Yes, the provisions of the new proposed standard related to identifying confirming parties are clear and appropriate.

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?

We believe that this requirement is clear and appropriate, and do not believe that any further procedures are required, other than our response to question 3 above.

25. Are the provisions of the new proposed standard related to the auditor's use of negative confirmation requests sufficiently clear and appropriate?

We believe the provisions of the new proposed standard related to the auditor's use of negative confirmation requests are sufficiently clear and appropriate. However, we would like to encourage the PCAOB to further consider adding more guidance about the types of substantive analytical procedures that may be appropriate when negative confirmations are used, and the impact of those particular substantive procedures on the extent of confirmations required.

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 account when using an intermediary in the confirmation process?

We have a number of concerns related to paragraphs .22 to .24 of the proposed standard:

- The existing version of the standard defines "maintain control." In the proposed standard, the requirement to "maintain control" and the sending of the confirmation request directly are in separate paragraphs, which may suggest there are different responsibilities for the auditor. We suggest combining paragraphs .22 and .23, with the requirement to "maintain control" coming after the requirement to send the confirmation request directly so that it is clear that the auditor's responsibility is to send the confirmation directly while maintaining control of this process.
- It is not clear from the standard what an "intermediary" is – further clarity to ringfence the types of intermediaries, available now or in the future, that should be considered for the purpose of this requirement will help auditors understand for whom the controls need to be further considered as current technology advances.

Office of the Secretary
 Public Company Accounting Oversight Board
 February 20, 2023
 Page 9

- It is not clear from the standard what should be done in instances when the intermediary's controls cannot be relied on (e.g., the intermediary's report on internal controls is qualified or the report is issued at a different time of year from the annual audit and, for example, a "gap letter" is not available). We encourage that the standard, when finalized, explains the process to be followed when the intermediary's controls cannot be relied on.

27. Is the potential interaction between using an intermediary in the new proposed standard and the proposed requirements in QC 1000 related to third-party providers sufficiently clear?

We do not believe that the interaction between an 'intermediary' in the proposed standard and 'third-party provider' in QC 1000 is clear. While an intermediary is a type of third-party provider, the description of each is different, which may be confusing and suggest that they are something separate. We do not believe this is the intent. We therefore encourage the PCAOB to use consistent language to describe an intermediary in this proposed standard and a third-party in QC 1000 so that it is clear how these interact.

28. Are the provisions of the new proposed standard related to evaluating the reliability of confirmation responses sufficiently clear and appropriate?

We believe the provisions of the new proposed standard related to evaluating the reliability of confirmation responses is sufficiently clear and appropriate. The indicators that a confirmation response may have been intercepted or altered provided in paragraph .25 are helpful, with the example provide in paragraph .25a. being experienced commonly in practice.

29. Are the provisions of the new proposed standard related to confirmation exceptions and nonresponses sufficiently clear and appropriate?

We believe the provisions of the new proposed standard related to confirmation exceptions and nonresponses is sufficiently clear and appropriate.

30. Are the provisions about when the auditor should send a second positive confirmation request sufficiently clear and appropriate? Would this provision be a change from current practice?

We believe sending second positive confirmations may be appropriate, but not necessarily in all circumstances, and therefore the standard should allow for more judgment when determining whether to send a second confirmation or not. In addition, we believe that it should be clarified when confirmations should be sent, either the initial or the second request, when the auditor is aware of "information that indicates that the confirming party would be unlikely to respond to the auditor" (paragraph .28 of the proposed standard) or whether the auditor should then proceed to use alternative procedures.

31. Are the proposed circumstances in the new proposed standard under which the auditor generally would be required to perform alternative procedures sufficiently clear and appropriate?

While we believe that the requirements in new proposed standard for which the auditor generally would be required to perform alternative procedures is appropriate, we do not believe the intent of the "note" in paragraph .31 is clear. The interaction between this note and AS 2810.17 (describing the auditor's responsibilities to evaluate the effect of uncorrected misstatements) is confusing and should be clarified.

33. Are the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses sufficiently clear and appropriate? If not, what changes should be considered?

Office of the Secretary
 Public Company Accounting Oversight Board
 February 20, 2023
 Page 10

While we believe that the requirements in the new proposed standard to exclude the internal auditor from selecting items to be confirmed are appropriate, there are other aspects of direct assistance where we do not agree with the proposals because prohibiting such activities would conflict with the ability to use internal auditors to provide direct assistance to the auditor as set out in paragraph .27 of AS 2605, *Consideration of the Internal Audit Function*. We encourage that the requirements within the proposed standard be modified to be consistent with what is currently allowable under AS 2605.

34. Based upon information available, we understand auditors' use of internal audit in a direct assistance capacity to send confirmation requests or receive confirmation responses to be infrequent. Are commenters aware of information to the contrary?

For audit engagements conducted by our firm, we are not aware of internal audit being used in a direct capacity to send and receive responses on a frequent basis.

35. In the event of a management request not to confirm a certain item, are there procedures that the auditor should perform which are not currently required by other PCAOB standards? If so, what other procedures should be required?

We do not believe that there are other procedures that should be included in the proposed standard that are not currently required by other PCAOB standards.

36. Based upon information available, we understand management requests not to confirm certain items or accounts to be infrequent. Are commenters aware of information to the contrary? If so, in what circumstances do management requests not to confirm commonly arise in practice?

Based on our experience, this is primarily relevant in the financial institution industry where management may request the auditor not to confirm certain accounts if they are in the process of collection (e.g., bankruptcy, restructure) or if the customer has elected not to receive mail. For other industries, we have experienced infrequent instances of management requesting us not to confirm certain items or accounts.

37. Are the definitions included in the new proposed standard sufficiently clear and appropriate? If not, what changes should be made to the definitions?

We have detailed in our comments to question 26 that further clarification (including possible definitions) be made regarding the term's "intermediaries" and "maintaining control."

In addition, we believe in the definition of "nonresponse" it should be made clear that this means the confirmation is received 'directly' by the auditor (i.e., add 'directly' to (ii) within that definition).

.A8 Nonresponse – A situation in which (i) after sending a confirmation request(s), the request is returned undelivered; (ii) the auditor does not receive a confirmation response to a positive confirmation request **directly** from the intended confirming party; (iii) the auditor receives correspondence from the intended confirming party indicating that the confirming party is unable or unwilling to respond to the confirmation request; or (iv) the auditor receives an oral response only.

38. Are there other amendments that should be made to the PCAOB's existing standards to conform them with the new proposed standard?

We do not believe any other changes are needed.

Office of the Secretary
Public Company Accounting Oversight Board
February 20, 2023
Page 11

48. How much time following SEC approval would audit firms need to implement the proposed requirements?

We believe that an effective date that is two years after SEC approval would allow firms sufficient time for the implementation of the changes needed.

49. Would requiring compliance for fiscal years beginning after the year of SEC approval present challenges for auditors? If so, what are those challenges, and how should they be addressed?

This would be dependent on when the SEC approves the final standard. We encourage that sufficient time be allowed for effective implementation, which would involve changes to methodologies, manuals and procedures, training and appropriate planning for audits following the effective date.

We would be pleased to respond to any questions the PCAOB or its staff may have about our comments. Please direct any questions to Adam Hallemeier, Deputy Chief Auditor, at 619.641.7318, or Sara Lord, Chief Auditor, at 612.376.9572.

Sincerely,

RSM US LLP

RSM US LLP

From: Paul F Schneider <parkfor@bluefrog.com>
Sent: Monday, February 13, 2023 11:16 AM
To: Comments
Subject: [EXT]: PCAOB Rulemaking Docket Matter No. 028

I noticed the recent request for comment on the new proposed PCAOB standard : “The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards.”

Given that this significantly changes the position “Consideration of the Internal Audit Function.” stated in Accounting Standard 2605 (AS 2605). I have some concerns.

Note that I have been both an External and Internal Auditor and am well aware of independence requirements, responsibilities and standards.

My concerns are:

- What evidence is there that the External / Internal Audit relationship being revised is failing and does not demonstrate independence?
- Absent proof, what impetus caused this decision?

Action without ***demonstrated or documented*** reasons is foolhardy and could have very negative impacts in the future on the professions and the stakeholders it serves.

Respectfully,

Paul F. Schneider, MA, MBA, CIA, CISA, CISM, CGEIT, CRISC, CDPSE, CRMA, CCP, COAP
parkfor@bluefrog.com

February 17, 2023

PCAOB
Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

Email: comments@pcaobus.org

RE: Request for Comments on PCAOB's Release No. 2022-009 – The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards

PCAOB Board:

The views expressed herein are written on behalf of the Professional Standards Committee (PSC) of the Texas Society of CPAs. The committee has been authorized by the Texas Society of CPAs' Board of Directors to submit comments on matters of interest to the membership. The views expressed in this document have not been approved by the Texas Society of CPAs' Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the Texas Society of CPAs. Please find our responses below to the requests for comment in the above-referenced Release No. 2022-009.

Overall, the PSC is supportive of the Board's efforts to replace the existing AS 2310 with an updated standard that is more aligned with the current risk assessment requirements. Additionally, the PSC thinks the proposed standard is clear and provides sufficient guidance for the proposed changes. The PSC also thinks that the proposed standard provides the flexibility to respond to the current use of technology in the audit process.

The PSC supports the new requirement regarding the use of confirmations when auditing cash. While confirmation of cash held by third parties has long been an audit best practice, formalizing the requirement will lead to consistent confirmation practices and improve audit quality. However, additional guidance on alternative procedures to confirming cash that are not deemed to be high risk would be practical.

The PSC agrees with the PCAOB's approach to the use of negative confirmations in the proposed standard. The PSC does not think the use of negative confirmations adds value to the audit process, except when combined with other substantive procedures to obtain sufficient and appropriate evidence.

The PSC agrees with the limitations proposed in the use of internal auditors in the confirmation process. While there are appropriate uses of the internal audit staff during the performance of the audit, it is necessary for control of the confirmation process to be maintained by the external auditors.

Lastly, the PSC has a concern about the proposed requirement to communicate to the audit committee when the auditor determines that the presumption to confirm accounts receivable has been overcome. The PSC thinks that AS 1301 contains sufficient communication requirements for audit matters. The auditor makes numerous account specific strategy decisions when planning the audit not required to be separately reported to the audit committee. If the Board's intent is a principles-based approach without guidelines on when the confirmation presumption may be overcome, this is an unnecessary addition to the list of required communications.

We appreciate the opportunity to provide feedback on the application of PCAOB's Confirmation Standards, and other proposed amendments.

Sincerely,

A handwritten signature in cursive script, appearing to read "J. Ramsey Womack III".

J. Ramsey Womack III, CPA
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants



February 3, 2023

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

RE: IIA Comments Regarding PCAOB Rulemaking Docket Matter No. 028

Dear Chair Williams and PCAOB Members DesParte, Ho, Stein, and Thompson:

On behalf of The Institute of Internal Auditors (The IIA), the international professional association representing approximately 230,000 internal auditors, I appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard, "[The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards.](#)"

Although the recommended policy change minimally impacts the provision of internal audit services, it represents a significant departure from the regulatory status quo regarding the relationship between internal and external auditors.

The IIA is concerned about and objects to this proposed change in PCAOB standards which is presented without any explanation or evidence for the need for such a change. In addition, we are deeply concerned by the PCAOB's characterization of internal auditors – both in the release and in comments made by PCAOB staff to the press – which imply that internal auditors are untrustworthy or incapable of exhibiting due care in the performance of their duties.

More specifically, Section III(I) of the PCAOB proposal states:

*Involving internal auditors or other company employees in these activities [confirmation process] would create a risk that information exchanged between the auditor and the confirming party is **intercepted and altered**, (emphasis added).¹*

Upon publication of the proposed auditing standard, PCAOB officials indicated in a *Wall Street Journal* article, "The goal is to make sure that internal auditors don't manipulate the confirmation requests before they go out or the responses after they come back."²

These false and inflammatory assertions mischaracterize the internal audit profession and are completely unwarranted. The proposal fails to cite any examples, recent or historic, where internal auditors have failed external auditors in the confirmation process. My conversations with IIA members and other external stakeholders in the audit community have similarly yielded no evidence of internal audit failures that may have prompted the PCAOB's drastic proposed change. If there have been problems, we would like to work with you to find ways to resolve them in the most effective way.

¹ "The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards," The Public Company Accounting Oversight Board, December 20, 2022: https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket_028/2022-009-confirmation.pdf?sfvrsn=d3d14ede_2

² "PCAOB Proposes Tighter Requirements for Audit Firms Verifying Outside Information About Clients," *The Wall Street Journal*, December 20, 2022: <https://www.wsj.com/articles/pcaob-proposes-tighter-requirements-for-audit-firms-verifying-outside-information-about-clients-11671561236>

Internal auditors pride themselves on their commitment to providing objective assurance, **independent from management**, in accordance with the globally recognized International Standards for the Professional Practice of Internal Auditing (*Standards*) and the requirements of The IIA's Code of Ethics.

Adherence to the mandatory principles-based IIA *Standards* promotes a sound ethical culture and establishes the basis for relying upon the work and judgment of internal audit professionals. The *Standards*, coupled with the Code of Ethics, creates a process for evaluating the performance and efficacy of internal audit services.

It is also important to note that internal auditors and external auditors possess the **same independent reporting relationship** to an organization's audit committee. Both internal auditors and external auditors also have an **obligation to exercise due care** in the handling of all information.

Prior to this new proposal, as you are aware, the PCAOB's standard for evaluating internal auditors has been Accounting Standard 2605 (AS 2605) entitled, "[Consideration of the Internal Audit Function](https://pcaobus.org/oversight/standards/auditing-standards/details/as-2605-consideration-of-the-internal-audit-function-1528)." In that standard, the PCAOB specifically acknowledges that "**internal auditors maintain objectivity** with respect to the activity being audited," (emphasis added).³

AS 2605 also unequivocally grants external auditors the authority to utilize an internal audit function, as needed, to provide direct assistance during an audit. This longstanding partnership is governed by the requirements set forth in AS 2605.27 which states:

*When direct assistance is provided, the auditor should assess the **internal auditors' competence and objectivity** (see paragraphs .09 through .11) and supervise, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances, (emphasis added).*⁴

The PCAOB's new proposal, in a radical departure from AS 2605, seemingly implies no assessment of competence and objectivity can possibly permit internal auditors to assist external auditors in certain facets of the confirmation process. According to this new standard, internal auditors are, *prima facie*, not to be considered trustworthy.

The incongruity between the PCAOB's positions in AS 2605 and the present proposal (which the PCAOB acknowledges is a substantive deviation but does not provide a policy rationale for the change) creates regulatory mixed messages:

- The PCAOB affirms in AS 2605 that "internal auditors maintain objectivity" and may provide "direct assistance;" however, the current proposal prohibits the direct assistance of internal auditors in the confirmation process and suggests internal auditors are not objective.
- AS 2605 requires external auditors to assess the "internal auditors' competence and objectivity" prior to accepting direct assistance; however, the current proposal unilaterally dismisses the objectivity of internal audit without an evaluation required under AS 2605.27.

These assertions jeopardize longstanding collaborations between external audit firms and internal auditors. While the scope of responsibilities for each profession is different, internal and external auditors must work in harmony to ensure that governance, risk and control processes are in place and

³ "AS 2605: Consideration of the Internal Audit Function," The Public Company Accounting Oversight Board: <https://pcaobus.org/oversight/standards/auditing-standards/details/as-2605-consideration-of-the-internal-audit-function-1528>

⁴ "AS 2605: Consideration of the Internal Audit Function," The Public Company Accounting Oversight Board: <https://pcaobus.org/oversight/standards/auditing-standards/details/as-2605-consideration-of-the-internal-audit-function-1528>

adequately working. Disparagement of either audit function – particularly from a government regulatory agency – undermines this partnership and risks engendering public mistrust in the auditing profession.

The prohibition on support by the internal audit function also stands in sharp contrast to the permissibility of other intermediaries in the confirmation process. The new proposal provides specific guidance on how external auditors can successfully work with intermediaries.

Indeed, paragraph .24 of “Maintaining Control over the Confirmation Process” states:

The auditor or the confirming party can engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. When using an intermediary for this purpose, the auditor should evaluate the implications on the reliability of confirmation requests and responses as discussed in Appendix B.

The section also affirms in paragraph .22:

The auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted or altered.

The new proposal seems to imply that external auditors are capable of assessing the reliability and associated risks of using other intermediaries, but they lack the ability to make an informed choice about engaging independent internal auditors for assistance. According to the PCAOB’s language, internal auditors are presumptively never to be trusted. Such a position is offensive to the long-standing history of collaboration and cooperation between external auditors and internal audit functions and unnecessarily casts suspicion on the integrity of all internal auditors.

While internal auditors are not often involved in the confirmation process, they should be treated without prejudice and external auditors should be trusted to evaluate the objectivity, competence, and independence of the internal audit function from management.

Therefore, I respectfully ask that you maintain AS 2605 as the standard for evaluating internal auditors’ involvement in the confirmation process.

The IIA recommends that the proposed language contained in the section “Using Internal Audit in the Confirmation Process,” be modified and replaced with the following:

Using Internal Audit in the Confirmation Process

.32 The auditor may ~~use~~ engage internal auditors to provide direct assistance to the auditor in the confirmation process in accordance with AS 2605, *Consideration of the Internal Audit Function*, ~~except that an internal auditor should not (i) select the items to be confirmed, (ii) send confirmation requests, or (iii) receive confirmation responses. In reviewing AS 2605, the auditor should focus particularly on evaluating the internal auditors’ competence, objectivity, and independence from management (reporting directly to the audit committee or board of directors).~~

Any assistance by internal auditors, including acting as an intermediary, does not reduce or absolve the auditor of any accountability or due diligence requirements in ensuring the integrity, thoroughness, accuracy, and custody safeguards of the confirmation process.

This language does not implicitly impugn the integrity of internal auditors and maintains the current standard allowing external auditors to evaluate the appropriateness of engaging an internal audit function in the confirmation process. Moreover, the suggested language underscores that engaging internal auditors does not change the requirements of due care that are the ultimate responsibility of external auditors.

In further updating this proposal with our new language, I would note that the new addition to .27 "Using Internal Auditors to Provide Direct Assistance to the Auditor" (as discussed on Page A2-4) is also no longer necessary.

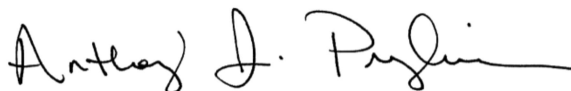
Using Internal Auditors to Provide Direct Assistance to the Auditor

.27 In performing the audit, the auditor may, ~~unless prohibited by PCAOB standards,~~ request direct assistance from the internal auditors. This direct assistance relates to work the auditor specifically requests the internal auditors to perform to complete some aspect of the auditor's work. For example, internal auditors may assist the auditor in obtaining an understanding of internal control or in performing tests of controls or substantive tests, consistent with the guidance about the auditor's responsibility in paragraphs .18 through .22. When direct assistance is provided, the auditor should assess the internal auditors' competence and objectivity (see paragraphs .09 through .11) and supervise, review, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances. The auditor should inform the internal auditors of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible accounting and auditing issues. The auditor should also inform the internal auditors that all significant accounting and auditing issues identified during the audit should be brought to the auditor's attention.

I thank you for your consideration of The IIA's views. It is important to The IIA and the entire internal audit profession that we have a constructive, collaborative, and open dialogue with the PCAOB and all external auditors to ensure that we are partnering and aligning whenever possible. This important relationship benefits investors, corporations, auditors, and the public interest. I look forward to continuing to work with you on this proposal and other issues before the PCAOB.

Should you or your staff have any questions regarding our recommendations or if you would like to discuss this matter in greater detail, please have your staff contact Mat Young, IIA Vice President for Global Advocacy, Policy, and Government Affairs at Mat.Young@TheIIA.org.

Respectfully,



Anthony J. Pugliese, CIA, CPA, CGMA, CITP
President and Chief Executive Officer
The Institute of Internal Auditors

February 17, 2023

Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 028

Dear Commissioners Williams, DesParte, Ho, Stein, and Thompson:

On behalf of The Wendy's Company, we appreciate the opportunity to comment upon the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard entitled: "The Auditor's Use of Confirmations and Other Proposed Amendments to PCAOB Standards."

Although the proposed standard rightly modernizes certain aspects of the confirmation process, we are troubled by the PCAOB's assertions concerning the internal audit profession. For example, Section III(I) of the PCAOB proposal speciously argues:

Involving internal auditors or other company employees in these activities would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered.¹

The PCAOB's allegation that internal auditors would purposely manipulate confirmation data raises an important audit question: where is the evidence that internal auditors have altered documentation while working as part of the external audit team?

In our opinion, the PCAOB's comments will unnecessarily compromise confidence in the internal audit profession. The potential consequences of this proposal extend beyond the confirmation process and establish a dangerous precedent regarding the proper evaluation of risk and internal controls.

As the Chief Financial Officer of The Wendy's Company with over 30 years in the financial industry, I can personally attest to the integrity and professionalism of internal auditors. These dedicated individuals provide objective assurance, independent from management, on a range of issues that promote organizational transparency and accountability. Internal audit represents, at its core, a critical safeguard to governing bodies, management, consumers, and investors. It is essential that Federal regulators, such as the PCAOB, acknowledge the importance of internal audit and utilize the profession as a resource in strengthening audit practices.

Additionally, I recognize the value of having our internal auditors assist the external audit teams to learn different audit practices, see different perspectives, and even learn from different managers. These experiences only improves their competencies to bring back to the business for

¹ "The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards," The Public Company Accounting Oversight Board, December 20, 2022: https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket_028/2022-009-confirmation.pdf?sfvrsn=d3d14ede_2

future audit work. By minimizing the work internal auditors can assist with, some of those learning opportunities will be lost.

As the Chief Audit Executive for Wendy's with over 15 years of Internal Audit work, I disagree with the assertion that we would alter or intercept audit evidence as you stated in your proposal. I hold my team to our professional standards issued by the Institute of Internal Auditors and annually require all of us to read and sign our code of conduct statements, including needing to maintain independence. We perform rigorous self-assessments to our Standards annually and every 5 years are reviewed by external partners. Additionally, I report directly to the Audit Committee to maintain independence, and they expect my team to be the eyes and ears of the Board. By implying we work for management and would cover up wrongdoing, we would lose that trust of the Board and damage our reputation.

Therefore, we respectfully urge the PCAOB consider the following modifications to the proposed auditing standard:

- Maintain the existing regulatory scheme concerning the role of internal auditors in the confirmation process
- Remove claims – both in the proposal and other external communications – that imply internal auditors may “intercept” or “alter” confirmation data

Should you have any questions regarding this letter, please do not hesitate to contact us at melissa.clawson@wendys.com or Gunther.plosch@wendys.com.

Thank you for the opportunity to share perspective on this important matter.

Respectfully,

Gunther Plosch
Chief Financial Officer
The Wendy's Company

Melissa Clawson
Chief Audit Executive
The Wendy's Company



February 16, 2023

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006-2803
By email: comments@pcaobus.org

Dear Madam Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or "the Board") Docket 028: *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (The Proposal). We value and support the PCAOB's critical role and mission to protect investors and further the public interest.

US capital markets operate at a higher level of efficiency because of dedicated work by the PCAOB and the many public accounting firms auditing PCAOB issuer financial statements, and we commend and seek to support those efforts.

We strongly concur with the Board's intended benefits of the Proposal, including improving the quality of audit evidence and increasing the auditor's likelihood of identifying potential financial statement fraud.

As the Board and regulators globally are well-aware, material financial statement fraud occurs rarely and can be difficult to detect on a timely basis, but its impact can be immense and far reaching in terms of investor losses and erosion of public confidence.

We believe that high quality technology-enabled confirmation tools provide the profession with a confirmation process that is uniquely efficient and secure, making it reasonable for the Board to require independent third-party confirmation more extensively in all audit engagements, expanding fraud detection opportunities and furthering the public interest without imposing undue burden on audit firms or audited companies.

About Thomson Reuters

Thomson Reuters is one of the world's most trusted providers of answers, helping professionals make confident decisions. Our customers operate in complex arenas that move society forward, including law, auditing, accounting, tax, government, and media. Thomson Reuters Confirmation® is the digital solution and global network trusted by audit firms, banks, law firms, and other businesses to quickly and securely verify financial data.

Confirmation® invented electronic confirmations over 20 years ago, and our focus from the beginning has been on reducing the risk of fraud in the confirmation process. We have built an extensive network of over 4,000 validated financial institutions, helping ensure that audit



confirmations get to the appropriate individuals within responding organizations, all within a highly secure environment designed specifically to prevent unscrupulous players from undermining the integrity of the audit confirmation process. We work closely with audit firms and confirming parties to continually maintain and evolve a high-quality confirmation process that is efficient, secure, and designed specifically to minimize fraud opportunities.

Confirming Cash and Cash Equivalents Held by Third Parties – Question 10, pg. 22 of the Proposal

We believe that the guideline provided in paragraph .10 of the proposed new standard (stating that the selection of individual items of cash to confirm should be based on ‘the auditor’s understanding of the company’s cash management and treasury function’) is overly vague and may lead to unintended variability in practice.

Given that existing PCAOB standards (both at paragraph .06 of the proposed new standard and, as noted there, in AS 1105.08) acknowledge that “audit evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources” we believe that the profession should display a strong bias toward obtaining audit evidence from sources independent of the company whenever feasible and cost-effective.

Through the use of high quality technology-enabled confirmation tools, the confirmation process can be both highly efficient and secure. In addition, data indicates that while overall usage of electronic cash confirmations is increasing, a noticeable percentage of firms are confirming fewer cash accounts on each audit engagement.

For these reasons as well as the importance and unique power of independent confirmation as a tool for highest-quality audit evidence, early fraud detection, and investor protection, we suggest that paragraphs .09 and .10 of the proposed standard be revised to require confirmation with all financial institutions with which the company had significant activity during the period under audit, or for which there is reason to believe material assets or liabilities are held by the company.

As an example, one of several potential ways of wording this is to revise paragraph .10 to read “In selecting the individual items of cash to confirm, the auditor should include all financial institutions with which the company had significant activity during the period under audit, or for which there is reason to believe material assets or liabilities are held, based on the auditor’s understanding of the company’s cash management and treasury function, and the substance of the company’s arrangements and transactions with third parties.”

**Confirming Other Financial Relationships– Question 12, pg. 23 of the Proposal**

For reasons similar to those noted above for confirming cash, we believe that the guideline provided in paragraph .11 of the proposed new standard (stating that the auditor “should consider” sending confirmation requests about other financial relationships) is overly vague and may lead to significant variability in practice.

High quality technology-enabled confirmation tools include capabilities and controls making it feasible and practical to direct confirmation requests to knowledgeable individuals and specific parties within confirming organizations.

Undisclosed financial relationships, including off-balance sheet relationships, can take many forms. This could include undisclosed lines of credit, indebtedness, compensating balance requirements, liens, encumbrances, contingent liabilities, or guarantees; any of which would represent a significant fraud risk factor (similar to AS 2410.16 regarding fraud considerations if undisclosed related party transactions are discovered).

Confirming financial relationships represents a uniquely powerful opportunity for auditors to test their initial fraud risk assessment. Paragraph .03 of the proposed new standard would come into play here if the auditor obtains evidence during the course of the audit (including through the confirmation process) that contradicts the original risk assessment.

For these reasons, we suggest that overcoming the presumption for confirming other financial relationships be available only in circumstances where the financial entity with which the company does business simply does not offer services that would give rise to the financial relationships. This is referred to on p. 22 of the Proposal and represents a reasonable guideline in light of the confirmation’s uniquely critical role in fraud detection and investor protection.

Confirming other financial relationships under these guidelines would be consistent with the auditor’s required exercise of professional skepticism and other procedures designed to avoid confirmation bias, as noted on pg. 18 of the Proposal.

Relationship of the Confirmation Process to the Auditor’s Identification and Assessment of and Response to the Risks of Material Misstatement – Question 7, pg. 19 of the Proposal

We recognize that the Board has elected to not include a requirement that confirmation procedures be applied wherever and whenever they can address significant risks related to relevant assertions, and we agree that this requirement would be too broad as stated on p. 69 of the Proposal.

We would contrast this, however, with our suggestions above regarding confirmation of cash balances and other financial relationships. Establishing that level of requirement for cash and other financial relationships is not overly broad, but instead is focused and pertains to using confirmation as a uniquely powerful fraud risk detection procedure which will inform the auditors fraud risk assessment.



Identifying Confirming Parties for Confirmation Requests – Question 24, pg. 32 of the Proposal

We agree that, as noted on p. 30 of the Proposal, identifying a knowledgeable individual within a confirming party's organization and sending the confirmation request directly to that individual could increase the reliability of audit evidence obtained through the confirmation process.

We point out that the Thomson Reuters Confirmation® ecosystem includes controls related to validation of banks and bank users for all network banks, enabling efficient communication between auditors and confirming banks and making it feasible and practical to direct confirmations of cash and other financial relationships to knowledgeable individuals and specific parties within the confirming organization.

For this reason, we believe it would be reasonable for the Board to establish a presumption that confirmation requests be sent to specific individuals unless clearly not feasible, rather than reserving this as only 'a response to fraud risk' as noted in paragraph .18 of the proposed new standard. Establishing such a presumption reduces the risk that confirmed information is incomplete due to the responding party not being sufficiently knowledgeable.

Using an Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses – Question 26, pg. 36 of the Proposal

We strongly support standardizing the procedures that auditors perform to support their use of intermediaries to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. This will help ensure that all third-party confirmation service providers are held to this same level of security and timeliness and will increase the quality of the confirmation process across the profession.

Thomson Reuters Confirmation® maintains robust and industry-standard security controls to protect customer, company and confirming party data. We undergo annual SOC 1, SOC 2 and ISO 27001 examinations using premiere service providers, and controls are documented accordingly.

Also, the Board's March 2022 *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation* has, as intended, caused firms and service providers to seek clarity with regard to two key questions: a) how frequently do confirmation service providers need to have SOC (or equivalent) examinations performed – annually or semi-annually and b) what is an acceptable window of time to be covered by bridge letters. This relates to the Note following paragraph .B2,b. of the new proposed standard regarding interim testing.

It would be of benefit to the profession for the Board or PCAOB staff to provide guidance on these two issues. This will ensure that all confirmation service providers are operating to the same level of security and timeliness and will promote a consistent standard of quality across the profession. Without such guidance, we could see variation across various firms and various intermediaries.

In addition, the considerations listed in paragraph .B2 of the new proposal are stated in the negative and relate to risks when using an intermediary. "Implications" of using an intermediary can be potentially negative or potentially positive, depending on the intermediary. We believe that this



section fails to recognize the proven benefits of using well-qualified intermediaries. The tone of this section could have the unintended effect of discouraging use of intermediaries and lead firms to fall back to outdated and higher risk confirmation processes. We suggest that the Board add a bullet to this paragraph requiring the auditor to consider the benefits of using an intermediary in relation to other alternatives. Such a bullet might, as an example, be worded as follows –

- Considering the extent to which the intermediary’s infrastructure and controls enhance the value of the confirmation process and quality of audit evidence by, for example, enabling confirmations to be directed to knowledgeable individuals and specific parties within the confirming organization.

Other Matters/Direct Access – pg. 46 of the Proposal as well as Question 3, pg. 16 of the Proposal

It is our understanding that some providers of technology-enabled confirmation tools rely on providing direct access to a client’s cash balances and transactional information through the audit client’s open banking portal. This use of open banking portals in their current state would meet the Board’s definition of Direct Access and thus would not constitute a confirmation procedure “. . . because it does not involve sending a confirmation request and receiving a confirmation response.”

To maintain the value and quality of the confirmation process, we believe it is important that the Board retain its stated position regarding Direct Access and clearly state that open banking in its current state does not constitute a confirmation procedure. Otherwise, there is a risk that until open banking capabilities evolve and mature, the cash confirmation process will quickly devolve to a perfunctory check of cash balances, which significantly diminishes the Board’s intended value of the confirmation process.

Also, because open banking portals currently do not support confirmation of other financial relationships, audit firms relying on these solutions would be less likely to confirm other financial relationships, which in our opinion, furthers the view that the confirmation process consists only of a perfunctory check of cash balances and diminishes the value of the confirmation process. Said another way, the confirmation process is more likely to be viewed as being of little value if it is allowed to be reduced to a procedure that truly is of limited value.

In addition, technology holds the promise of enabling efficient ingestion of comprehensive transactional data from a client’s financial institutions, and various vendors and firms are exploring technology solutions to utilize such data in efficient testing procedures (e.g., automatically testing bank reconciliations or automatically validating all cash journal entries). As these technologies evolve and auditors rely more heavily on utilizing intermediaries to ingest transactional data from clients’ financial institutions, it will become ever more critical that controls are in place to ensure that such transactional data is *confirmed* and has not been intercepted or altered by management. For this reason, it is important that the Board make clear that evaluation of controls is a critical procedure not only when intermediaries are used to confirm cash and other financial relationships, but also when intermediaries are used to ingest financial institution transactional data for substantive testing purposes. This issue would be relevant both to the Proposal and to AS 1105.10: *Audit Evidence*.



* * * * *

We appreciate the opportunity to provide input on the Board's proposal and would be pleased to discuss our comments with you or your staff at your convenience. Please contact Scott Spradling at scott.spradling@thomsonreuters.com regarding our submission.

Sincerely,

A handwritten signature in black ink that reads "E. Beastron". The signature is fluid and cursive, with the first letter of each word being capitalized and prominent.

Elizabeth S. Beastron
President, Thomson Reuters Tax & Accounting Professionals



February 27, 2023

Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

**Re: Proposed Auditing Standard, Public Company Accounting Oversight Board;
The Auditor’s Use of Confirmation and Other Proposed Amendments to PCAOB
Standards; PCAOB Release No. 2022-009; PCAOB Rulemaking Docket Matter No.
028 (December 20, 2022)**

Dear Ms. Brown:

The Center for Capital Markets Competitiveness (“CCMC”) appreciates the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB” or the “Board”) Exposure Draft on *The Auditor’s Use of Confirmation and Other Proposed Amendments to PCAOB Standards* (the “Exposure Draft” or “Proposal”).

The PCAOB’s existing confirmation standard was promulgated by the American Institute of Certified Public Accountants (“AICPA”) before the Sarbanes-Oxley Act of 2002 (“SOX”).¹ In 2009, the Board issued a concept release on confirmations and, in 2010, the Board proposed a standard on confirmations, which was not acted upon.^{2,3}

The proposal is now part of an aggressive effort by the Board to overhaul standards in a condensed timeframe. For example, the PCAOB is engaged in actively working to update more than twenty-five standards within eight standard-setting projects and apparently “is just getting started.”⁴

¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) added broker-dealer audits to the PCAOB’s oversight responsibilities.

² See the *Concept Release on Possible Revisions to the PCAOB’s Standard on Audit Confirmations* (April 14, 2009) and the *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (July 13, 2010).

³ The CCMC provided comments on the standard proposed in 2010. See the letter to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the *PCAOB Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* dated September 13, 2010.

⁴ See “PCAOB Chair Williams Remarks on 20th Anniversary of Sarbanes-Oxley Act and Establishment of the PCAOB” (July 28, 2022).

While CCMC supports the PCAOB's goal to update its Auditing Standards,⁵ It is important that those projects are undertaken with appropriate due process and informed deliberation to achieve the right outcome. CCMC encourages the Board to focus on crafting well-informed, balanced, cost-effective standards that will improve audit quality and stand the test of time, rather than simply "rushing to revise."

We appreciate that the Proposal intends to expressly integrate the use of confirmations into the PCAOB's risk assessment standards. We support principles-based auditing standards and a risk-based approach to the audit process.

CCMC acknowledges that the Proposal is scaled back from the 2010 proposal. While we believe this is the right approach, we are concerned that the Proposal continues to be overly prescriptive and assumes that confirmations represent "first best" audit evidence, regardless of the facts and circumstances.

We are also concerned that the Proposal is not sufficiently "forward looking." Thus, we question whether the proposed requirements will allow for audits in the future to incorporate advances in technology and innovations to obtain audit evidence from third parties.

Our concerns are discussed in more detail below. We also provide some recommendations to help address these concerns.

Discussion

The Proposal includes a number of prescriptive requirements. For example, the Proposal includes a new requirement to confirm cash; requires that auditors must consider confirming other financial relationships with third parties sent cash confirmations;⁶ maintains the requirement to confirm accounts receivable;⁷ and specifies, for complex transactions and significant unusual transactions associated with significant risks of material misstatement, that auditors must consider confirming terms of the transactions with counterparties.⁸

⁵ For example, see the letters to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB Concept Release on *Potential Approach to Revisions to PCAOB Quality Control Standards* dated March 16, 2020; the PCAOB Request for Comment on *Advisory Groups – Draft Governance Frameworks* dated February 28, 2022; and the PCAOB Request for Comment on the *Draft 2022-2026 Strategic Plan* dated August 16, 2022.

⁶ PCAOB requirements that the auditor "must" consider also invoke requirements for auditors to document that consideration and the conclusion reached (Exposure Draft, pages 21 and 22).

⁷ Accounts receivable are defined as those arising from the transfer of goods or services to a customer and a financial institution's loans (Exposure Draft, page A1-3).

⁸ As previously noted, these requirements "to consider" likewise involve documentation requirements.

Further, the Proposal provides requirements for assessing the reliability of confirmation responses and the performance of alternative procedures; includes requirements limiting the use of negative confirmation requests, along with limitations on the use of internal auditors in the confirmation process; and adds requirements for audit committee communications and documentation.⁹

These prescriptive requirements appear premised on an assumption that third party confirmations represent “first best” audit evidence. For example, the Proposal states that “evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources.”¹⁰ However, this statement fails to include essential context. The overarching point is that the reliability of audit evidence depends on the nature and source of the evidence and on the circumstances under which it is obtained.¹¹

The Exposure Draft states “we [the Board and staff] continue to believe that confirmation procedures would generally provide more persuasive audit evidence than other procedures (without confirmation) for cash and accounts receivable.”¹² Unfortunately, this assertion does not sufficiently appreciate the realities faced by auditors in using confirmations and third parties in responding to confirmations.

Confirmations involve difficulties, including the absence of any obligation for third parties to respond to such requests and the absence of any standards of due diligence or inquiry imposed on responding third parties. As CCMC has previously noted, whatever requirements the PCAOB imposes on auditors to confirm accounts and transactions, they cannot overcome these difficulties. Confirmations are also subject to delay, error, or lack of response by third parties. Moreover, third-party confirmations may produce misleading information, such as in cases of collusive fraud.¹³

Adding to these longstanding difficulties, third-party incentives to respond to audit confirmation requests have significantly declined.¹⁴ There has been an explosion of nefarious activities by bad actors – whether using email, U.S. mail, or phone – that mimic otherwise legitimate sources. Thus, a natural response by third parties is to distrust and ignore most external requests for internal (private) information

⁹ For example, see the Exposure Draft, pages 5, 21, 25, 62, and Appendix 1.

¹⁰ See the Exposure Draft, pages 5 and A1-2.

¹¹ See AS 1105.08 on *Audit Evidence*.

¹² See the Exposure Draft, page 19.

¹³ See the letter to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* dated September 13, 2010.

¹⁴ The Exposure Draft notes that anecdotal evidence and some research suggest confirmation response rates are declining (page 52).

CCMC acknowledges the Proposal provides that the auditor may overcome the presumption to confirm accounts receivable, if the auditor determines that other substantive audit procedures would provide audit evidence that is at least as persuasive as that from confirmations.¹⁵ However, the Proposal also requires that this determination be communicated to the audit committee and that both the determination and audit committee communication must be documented.¹⁶ Further, as judgments, these determinations are prone to second-guessing, including through the PCAOB inspection process. Thus, regardless of the intent of the Proposal,¹⁷ it is likely auditors will generally decide to simply use confirmations, even when other audit evidence would be at least as persuasive.

CCMC recognizes that the PCAOB has engaged in efforts to understand audit firm methodologies, audit tools and technologies, and the role of intermediaries (facilitators¹⁸) in obtaining audit evidence via confirmations.¹⁹ However, we remain concerned that the Proposal is not sufficiently forward looking to allow future developments in technology, tools, and innovation to be integrated into the audit process for obtaining audit evidence from third parties.

This concern is exacerbated by the Proposal's prescriptive requirements for confirmations and presumption that confirmations represent "first best" audit evidence. For example, in the current environment under some circumstances, auditors can obtain direct access to information in a third party's information system concerning that party's transactions or balances with a company under audit. Yet, the PCAOB does not consider direct access to fall under its definition of "confirmation."²⁰ Thus, to comply with the proposed requirements, audit evidence using confirmations would still have to be obtained for cash and accounts receivable (and considered for complex and significant unusual transactions) even in circumstances of direct access.

Recommendations

To help address our concerns, CCMC recommends that the PCAOB extend its outreach to stakeholders, particularly to businesses. Discussions with representatives of the business community would help the PCAOB better understand the context, conditions, and limitations that third parties face in responding to confirmation requests from external auditors.

¹⁵ See the Exposure Draft, page A1-3.

¹⁶ See the Exposure Draft, page A1-4.

¹⁷ See the Exposure Draft, page 66.

¹⁸ See the Exposure Draft, page 35.

¹⁹ See the Exposure Draft, pages 47 to 51.

²⁰ See the Exposure Draft, page 46.

Further, the CCMC encourages the PCAOB to use its current initiative to “modernize auditing standards” as an opportunity to consider new and different mechanisms to engage with stakeholders. These new mechanisms could help inform the PCAOB, educate stakeholders, and facilitate feedback as the PCAOB develops and proposes auditing standards. Using roundtables that include preparers and (pre-implementation) field-testing with audit firms are just two suggestions. The key is for the PCAOB to go beyond its current approaches that rely on inspection and oversight,²¹ notice and comment (with limited participation because of stakeholder constraints, including time and resources), and advisory groups with limited membership.

Finally, we recommend that the Board extend the effective date to two years after approval of any final standard by the Securities and Exchange Commission. PCAOB-registered audit firms need ample time to update and integrate new confirmation requirements, including documentation requirements, into their quality control systems (including methodologies, tools, and training) and audit engagements.

Concluding Remarks

CCMC hopes that the Board will heed our recommendations on the Exposure Draft. Thank you for your consideration. We stand ready to discuss these matters with you further.

Sincerely,

A handwritten signature in black ink, appearing to read 'TK' with a long horizontal flourish extending to the right.

Tom Quaadman
Executive Vice President
Center for Capital Markets Competitiveness
U.S. Chamber of Commerce

²¹ The Proposal was developed relying on the PCAOB’s inspection and oversight (Exposure Draft, page 47).

U.S. GOVERNMENT ACCOUNTABILITY OFFICE

441 G St. N.W.
Washington, DC 20548

February 21, 2023

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

GAO's Comments on the PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2022-009, *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*, December 2022

This letter provides GAO's comments on the Public Company Accounting Oversight Board's (PCAOB) exposure draft, *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*. The PCAOB seeks comment on 49 specific questions. We are providing a high-level response; the overarching nature of our comments makes them applicable to multiple questions.

GAO provides standards for performing high-quality audits of government organizations, programs, activities, and functions and of government assistance received by contractors, nonprofit organizations, and other nongovernment organizations with competence, integrity, objectivity, and independence.¹ These standards, often referred to as generally accepted government auditing standards (GAGAS), are to be followed by auditors and audit organizations when required by law, regulation, agreement, contract, or policy. For financial audits, GAGAS incorporates by reference the AICPA's Statements on Auditing Standards.

We appreciate the PCAOB's efforts to establish auditing standards on audit confirmations for registered companies and agree that confirmation procedures can be an important means of obtaining audit evidence. However, we encourage the PCAOB to harmonize its standards with those of other standard setters to the extent possible. We believe the proposed standard should allow for greater use of auditor professional judgment around alternative procedures to confirmations.

We encourage the PCAOB to Harmonize its Standards with Other Standard Setters to the Extent Possible and Clarify the Expected Result From Any Differences That Are Considered Necessary

We commend the PCAOB for developing supplemental materials to help users recognize differences between the requirements of this proposed standard and analogous standards of the International Auditing and Assurance Standards Board (IAASB) and the AICPA Auditing Standards Board (ASB). However, while the comparison of the new proposed standard identifies certain significant differences among the various standards, it does not adequately explain the reasons for all significant differences or the changes in practice that are expected to result from these differences.

We urge the PCAOB to consider whether its planned revisions to the standards will create unnecessary differences between its auditing standards and standard setters for non-issuers.

¹GAO, *Government Auditing Standards: 2018 Revision*, [GAO-18-568G](#) (Washington, D.C.: July 2018).

For those areas where the PCAOB believes that differences are necessary, we urge PCAOB to clearly explain the changes in practice that are expected to result from these differences.

The Proposed Standard Should Allow for Greater Use of Auditor Professional Judgment around Alternative Procedures to Confirmations, as Long as Evidentiary Requirements Are Met

GAO does not dispute the premise that confirmation procedures can provide adequate and reliable evidence, but (1) such procedures may not provide the most adequate and reliable evidence to support management's assertions in every situation and (2) such requirements could reduce the use of auditor professional judgment when determining the proper combination of procedures for obtaining adequate and reliable evidence to support management's assertions, based on audit risk and materiality.

The proposed standard could lead to overreliance on confirmation procedures. In addition, it could cause auditors to spend time on confirmations when other audit procedures may be more appropriate, especially in unique situations. For instance, confirmations may not be the most effective audit procedure for immaterial cash balances. For accounts receivable, as described in AICPA's AU-C Section 330, external confirmation procedures may be ineffective in certain circumstances such as when the confirming party lacks objectivity or responses are expected to be unreliable. Additionally, when the auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk, other audit procedures may be more effective.

A more effective approach for obtaining evidence to support the entity's assertions is to apply provisions of the audit risk and evidence standards to determine whether audit confirmation procedures would be most effective. These standards and the related guidance provide sufficient principles-based direction for auditors in determining when to use confirmation procedures.

- - - - -

Thank you for the opportunity to comment on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact me at (202) 512-3133 or dalkinj@gao.gov.



James R. Dalkin
Director
Financial Management and Assurance

From: Mary Rohas <mrohas@vccs.edu>
Sent: Wednesday, February 15, 2023 5:15 PM
To: Comments
Subject: [EXT]: PCAOB Rulemaking Docket Matter No. 028

Please see my comments below regarding the new change:

I have read the proposed auditing standard “The Auditor’s Use of Confirmation, and Other Proposed Amendments to PCAOB Standards” published on December 22, 2022. I am concerned and object to the proposed change in the PCAOB standards that bars external auditors from utilizing an internal audit function to provide direct assistance in certain aspects of the confirmation process.

When external audits use internal auditors, they must adhere to AS2605: Consideration of the Internal Audit Function which states:

- .01: The auditor considers many factors in determining the nature, timing, and extent of auditing procedures to be performed in an audit of an entity's financial statements. One of the factors is the existence of an internal audit function.¹ This section provides the auditor with guidance on considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor in an audit performed in accordance with the standards of the PCAOB.
- Assessing the Competence and Objectivity of the Internal Auditors
 - Competence of the Internal Auditors
 - .09: When assessing the internal auditors' competence, the auditor should obtain or update information from prior years about such factors as
 - Educational level and professional experience of internal auditors.
 - Professional certification and continuing education.
 - Audit policies, programs, and procedures.
 - Practices regarding assignment of internal auditors.
 - Supervision and review of internal auditors' activities.
 - Quality of working-paper documentation, reports, and recommendations.
 - Evaluation of internal auditors' performance.
 - Objectivity of the Internal Auditors
 - .10 When assessing the internal auditors' objectivity, the auditor should obtain or update information from prior years about such factors as—
 - The organizational status of the internal auditor responsible for the internal audit function, including—
 - Whether the internal auditor reports to an officer of sufficient status to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal auditors.
 - Whether the internal auditor has direct access and reports regularly to the board of directors, the audit committee, or the owner-manager.
 - Whether the board of directors, the audit committee, or the owner-manager oversees employment decisions related to the internal auditor.
 - Policies to maintain internal auditors' objectivity about the areas audited, including—
 - Policies prohibiting internal auditors from auditing areas where relatives are employed in important or audit-sensitive positions.

- Policies prohibiting internal auditors from auditing areas where they were recently assigned or are scheduled to be assigned on completion of responsibilities in the internal audit function.

The current standard does not need to be changed. The proposed change in PCAOB standards is presented without any clear explanation for or examples of the need for such a change. There are no examples where internal auditors have failed external auditors in the confirmation process.

Internal auditors are independent from management per our standards and the IIA's Code of Ethics. I have been both an external auditor and an internal auditor and have had the same independent reporting relationship to the audit committees in my organizations. Both have an obligation to exercise due care in handling all information.

The PCAOB's new proposal seems to imply internal auditors are not competent, objective, and trustworthy.

Thank you!
Mary Rohas

Mary C. Rohas
Independent Verification & Validation Manager
Audit & Consulting Team
Virginia Community Colleges – System Office
300 Arboretum Place, Suite 200
Richmond, VA 23236
Office: (804)819-4952
Cell: (804)647-0690





Exhibit 2(a)(E)

Alphabetical List of Commenters on the Concept Release in PCAOB Release No. 2009-002	
---	--

1	American Accounting Association
2	AuditConfirmations, LLC
3	BDO Seidman, LLP
4	California Society of Certified Public Accountants
5	CalPERS
6	Capital Confirmation, Inc.
7	Center for Audit Quality
8	Deloitte & Touche LLP
9	Ernst & Young LLP
10	Federation of European Accountants
11	Grant Thornton LLP
12	Illinois CPA Society
13	Institut der Wirtschaftsprüfer
14	Joseph Decosimo and Company, LLC
15	KPMG LLP
16	Mark Lyle
17	Dan Mahaffey
18	Mazars Risk Management & Audit Quality
19	McGladrey & Pullen, LLP
20	Piercy Bowler Taylor & Kern, Certified Public Accountants
21	PricewaterhouseCoopers LLP
22	RPost, the Registered E-mail® Company
23	The Institute of Chartered Accountants in England and Wales
24	United States Government Accountability Office

May 28, 2009

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

Via email to comments@pcaobus.org

RE: PCAOB Rulemaking Docket Matter No. 028: Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the *PCAOB Rulemaking Docket Matter No. 028: Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*. We appreciate the opportunity to provide input.

The views expressed in this letter and attachments are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member.

We hope that our attached comments and suggestions are helpful and will assist in developing revisions to the PCAOB's standard on audit confirmations. If the Board has any questions about our input, please feel free to contact our committee chair for any follow-up.

Respectfully submitted,

Auditing Standards Committee
Auditing Section - American Accounting Association

Committee Members:

Chair – Randal J. Elder, Syracuse University, tel: 315-443-3359, email: rjelder@syr.edu

Past Chair – Thomas M. Kozloski, Wilfrid Laurier University

Vice Chair – James Bierstaker, Villanova University

Larry Abbott, University of Memphis

Paul Caster, Fairfield University

Steven Firer, Monash University – South Africa

Ed O'Donnell, University of Kansas

Susan Parker, Santa Clara University

Brad Reed, Southern Illinois University

Sandra Shelton, DePaul University

Auditing Standards Committee
Auditing Section – American Accounting Association

General Comments

The Committee commends the PCAOB (“the Board”) for addressing the use of confirmations, including electronic confirmations, and confirmations of other accounts and special terms. The following section presents a number of specific comments or suggestions, organized along the lines of the questions posed by the Board in the concept release. These comments are followed by additional comments and observations on the use of confirmations.

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

The Committee believes that the objective of the confirmation standard should be for the auditor to design and perform confirmation procedures to obtain sufficient competent audit evidence from knowledgeable third parties outside the company. We note that other questions in this concept release address the definition of a confirmation. We also note that addressing the knowledge of the third party is challenging, and may not be relevant when the procedures involve direct access to information held by a third party.

We believe all testing should be responsive to risk, and that requirements in the confirmation standard be responsive to risk. Other questions in this concept release address the question of risk and when confirmations are required. However, we believe the wording “in response to identified risks” may suggest that confirmations should only be used when specific risks have been identified.

The primary audit objective for receivable confirmations is existence, which is related to the management assertion of existence, and should be emphasized in any changes to the proposed standard. This emphasis on existence affects how many other issues are viewed, such as confirmation differences and the use of negative confirmations.

2. Should the definition of confirmation allow for response other than traditional mailed responses, such as oral confirmation, facsimile, email, responses provided through third-party service providers, and direct on-line access to information held by a third party? Why or why not?

The Committee believes that these alternative forms of responses should be permitted. However, the auditor should consider the risk of significant misstatement and the need for authentication depending on the identified risk.

The primary objective of confirmations is to obtain evidence directly from a third party. When the interim confirmation standard was developed, many of these alternative forms of communication did not exist. Cost and low response rates suggest that traditional written, mailed confirmations are not very effective.

Auditing Standards Committee
Auditing Section – American Accounting Association

The various alternative forms of communication vary in reliability. It may be appropriate to consider the reliability of the various forms of communication in the standard. The evidence in Caster et al. (2008) suggests that mailed responses also have reliability issues, although they are likely more reliable than faxed or emailed responses. It is quite likely that third-party providers and direct on-line access may be more reliable than a mailed response.

Some of the other forms of communication have lower reliability. We believe that oral confirmations should be discouraged, especially for material balances, and that auditors should be encouraged to consider the need for authentication when relying on all other types of responses.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

Direction regarding these types of confirmations should be addressed in the broader context of the need for authentication of confirmation evidence from any source. Auditors that use third-party service providers should request reports on the controls at the service provider. This is similar to a report on internal controls at a service organization, but sufficiently different that the need for such a report may need to be addressed in any changes to the proposed standard. However, the third-party service provider could also be viewed as merely a communication intermediary like the postal service.

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and risk of the integrity of the data is not compromised?

The need for authentication of responses should be based on risk and materiality for all types of confirmation. As noted above, third-party providers should provide evidence of the effectiveness of controls over the confirmation procedures. For mailed confirmations, this could involve verification of addresses. For fax and email responses, procedures to verify the respondent would be appropriate.

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include the confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

The Committee believes that terms of complex or unusual agreements should be confirmed where material. The term “complex or unusual agreements” indicates that these have higher risk. It could be argued that confirming this information is more important than confirmation of receivable balances, since the latter can be readily addressed through alternative procedures.

Auditing Standards Committee
Auditing Section – American Accounting Association

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

We believe that auditors should be required to confirm significant cash balances. We also believe they should be required to consider confirmations for material investments, credit facilities, debt agreements, and compensating balance agreements. Auditors should also be required to consider confirmation of accounts payable and other accounts or agreements when a significant risk has been identified.

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

The Committee believes the existing guidance in AU sec. 330 is appropriate. Auditors should document the reason for not sending confirmations. When confirmations are considered to be ineffective, the auditor should document previous response rates or response rates on similar engagements to support the conclusion that confirmations would be ineffective.

8. Should the Board include direction in the standard on what constitutes “unusual” or “complex” agreements or transactions, including revenue transactions? If so, what should that direction include?

The committee believes that this should be left to auditor judgment, as these concepts are difficult to define and it is impractical to address all issues in the standard. The standard could include examples, or the PCAOB could provide implementing guidance.

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful to auditors?

The committee does not believe that additional guidance is needed in the standard. The PCAOB may wish to provide implementing guidance, similar to existing sources such as AICPA Practice Alert 2003-01 (AICPA 2007) and Auditing Procedure Study, *Confirmation of Accounts Receivable* (AICPA 1996). In our additional comments we indicate that the standard should discuss confirmation form and its relation to audit objectives and audit evidence.

Auditing Standards Committee
Auditing Section – American Accounting Association

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

This question specifically addresses mailed confirmations, and we believe it is best considered under the broader context of authentication of all responses. We do not believe auditors should be required to test addresses, but believe the auditor should consider testing a sample of addresses based on risk and materiality. Large balances, especially those to unknown parties or to PO boxes are examples of accounts that should be considered for authentication.

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses.

The Committee believes existing guidance on maintaining control over confirmations is sufficient.

12. What direction is necessary in the standard regarding maintaining control over electronic confirmations?

Some guidance may be necessary in the standard or implementing guidance for electronic and other types of confirmations. Use of a third-party service provider for electronic confirmations indicates some loss of control, and we have noted that there may be a need for a report on controls at the third-party provider.

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

The committee believes guidance similar to that contained in ISA 505 is appropriate. We note that evidence reliability is a general concept that should apply to all evidence, including alternative procedures. We believe that auditors should be encouraged to at least consider authentication of the confirmation source, particularly for highly material amounts or where significant risks exist.

14. When an auditor uses direct on-line access to a third party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party databases or provided by the third-party service provider is reliable?

We believe that third-party providers should provide evidence of the effectiveness of their controls, similar to a SAS 70 report. If the auditor uses direct on-line access to a third-party database, the auditor should evaluate the reliability and authenticity of the source.

Auditing Standards Committee
Auditing Section – American Accounting Association

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

The committee did not identify any additional factors to be considered.

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

In general, the committee believes that auditors should be required to perform alternative procedures for non-responses to positive confirmation requests to obtain sufficient evidence, particularly to address the existence assertion. The committee does note the use of PONI (positive-out, negative-in) confirmations (Williams and Ziegler 1987). In these circumstances, the auditor increases the total number of positive confirmations sent so that sufficient responses are received; the non-responses are treated as negative confirmations. The committee believes such an approach can be appropriate if the total number of positive confirmations received provides sufficient evidence, and the auditor evaluates whether the non-responses indicate any pattern or provide evidence of risks not previously identified.

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

All confirmation differences should be investigated, unless they are clearly immaterial and treated as misstatements in the evaluation of results. If the client is asked to reconcile confirmation differences, the auditor must test the client's reconciliation. Where a difference is treated as an exception, the auditor should evaluate whether the cause of the exceptions indicates a previously unidentified risk.

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

We believe that risks should be reconsidered whenever exceptions are identified in any audit testing. We note that such guidance is contained in proposed standard *Evaluating Audit Results* (PCAOB Release 2008-08, p. A5-6).

Auditing Standards Committee
Auditing Section – American Accounting Association

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

If the auditor deems it appropriate to confirm significant terms, then it seems appropriate to perform alternative procedures for non-responses such as reading agreements or other documents that address the special terms. However, depending on the materiality of the individual agreements or transactions, it may not be necessary to perform alternative procedures for all non-responses of special terms. The purpose of the alternative procedures in this case is to learn about the nature of the agreements or transactions, whereas alternative procedures for positive confirmations of receivable balances are used to generalize from the sample to the population.

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not to confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

The Committee believes that if confirmation is a required audit procedure, management requests that certain confirmations not be sent should be regarded as a scope limitation. However, if management is allowed to request that confirmations not be sent, the procedures listed are appropriate.

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

As noted earlier, we believe that accounts receivable confirmations should primarily be used to address the existence assertion. We do not believe such disclaimers substantially reduce the evidence provided by the confirmation, and would not require the auditor to perform alternative procedures.

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

Negative confirmations do not appear to be widely used, and the existing requirements in AU Sec. 330 that negative confirmations be used when controls are effective and individual balances are small seem appropriate. If confirmations are used primarily to address the existence assertion, the Committee believes use of negative confirmations should be encouraged when the requirements for sending negative confirmations are met, especially when negative confirmations are used in addition to positive confirmations.

Auditing Standards Committee
Auditing Section – American Accounting Association

23. *Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?*

The committee does not believe that additional substantive procedures should be required when negative confirmations are used. We also distinguish situations where negative confirmations are used in addition to positive confirmations, and situations when only negative confirmations are sent. Although we don't believe additional substantive procedures should be required, substantive analytical procedures should be encouraged when only negative confirmations are used.

Additional Considerations

Confirmation Reliability – The Committee believes that confirmations are useful, especially for addressing the existence assertion. However, the AAER evidence in Caster et al. (2008) suggests the collusion involving confirmation respondents is relatively common. The existence of a business relationship between the client and respondent suggests that confirmations may not represent independent evidence. Auditors should consider the need for authentication and/or additional evidence when a significant risk exists, or when there is reason to question the independence of the confirmation respondent.

Confirmation Form – We believe the standard should address confirmation form. The concept release discusses negative confirmations, which appear to be rarely used, and perhaps underused. The concept release also discusses confirmation of unusual transactions and significant terms. However, other issues of confirmation form are not addressed.

Forty years ago, blank forms were probably the predominant form of confirmation; and balance confirmations were the primary confirmation form twenty years ago. Invoice confirmations are the predominant confirmation form today. Krogstad and Romney (1980) encouraged the use of invoice confirmations with larger sample sizes, on the basis of efficiency and improved responses. However, Allen and Elder (2001) do not find improved response rates and also do not find larger sample sizes with invoice confirmations. Williams and Ziegler (1987) suggest the use of PONI confirmations, but standards do not address whether a positive confirmation can be treated as a negative confirmation if no response is received.

Whether electronic forms of confirmation replace traditional mailed confirmations is closely tied to the objectives of confirmations. If confirmations are used primarily to address the existence assertion, then written confirmations, regardless of form, may be more effective than electronic confirmations. We believe that electronic confirmations or alternative procedures are effective, and perhaps more effective than written, mailed confirmations, in addressing the valuation assertion. This suggests that the form of

Auditing Standards Committee
Auditing Section – American Accounting Association

confirmation (blank, balance or invoice) is less important, and the confirmation and authentication of the customer, including confirmation of significant terms, should be regarded as the primary purpose of confirmations. The valuation assertion can be addressed through alternative procedures or substantive analytical procedures. This also suggests that negative confirmations can be highly effective where unusual transactions or special terms do not exist.

References

American Institute of Certified Public Accountants (AICPA), Professional Issues Task Force. 2007b. Practice Alert 2003-01, *Audit Confirmations*. New York: AICPA.

_____. 1996. Auditing Procedure Study, *Confirmation of Accounts Receivable*. New York: AICPA.

Allen, R., and R. Elder. 2001. An empirical investigation of the effectiveness of balance and invoice confirmations. *Journal of Forensic Accounting* 2: 3-16.

Caster, P., Elder, R., & Janvrin, D. 2008. A summary of research and enforcement release evidence on confirmation use and effectiveness. *Auditing: A Journal of Practice & Theory* 27 (2): 253-279.

Krogstad, J., and M. Romney. 1980. Accounts receivable confirmation: An alternative approach. *Journal of Accountancy* 149 (February): 68-74.

Public Company Accounting Oversight Board. 2008. Rulemaking Docket Matter No. 026: Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Conforming Amendments to PCAOB Standards. Washington, D.C.: PCAOB.

Williams, D., and T. Ziegler. 1987. Positive-out negative-in confirmations—An innovative confirmation approach. *The CPA Journal* (July): 78-81.



▪ AuditConfirmations, LLC
250 Steele Street, Suite 300
Denver, CO 80206

▪ Phone: (720) 330-7201
Fax: (303) 468-1989
AuditConfirmations.com

May 14, 2009

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

Re: PCAOB Rulemaking Docket Matter No. 028

Dear Board Members and Staff:

AuditConfirmations, LLC appreciates the opportunity to comment on the PCAOB's concept release, *Possible Revisions to the PCAOB's Standard on Audit Confirmations*. AuditConfirmations, LLC is a new service provider that owns and operates a web based application for processing electronic audit confirmations for use by public accounting firms.

We welcome the Board's efforts to broaden the existing confirmation standard and provide guidance on the use of electronic confirmations. Our comments to certain technology specific questions are noted below.

QUESTIONS & RESPONSES

2. *Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct on-line access to information held by a third-party? Why or why not?*

Modern advances in technology have changed the landscape in the area of communications. Traditional mail is no longer the preferred method for most forms of communication in the current business environment; e-mail and the Internet are the preferred methods. The definition of confirmation should accommodate both certain modern forms of electronic communications (eg, e-mail, third-party service providers) and yet unknown future forms of communication that will almost certainly be developed and deployed in the business setting. Furthermore, the definition should also accommodate direct access to information held by a third-party.

Traditional mail is inferior to other forms of communication in many respects including timeliness, security, and status tracking. First, with traditional mail confirmations, it can take weeks to receive responses. Alternatively, confirmations using electronic communications (ie,



electronic confirmations) can usually be completed within minutes or days. Secondly, electronic confirmations can be encrypted whereby only the auditor, company, and respondent can view and enter only specific allowable information. Traditional mail offers no such mechanism. Lastly, electronic confirmations can provide status tracking for each phase of the confirmation process including initiation, authorization, approval, and completion. Status tracking enables the auditor to know where the confirmation is in the process, date and time stamps for each phase, and electronic address stamps (eg, Internet Protocol (IP) address) for the auditor, company, and respondent. Traditional mail does not provide any type of status information.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

Direction should address the responsibilities of the auditor to confirm that the electronic confirmation process is secure and controlled by the auditor. When service providers are used, auditors should confirm the provider's identity, company identity, respondent's identity, information technology (IT) security, and gain an understanding of the provider's electronic confirmation process. A service provider's identity and certain aspects of IT security can be confirmed through an independent organization such as VeriSign or Trustwave. These organizations are commonly used and trusted among e-commerce transaction websites. Additionally, an auditor can use any number of commonly used methods to confirm a company's and respondent's identity. Furthermore, auditors should gain an understanding of how the electronic confirmation process works. This can usually be accomplished from information supplied by the service provider.

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

Increased auditor control over the process reduces source risk. To reduce risk further, the auditor should attempt to confirm the identity of the respondent. In the case of electronic confirmations, the auditor can easily do this through domain address verification of the respondent. Additionally, the auditor can use the Internet to corroborate physical addresses and phone number pre-fixes to substantiate the validity of the respondent source. The auditor can also call the respondent to verify information. Data integrity can be achieved through encrypted data transmission, input controls for auditors, companies and respondents, and secure storage on data servers. With electronic confirmations, the likelihood that data will be compromised and still tie-out to information provided to the auditor by the company is low, provided the auditor uses blank balances and requires the respondent to provide balance information.



9. *Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?*

We believe standardized confirmation request forms should be created for commonly used confirmations, including accounts receivable, accounts payable, investments, credit facilities, and debt agreements. The *Standard Form to Confirm Account Balance Information with Financial Institutions* is a consistent method to confirm specific information and is familiar to both bankers and auditors alike. We believe the more consistent the language and format used for confirming information from respondents, the greater the response rate.

For example, many bankers immediately recognize the *Standard Form* for confirming bank balances, and although they may view the form as an administrative burden, bankers are well practiced at processing the form. On the other hand, accounts receivable confirmations are sent to respondents with widely varying language and formats including a range of requested information. Many respondents view these disparate forms as confusing and an even greater administrative burden than the bankers, which contributes to a lower response rate for these types of confirmations.

10. *Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?*

Yes, auditors should perform procedures sufficient to validate *all* the addresses of respondents to substantiate the confirmations were directed to the intended recipients. Likely, many of the audit confirmations already represent a sample of transactions making up a larger account balance. Taking a further sample from this sample to test addresses dilutes the efficacy of this portion of the audit process. Moreover, the technology available today can assist an auditor in quickly testing the validity of respondent addresses, whether physical, facsimile, or electronic (eg, e-mail or Internet).

12. *What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?*

We believe whether electronic or traditional mail confirmations are used, auditors should maintain control over each step in the process. Although, we believe that electronic confirmations significantly reduce risk compared to traditional mail confirmations since traditional methods require more hands to move the mail. Auditors should maintain the ability to initiate the audit confirmation for a company, dictate the required information in accordance with audit guidance, direct the confirmation to the intended respondent, and receive the information directly from the respondent. Furthermore, we believe the Board should require electronic audit confirmations be encrypted, which would further strengthen the auditor's control over the process.



The objective of third-party service providers that facilitate electronic audit confirmations is to provide a secure electronic mechanism between the auditor, company, and respondent to reduce the auditor's time spent processing confirmations, and improve the timeliness and number of responses from respondents. The control of this process can and should remain in the hands of the auditor.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

Similar to the response to previous questions, when auditors use a third-party service provider to facilitate the confirmation process, the auditor should confirm the service provider's identity, independence from the company, IT security, respondent address verification, and gain an understanding of the process. We consider third-party service providers that facilitate communications between auditors and respondents to be comparable in many respects to how the U.S. Postal Service and FedEx facilitate exchanges between parties. The fact that the methods of transport are electronic rather than traditional does not necessarily increase the risk of the confirmation process. On the contrary, given the very nature of encrypted electronic communications, the risk of interception and data manipulation by unauthorized individuals is lower compared to traditional mail methods.

* * * * *

We would be pleased to discuss our comments with members of the Public Company Accounting Oversight Board or a member of its staff. Please feel free to contact Newel C. Linford at (720) 330-7202 or newel@auditconfirmations.com. We thank you for your consideration in this matter.

Very truly yours,
/s/ AuditConfirmations, LLC



Public Company Accounting Oversight Board
May 29, 2009
Page 1 of 13

May 29, 2009

Via e-mail: comments@pcaobus.org

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

**Re: PCAOB Request for Public Comment: *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* - PCAOB Rulemaking
Docket Matter No. 028**

Dear Board Members and Staff:

BDO Seidman, LLP appreciates the opportunity to provide comments on the *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* ("Concept Release"). We encourage the PCAOB to continue to solicit input early in the development of proposed standards through the use of the Concept Release format in an effort to obtain as wide a range of views as possible before the issuance of proposed standards. We believe that the insight gained through this process will not only supplement the advice provided to the Board by the Standing Advisory Group, but will also provide invaluable input from other interested parties in the standard setting process.

In addition to using the Concept Release process, we believe it is also important to participate actively in an open dialogue with the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") to benefit from the discussions held at these organizations on many of the same issues now under consideration by the Board. This is especially relevant as it relates to this Concept Release, because the ASB has recently completed its deliberations regarding external confirmations, and is expected to soon expose its proposed standard on the confirmation process that we believe will converge in many respects with International Standard on Auditing ("ISA") 505, *External Confirmations*.

Our comments to the questions posed in the Concept Release are provided below for your consideration.



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 2 of 13

- 1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?**

We believe the proposed objective should clarify that only *when the auditor has concluded that confirmation procedures are appropriate*, should the auditor design and perform such procedures to obtain relevant and reliable audit evidence. This clarification is necessary to avoid any misunderstanding about when confirmation procedures should be performed. Guidance as to the determination of whether or not to perform confirmation procedures should be included within the risk assessment standards, similar to the ISA construct, such that the auditor considers whether external confirmation procedures are an appropriate response to assessed risk. (See ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 19).

Additionally, we note that the objective included in the Concept Release is derived from ISA 505, with the addition of the phrase "from knowledgeable third parties outside the company in response to identified risks." While we agree that confirmations should be from knowledgeable third parties we suggest revising the phrase "from knowledgeable third parties outside the company" to "from parties outside the company that the auditor has a reasonable expectation of being knowledgeable," to reflect the use of judgment in determining who may be a knowledgeable third party.

Definition of confirmation

- 2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct on-line access to information held by a third party? Why or why not?**

We agree that the definition of confirmation should allow for responses other than traditional mailed responses, such as facsimile, email, other forms of electronic communications, responses processed through third-party service providers and direct on-line access to information held by a third party. However, we do not believe that oral confirmations should be included as a confirmation procedure; instead, we believe that oral confirmations should be considered as a procedure that may provide some evidence about the relevant assertion, the sufficiency of which would be based on the auditor's judgment based on assessed risk. This is consistent with ISA 505 which defines external confirmations as:



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 3 of 13

Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

Additionally, we believe that the following phrase, “or through direct access by the auditor to information held by a third party in response to a written request,” which we believe will be included as part of the definition in the ASB’s proposed standard on confirmations when it is exposed, should be added to the definition to recognize direct access as an acceptable confirmation procedure.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

We believe that the AICPA’s extant guidance in AU section 9330, *The Confirmation Process: Auditing Interpretations of Section 330*, and ISA 505, paragraph A12 both provide appropriate application guidance about the use and reliability of electronic confirmations. We believe, consistent with the guidance in ISA 505, that any guidance should emphasize judgment based on assessed risk of material misstatement. The guidance in ISA 505, paragraph A12, which is consistent with AU section 9330.03, states:

Responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. A process used by the auditor and the respondent that creates a secure environment for responses received electronically may mitigate these risks. If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced. An electronic confirmation process might incorporate various techniques for validating the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify web site authenticity.

Additionally, the AICPA’s extant guidance in AU section 9330, paragraph .07 provides guidance in situations when a system or process, such as a third-party service provider, facilitates electronic confirmation between the auditor and the confirmation respondent. We believe such guidance should also be included as application guidance.



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 4 of 13

AU section 9330, paragraph .07, states:

If a system or process that facilitates electronic confirmation between the auditor and the confirmation respondent is in place and the auditor plans to rely on such a system or process, an assurance trust services report (for example, Systrust), or another auditor's report on that process, may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls with respect to that process. Such a report would usually address the risks described in paragraph .03 [the information obtained may not be from an authentic source, a respondent may not be knowledgeable about the information to be confirmed, or the integrity of the information may have been compromised]. If these risks are not adequately addressed in the report, the auditor may perform additional procedures to address those risks.

Further, we believe that when a third-party service provider is used in the confirmation process, approval from the client should be obtained prior to the use of such a service because the process will entail providing confidential client information to a third party.

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

Confirmation from proper source

Consistent with ISA 505, paragraph 7, we believe that as part of maintaining control over external confirmation requests, the auditor should ensure that confirmation requests are properly addressed, whether the confirmation process is electronic or in paper form, to address the risk that the confirmation response is not obtained from a proper source. However, we do not believe that specific procedures should be required but instead suggest providing guidance such that the decision to test the validity of the addresses on confirmation requests before they are sent should be based on assessed risk. For example, the greater the risk that confirmation requests are not properly addressed; the more likely it is that testing the validity of addresses would be an appropriate response.

Integrity of data

The confirmation process is not without risk, whether the process is in paper or electronic form. These risks (interception, alteration, and fraud) are mitigated in part through the appropriate design of the confirmation request and the process surrounding it. With respect to electronic confirmation requests, the design of the confirmation process may be complicated, because the proof of origin and authority of the respondent



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 5 of 13

may be more difficult to establish and alterations may be more difficult to detect. We believe that ISA 505, paragraph A12 (refer to question 3 above for the text of paragraph A12) provides appropriate guidance in circumstances where the auditor has doubts about the reliability of the responses to a confirmation request and, as such, the audit response should be based on the auditor's judgment about the assessed risk related to the integrity of the data.

In addition to the guidance set out in ISA 505, we believe that examples that demonstrate how risks unique to the electronic confirmation process may be addressed should be included in any proposed standard. In developing such guidance and examples, we encourage the Board to reach out to information technology experts with experience in electronic confirmations.

Requirement to confirm

- 5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU section 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?**

We do not believe that the presumptively mandatory requirement to request confirmation of accounts receivable in AU section 330 should be expanded to include items such as significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. Instead, we support a risk-based approach to determining when the use of confirmations would provide sufficient appropriate evidence, as set out in ISA 330, paragraph A19. This paragraph states:

When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

We recognize that AU section 316, paragraph 54 (to address the presumption that there is a risk of material misstatement due to fraud relating to revenue recognition), provides guidance about procedures the auditor may consider performing, which includes confirming with customers certain relevant contract terms and the absence of side agreements. As a result of the heightened risk of material misstatement due to fraud with respect to revenue recognition for complex revenue arrangements, we support



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 6 of 13

including guidance relating to factors to consider in determining whether to perform confirmation procedures, related to these items.

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

We do not believe that the auditor should be required to consider confirming other items, but instead believe that the decision should be based on the assessed risks of material misstatement, such that as the assessed risk increases, the more persuasive the evidence needs to be. So for example, the auditor would design audit procedures in response to the assessed risk assessment and external confirmation procedures may be the most appropriate response. Such an approach is consistent with ISA 330, which provides for a risk-based approach that provides for increasing the quantity and/or relevance and reliability of evidence as assessed risk increases.

Further, rather than prescribing when confirmations should be used, we suggest providing guidance about circumstances when confirmation procedures may be appropriate, similar to the guidance contained in ISA 330, paragraphs A48 through A51, which describe circumstances when confirmation procedures are frequently used, the assertions for which confirmations are most often relevant, and factors that assist the auditor in determining when confirmation procedures may be appropriate.

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

We do not believe that specific procedures should be required when evaluating whether confirmation of accounts receivable would be ineffective. However, we recommend including guidance similar to that currently included in the footnote to AU section 330, paragraph 34b, which provides an example of when an auditor might consider the use of confirmations to be ineffective. The footnote offers the following as an example:

...if based on prior years' audit experience or on experience with similar engagements, the auditor concludes that response rates to properly designed confirmation requests will be inadequate, or if responses are known or expected to be unreliable, the auditor may determine that the use of confirmations would be ineffective.



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 7 of 13

8. Should the Board include direction in the standard on what constitutes “unusual” or “complex” agreements or transactions, including revenue transactions? If so, what should that direction include?

We do not believe that it would be practical to describe what constitutes “unusual” or “complex” agreements or transactions, including revenue transactions, as such a definition would depend on specific facts and circumstances. However, if the Board expands the presumptively mandatory requirement to request confirmation of accounts receivable in AU section 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions, it would be necessary to develop a framework for identifying such transactions.

Designing confirmation requests

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

ISA 505, paragraph A4, describes factors to consider when designing confirmation requests, which we believe provides appropriate direction. Some of these factors are already included within the extant standard; however, we believe these additional factors, which are similar to factors included in ISA 505, would be helpful to auditors:

- the assertions being addressed;
- specific identified risks of material misstatement, including fraud risks;
- the layout and presentation of the confirmation request;
- the method of communication (for example, in paper form, or by electronic or other medium); and
- management’s authorization or encouragement to the confirming parties to respond in a timely manner to the auditor. Confirming parties may only respond to a confirmation request containing management’s authorization.

In addition to the above, we suggest including guidance related to the timing of confirmation procedures such that the auditor may consider sending confirmations throughout the year when confirming specific transactions, rather than performing these procedures only at year-end, as this could help identify potential additional risks at an earlier stage.



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 8 of 13

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

As noted in our response to question 4, we believe that the decision to test the addresses of confirming parties should be based on the assessed risk that the information has been compromised.

Maintaining control over confirmation requests and responses

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

We believe that guidance, similar to ISA 505 and the extant PCAOB standard, that requires the auditor to maintain control over external confirmations by (a) determining the information to be confirmed, (b) selecting the appropriate confirming party, (c) designing the request, including directing it to the appropriate party, and (d) sending and receiving the request directly to/from the confirming party or applicable third-party service organization is appropriate.

In addition, our response to question 4 above provides recommendations about how the auditor may determine that confirmations are properly addressed.

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

Maintaining control over confirmations in electronic form may result in increasing certain risks that may not be as relevant when performing confirmation procedures in paper form. For example, risks relating to whether the information is obtained from an authentic source or whether the integrity of the information has been compromised may increase when the confirmation process is electronic. Although we believe that these risks exist even when confirmations are in paper form, we believe that, given the nature of electronic confirmation procedures, additional guidance about how to address these risks is appropriate.

As such, we believe additional guidance as set out in ISA 505, paragraphs A12 (refer to question 3 for text of paragraph A12) and A13, which specifically addresses the unique risks relevant to an electronic confirmation process, would be appropriate. Paragraph A13 states:

If a confirming party uses a third party to coordinate and provide responses to confirmation requests, the auditor may perform procedures



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 9 of 13

to address the risks that: (a) the response may not be from the proper source; (b) a respondent may not be authorized to respond; and (c) the integrity of the transmission may have been compromised.

Additionally, as set out in our response to question 4, we believe that examples that demonstrate how risks unique to the electronic confirmation process may be addressed should be included in any proposed standard.

Reliability of confirmation responses

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

We support incorporating the guidance from ISA 505, paragraphs 10 and 11, into a standard on external confirmations that provides guidance about what to do when (1) the reliability of a response is in doubt and (2) a response is deemed to be unreliable.

With respect to the use of electronic confirmations, additional matters to consider with respect to reliability include the guidance set out in AU Section 9330, paragraph .07. (Refer to question 3 above for text of paragraph .07).

Additionally, we recommend that the Board obtain input from information technology experts to help identify potential risks that may impact the reliability of electronic confirmation responses, including how these risks may be mitigated.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

Please refer to our response to question 3.

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

We are not aware of any other factors.



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 10 of 13

Exceptions and non-responses

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

We believe that the standard should require the auditor to perform alternative procedures for non-responses, except in the circumstance set out in AU section 330, paragraph 31, which states:

...the omission of alternative procedures may be acceptable (a) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (b) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated.

Further, we believe the requirement to perform alternative procedures for non-responses should be similar to ISA 505, paragraph 12, such that the auditor should perform alternative procedures to obtain relevant and reliable audit evidence and that examples of alternative procedures for selected accounts, similar to those provided in paragraph A18 of ISA 505, for accounts receivable and accounts payable, would be appropriate.

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

We believe the standard should require the auditor to investigate exceptions identified as a result of confirmation responses, consistent with the guidance included within ISA 505, paragraph 14, including the related application guidance in paragraphs A21 and A22. Paragraph 14 requires the auditor to investigate exceptions to determine if they are indicative of misstatements. The application guidance explains that exceptions may indicate misstatements or potential misstatements in the financial statements and that if a misstatement is identified, the auditor is required by ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, to evaluate whether such misstatement is indicative of fraud. Additionally, exceptions may provide a guide to the quality of responses received for similar accounts or confirming parties.



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 11 of 13

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

We believe that guidance that describes how the nature and extent of alternative audit procedures are affected by the account and assertion in question should be similar to that set out in paragraph A19 of ISA 505 and should not be a requirement. That guidance explains that a non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor.

With respect to investigating exceptions, while they may indicate misstatements (or potential misstatements) that require evaluation with respect to fraud or error, they may also represent such routine matters as clerical errors in completing the confirmation or timing differences in the confirmation process that do not represent misstatements. All exceptions that do not represent these types of routine matters should be investigated and considered as to their impact on the auditor's original risk assessment.

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

If confirmations are sent for such items as the significant terms of unusual or complex agreements or transactions, we believe that the alternative procedures in the event of non-responses would be dependent on the specific facts and circumstances, based on the nature of the item for which a confirmation was requested, the related assessment of risk and the strength of other audit evidence obtained addressing the same assertion that the confirmation was intended to address. Therefore, due to the wide variety of alternatives, it would not be appropriate to include specific alternative procedures in the standard that would be required whenever there is a non-response.

However, we believe that application guidance about how to determine the nature and extent of alternative procedures to address non-responses in this area would be helpful, in addition to examples of procedures to apply for various types of confirmed items.



BDO Seidman, LLP
Accountants and Consultants

Public Company Accounting Oversight Board
May 29, 2009
Page 12 of 13

Management requests not to confirm

- 20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not to confirm accounts, transactions, agreements, or other items?**

In addition to the guidance set out in the Concept Release, we believe that the guidance in ISA 505, paragraph 9, as set out below, would be appropriate to address the increased risk associated with a request by management not to confirm certain items:

- Communicate with those charged with governance if management's request is determined to be unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative procedures; and
- Evaluate the implications on the audit and audit opinion.

Disclaimers and restrictive language

- 21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?**

We believe that the auditor should be required to evaluate the effect of disclaimers and restrictive language on confirmation responses and to document the impact of such disclaimer or restrictive language on the use of the confirmation as audit evidence. In this regard, the guidance provided in ISA 505, paragraph A16, should be (1) supplemented to provide examples of the type of restrictive language being contemplated in the guidance (for example, language that disclaims on the accuracy or completeness of information), and (2) enhanced to include guidance about procedures the auditor should consider when the auditor has doubts about the reliability of the confirmation response due to the use of the restrictive language, in addition to when the restrictive language precludes the use of such information and as such, the confirmation response would be treated as a non-response. For example, if a restricted response is received in response to a confirmation request to confirm there are no side agreements, this should ordinarily cause a reevaluation of the auditor's risk assessment.



Public Company Accounting Oversight Board
May 29, 2009
Page 13 of 13

Further, we believe that the use of disclaimers and restrictive language on confirmations has had a negative impact on the reliability of audit confirmations, and we encourage the Board to engage in a dialogue with representatives of the banking regulators, the SEC, and others to develop an approach to confirmations that meets the needs of all interested parties and that is in the public interest.

Negative confirmations

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

We believe that there are instances when negative confirmations may be appropriate, such as those circumstances described in ISA 505, paragraph 15, where the auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion; the population comprises a large number of small, homogeneous, account balances, transactions or conditions; a very low exception rate is expected; and the auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

We believe that negative confirmations should continue to be permitted where considered appropriate, but should not be the sole source of evidence such that either the circumstances in ISA 505, paragraph 15 (as set out above), have been met or additional substantive procedures are performed that address the assessed risk of material misstatement at the assertion level.

We appreciate your consideration of our comments and suggestions, and would be pleased to discuss these with you at your convenience. Please direct any questions to Wayne Kolins, National Director of Assurance at 212-885-8595 (wkolins@bdo.com) or Susan Lister, National Director of Audit Policy at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO Seidman, LLP

BDO Seidman, LLP



California
Society
Certified
Public
Accountants

May 27, 2009

Office of the Secretary
PCAOB
1666 K Street, N. W.
Washington, D.C. 20006-2803

RE: Response to PCAOB Rulemaking Docket Matter No. 028

To the Members of the PCAOB:

The Accounting Principles and Auditing Standards Committee (the AP&AS "Committee") of the California Society of Certified Public Accountants (CALCPA) is pleased to provide our comments to the Public Company Accounting Oversight Board (PCAOB) on PCAOB Rulemaking Docket Matter No. 028, "Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations."

The AP&AS Committee is the senior technical committee of CALCPA. CALCPA has approximately 32,000 members. The Committee is comprised of 50 members, of whom 67 percent are from local or regional firms, 23 percent are sole practitioners in public practice, 5 percent are in industry and 5 percent are in academia.

General Comment

The Committee wants to emphasize its belief that the standards the PCAOB sets related to the audit confirmation process for audits of publicly owned entities should not differ significantly from the standards set for non-publicly owned entities. We noted the extensive efforts of the PCAOB to consider all the standards regarding audit confirmations in this Concept Release and commend it for these efforts. We recommend that the PCAOB carefully consider the content of the forthcoming Auditing Standards Board proposal to amend section AU330, which is planned to update the existing standard and converge it with International Standard on Auditing 505 ("ISA 505").

Objectives

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

1235 Radio Road
Redwood City, CA
94065-1217

(800) 922-5272
www.calcpa.org

There are inconsistencies in terminology. “Obtain sufficient, competent audit evidence” is the stated PCAOB proposed objective above, and these words are basically consistent with the third standard of field work at AU150.02, as well as AU sec. 326.1, to which the PCAOB refers in footnote 5. Changes proposed to that literature late in 2008 use the term “sufficient appropriate audit evidence.” This is an overarching concept. ISA 505 on confirmations uses the words: “obtain relevant and reliable audit evidence”. (in all, emphasis added.) “Relevant and reliable,” relate specifically to confirmations within the overarching concept of sufficient competent audit evidence.

The PCAOB proposed objective of audit evidence sought is “in response to identified risks.” AU sec. 330.06 says the audit evidence sought is “about financial statement assertions made by management.” Audit evidence is sought to address financial statement assertions, and this theme appears in various places in the auditing literature. No reason is given for the PCAOB’s reference to “identified risks” instead of financial statement assertions. ISA 505 does not state to what the audit evidence relates.

We suggest that the PCAOB adopt the ISA 505 approach, which is specific to confirmations. Thus, the objective would be stated:

The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definition of confirmation

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct on line access to information held by a third party? Why or why not?

Oral confirmations: The PCAOB definition of a confirmation on page 9 of the Concept Release does require external communication or access but does not require that the communication be in writing, which would allow oral communications to be considered “confirmations.” It also has the caveat from AU330.29 to get a written confirmation if the information is significant. ISA 505 requires the external communication be in writing, which excludes oral communications from the definition of “confirmations.” It also describes additional procedures if an auditor receives an oral communication.

We suggest that the PCAOB adopt the ISA 505 approach of requiring the external confirmation be in writing. Oral communications are not sufficiently reliable to be considered “confirmations.” Confirmation is a sufficiently important procedure that the PCAOB standard should require an adequate threshold of reliability.

Oral communications, if properly used, are a valid audit procedure. The PCAOB, in its standard, should include a discussion similar to that in ISA 505 paragraph A15.

The other than traditional responses should be allowed. Commerce is moving away from traditional mail, and audit confirmations should be able to move too. It is often easier to get a response by a non-traditional means, and in some cases, such as direct on-line access to information held by a third party, the “response” may be more reliable, and there may be better access to relevant information.

In defining a “confirmation” we recommend that the PCAOB incorporate paragraph 6 of ISA 505.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

The PCOAB should consider direction on the design of the confirmation request, specifically on determining the validity of the address to which the electronic confirmation is sent, and on the reliability of the responses to electronic confirmations and from third-party providers. See also our response to question 13 below.

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

These risks should be addressed in procedures for (i) selecting the appropriate confirming party, (ii) designing the confirmation requests, and (iii) reliability of the responses to the confirmation requests.

Selecting the appropriate confirming party is addressed in paragraph A2. of ISA 505, and we suggest that this be incorporated by the PCAOB in its standard.

The latter two are discussed in our responses to questions 9 and 10, and questions 11 through 15, respectively, below.

Requirement to confirm

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

The Board should not expand the presumptively mandatory requirement to request confirmation of accounts receivable to include the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. We are not aware of any demonstrated evidence that the existing “should consider” guidance in AU sec. 330.08 is inadequate. Articulating the

specific elements of “complex or unusual transactions” that ought to be confirmed would be difficult. And establishing the circumstances when the confirmation process may represent the most effective or efficient means to gather audit evidence with respect to assertions related to these transactions would also be difficult. Therefore, determining the appropriate audit procedures in these circumstances ought to be left to the professional judgment of the auditor.

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

The Board should, at a minimum, codify the guidance currently set forth in the interim audit standards, where the confirmation process is a suggested procedure, but refrain from establishing further mandatory items to confirm.

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

Many auditors have found the ability to confirm accounts receivable severely limited in certain industries, because of the lack of interest on the part of the debtors to respond to such confirmations (noted in the retail fashion industry, for example), or because the active response rate is inadequate, and have found the guidance in AU sec. 330.34 to be very useful. Therefore, the provision in AU sec. 330 allowing the auditor to apply professional judgment in determining when the use of confirmations would be ineffective ought to be retained in the standard. We believe the guidance set forth in Footnote 4 to AU sec. 330.34 that “if, based on prior years’ audit experience or on experience with similar engagements, the auditor concludes that responses are known or expected to be unreliable, the auditor may determine that the use of confirmations would be ineffective,” can be brought forward without modification.

8. Should the Board include direction in the standard on what constitutes “unusual” or “complex” agreements or transactions, including revenue transactions? If so, what should that direction include?

Consistent with our response to Question 5 above, we believe the existing guidance set forth in AU. sec. 330.08 is adequate. Auditors should be allowed to determine what constitutes “unusual” or “complex” agreements or transactions based on the application of professional judgment.

Designing confirmation requests

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

Yes. The first bullet point in this section should also address the assessed risks of material misstatement due to fraud. Fraud is discussed in the next section "maintaining control over the confirmation requests"; however, it is equally important to consider the design of confirmation requests to obtain additional corroborative information to address material misstatement due to fraud at the assertion level.

The confirmation requests should be designed to reflect management's authorization to respond to parties. Some parties may not be willing to respond to a confirmation request if not authorized by management.

The contents of ISA 505 paragraphs 7.(c) and A3. through A6. would be helpful and should be included.

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

Yes, addresses of confirming parties should be tested. The auditor needs assurance that confirmations are not misdirected by false addresses or interception to mitigate fraud risks.

The electronic form of confirmation requests presents a difficult situation. The auditor needs assurance that the confirmation process is secure and properly controlled. If the confirmation request and response are sent by electronic mail, the auditor should perform appropriate procedures to verify email addresses and to assure that the requests are sent to and received by the appropriate intended recipients. The auditor must consider what methods to use to mitigate the risk that the requests and responses are intercepted or altered. Such procedures as verifying email addresses or Web site authenticity, using encryption, or using digital signatures may help mitigate these risks.

Maintaining control over confirmation requests and responses

We recommend that a proposed standard not deal with control and reliability separately. It would be clearer if they were combined under a single heading "Reliability of confirmation procedures."

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

We recommend that the PCAOB incorporate paragraphs 7. and A2. through A.7 of ISA 505.

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

See response to question 13, below.

Reliability of confirmation responses

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

We recommend that the PCAOB incorporate paragraphs 10. and 11. and paragraphs A11., A12, A14. and A17 of ISA 505. In addition to our comments in response to Question 10 above, we recommend that the PCAOB provide guidance that the auditor should consider electronic confirmation results reliable if the electronic confirmation process is properly controlled, the information obtained is directly in response to a request, and the information is obtained from the intended respondent.

If the auditor plans to rely on a process for electronic confirmation between the auditor and the respondent, an assurance report addressing the risks discussed above may assist the auditor in assessing the design and operating effectiveness of the electronic and manual control techniques imbedded in that process. If these risks are not adequately addressed in an assurance report, the auditor may consider performing additional procedures to address those risks.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third party database or provided by the third-party service provider is reliable?

We recommend that the PCAOB incorporate paragraph A13. of ISA 505.

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

Response incorporated into response to question 13 above.

Exceptions and non-responses

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

Yes, the standard should, although it should employ the word "should" so that it will be a presumptively mandatory rather than an unconditional requirement. We recommend that the PCAOB incorporate paragraphs 12, 13, A18., A19. and A20. of ISA 505.

In performing alternative procedures for receivables by examining evidence of subsequent cash receipts, the auditor may consider documentation evidencing the existence assertion other than the invoices being paid and related shipping documentation.

We recommend that the standard permit an auditor to take into account an oral response to a confirmation request when considering what alternative procedures would be appropriate.

We recommend that circumstances under which an auditor, when testing for overstatement of amounts, may decide not to perform alternative procedures on non-responses be included. These circumstances may relate to the number, amounts or qualitative factors of the non-responses.

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

Yes. We recommend that the PCAOB incorporate paragraphs 14, A21. and A22. of ISA 505.

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

Yes, this is consistent with paragraphs A21. and A22. of ISA 505 and we recommend that the PCAOB incorporate those paragraphs.

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

Alternate procedures should be required, but the specific procedures performed should be left to the judgment of the auditor. We recommend that examples of specific alternative procedures not be included in the standard but perhaps alternatively in application guidance or supplementary information.

Management requests not to confirm

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Yes. We recommend that the PCAOB incorporate paragraphs 8., 9., and A8. through A10. of ISA 505.

Disclaimers and restrictive language

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

Yes. We recommend that the PCAOB incorporate paragraph A16. of ISA 505. We also recommend including guidance regarding when the auditor has doubts about the reliability of a response because of disclaimers or restrictive language. In those circumstances, the auditor should obtain additional audit evidence to resolve those doubts or treat the response as a non-response and perform alternate procedures.

Negative confirmations

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

Yes. We recommend that the PCAOB incorporate paragraphs 15 and A23. of ISA 505.

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

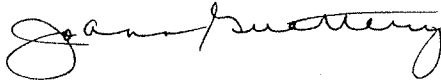
Yes. Additional substantive procedures are contemplated by ISA 505, paragraph 15.

Evaluating the Evidence Obtained

We note that the PCAOB did not request comment on evaluating the results of the confirmation procedures, even though the requirement is currently in AU sec. 330.33. We recommend that, for consistency, the PCAOB incorporate paragraphs 16, A24, and A25 of ISA 505 into any final standard.

We thank you for the opportunity to comment on this Concept Release. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Very truly yours,

A handwritten signature in cursive script, appearing to read "JoAnn Guattery".

JoAnn Guattery, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants

**CalPERS**

Investment Office

P.O. Box 2749

Sacramento, CA 95812-2749

Telecommunications Device for the Deaf - (916) 795-3240

Telephone: (916) 795-2731

May 29, 2009

J. Gordon Seymour, Secretary and General Counsel

Office of the Secretary

Public Company Accounting Oversight Board

1666 K Street N.W.

Washington, D.C. 20006-2803

RE: PCAOB Release No. 2009-002, Rulemaking Docket Matter No. 028

Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations

Dear Mr. Seymour:

I am writing you on behalf of the California Public Employees' Retirement System (CalPERS). CalPERS is the largest public pension fund, managing pension and health benefits for more than 1.6 million California public employees, retirees and their families. CalPERS manages approximately \$179.9 billion in assets.

We understand that through this rulemaking docket, the Public Company Accounting Oversight Board (Board) is evaluating its auditing standard on audit confirmation and is seeking public comment on the potential direction of a standards-setting project which could result in an amendment to AU sec. 330 or a new auditing standard that would supersede the current standard on audit confirmations.

As a long-term shareowner, CalPERS has a significant financial interest in seeking improvements in the integrity of financial reporting. The use of audit confirmations is a standard audit procedure which provides verification of the accuracy and existence of assets and liabilities of a company. Inherent in this audit procedure is the design and performance procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks. We believe that confirmations are an important source of the evidence auditors obtain as part of an audit of a company's financial statements and in ensuring the integrity of the company's financial reporting.

CalPERS is supportive of the Board and its evaluation of its existing auditing standard on audit confirmations AU sec. 330, the Confirmation Process. We agree and believe the confirmation process may need amending or a new audit standard that would supersede this existing standard with advancement in technology and the structuring of complex revenue and unusual transactions and agreements.

**California Public Employees' Retirement System
Lincoln Plaza East - 400 Q Street, Suite E4800 - Sacramento, CA 95811**

PCAOB Release 2009-009
May 29, 2009
Page 2 of 3

There are numerous examples of frauds¹ which continue to highlight the need for solid audit confirmation procedures and process. With this in mind, investors like CalPERS view the Board's evaluation of confirmation as critical, timely and as underline base of the integrity of financial reporting. We offer the following comments:

Definition of confirmation and requirement to confirm:

CalPERS supports the expansion of the definition of confirmation contained in AU sec. 330 to include direct access to information held by a third party. We also agree with the requirement to confirm, that the audit standard establishes the presumption that confirmations must be done. We believe with the depth and advances in technology that direct online confirmations may strengthen the audit confirmation process. However, we agree with advances in technology there is a higher risk that technology may be used to provide fraudulent confirmations as well. We agree and support that the objective of the confirmation standard should be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks.

Reliability of confirmation responses:

CalPERS believes the audit confirmation process should allow the auditor flexibility in determining the receipt of confirmation other than traditional mailed responses such as responses processed through third-party service providers, direct online access to information by a third party, etc. with the caveat that the auditor consider the risk, objectivity and competence in developing the audit confirmation procedures. We believe the auditor should be required to address and determine the level of risk in the design of audit confirmation procedures. We suggest the Board consider the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Enterprise Risk Management – Integrated Framework be considered in developing the requirements of audit confirmations and process.

Expansion and control of audit confirmation process:

CalPERS supports the expansion of audit confirmations to request significant terms of unusual agreements or transactions, including complex or unusual revenue transactions because of the risk of fraud. We also believe that auditors should consider confirming other items if risk factors warrant this additional confirmation. CalPERS agrees that the auditor should consider the effects of a respondent's objectivity and freedom from bias in designing the confirmation request and evaluating the results, including determining whether other procedures are necessary. We also agree with the Board that auditors must maintain control over confirmations since unauthorized individuals may acquire access into the confirmation process. We believe the audit work papers should document the assessment and mitigating factors considered and used in developing audit confirmation procedures to address this risk.

¹ Parmalat fraud, 2003, one of the largest cash and investment confirmation fraud

PCAOB Release 2009-009
May 29, 2009
Page 3 of 3

Additional/Alternative requirements for disclaimers, restrictive language or the inability to receive a confirmation:

CalPERS continues to believe that audit confirmation procedures should require the auditor to perform alternative procedures for non-responses to positive confirmation requests and require the auditor to investigate exceptions. Although these may be time consuming procedures, CalPERS continues to believe that performing alternative procedures and investigating exceptions may result in the identification of previously unidentified risk of material misstatements, including previously unidentified fraud risk factors that require evaluation.

We support the Board identifying additional procedures that need to be performed for disclaimers, restrictive language or the inability to receive a confirmation. We believe these present a red-flag that needs to be addressed to ensure the accuracy, reliability and existence of the data presented in the financial statements.

Thank you for considering our comments. If you would like to discuss any of these points please do not hesitate to contact me at 916-795-4129.

Sincerely,



Mary Hartman Morris
Investment Officer, CalPERS Corporate Governance

cc: Eric Baggesen, Senior Investment Officer – Global Equity, CalPERS
Kenneth W. Marzion – Interim Chief Operations Investment Officer, CalPERS
Bill McGrew, Portfolio Manager – Corporate Governance, CalPERS
Michael Riffle, Portfolio Manager – Corporate Governance, CalPERS



May 29, 2009

Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006
USA

By E-mail: comments@pcaobus.org

Re: Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations

Dear Mr. Seymour:

We would like to thank you for the opportunity to provide the Public Company Accounting Oversight Board (PCAOB) with our comments on the Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations (hereinafter referred to as "the Standard").

We believe that an updated Standard will provide a useful basis for improving the effectiveness and the efficiency of audits and more specifically will improve the audit confirmation process. We support revising the Standard.

The Concept Release asked for answers to specific questions and while we provide an answer to each question, we thought that it would be more beneficial to the PCAOB if we only took a position on the questions we felt we were best equipped to answer.

Questions raised by the PCAOB

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent evidence from knowledgeable third parties outside the company in response to identified risks?

Yes, the scope and focus of the confirmation standard should be to set the requirements that will improve auditor performance in designing and properly controlling the audit confirmation process.

Specifically, we believe the standard should start with the premise that the auditor's objective in performing audit confirmations is to properly control the process. Based on the high number of audit failures involving a compromised audit confirmation process, the standard should set the guidelines for what constitutes proper control over the confirmation process. Based on the collective guidance from the PCAOB, the IAASB and the ASB, as well as other non-authoritative research, we believe that proper control over the confirmation process requires the auditor to:

Properly control the process

1. Authenticate the identity and legitimacy of the responding source/entity;
2. Validate that the respondent is knowledgeable, free from bias, and authorized to respond on behalf of the responding source/entity;



May 29, 2009

3. Receive a direct, active response from the responding entity;
4. Ensure the integrity of the confirmation request and response throughout the process.

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party providers, and direct on-line access to information held by a third party?

We support an update to the definition by the PCAOB; however, we believe that this updated definition should take a forward looking approach since future technologies and processes will continue to improve the audit confirmation process. Therefore, we believe that instead of trying to identify within the standard all the approaches that exist today, and determining whether they meet the definition of a properly controlled confirmation process or not, that the new definition should allow for any confirmation process that adheres to the tenants of a properly controlled confirmation process. Through this approach the PCAOB ensures both adherence to the standard while crafting language that is prepared for each new advance in technology.

Specifically related to the question of which types of confirmations should or should not be allowed, we support the discussion from recent SAG meetings as well as ASB meetings that certain electronic processes such as email and direct access to a third-party database are unacceptable and not audit confirmations for assurance purposes but are instead alternative procedures.

Direct Access to Third-Party Database

Direct access to a third-party database is not a confirmation because there is not an active response and there is no ability for the auditor to assess the integrity of the data being pulled. It is also too easy for a client to create a fake website to circumvent the auditor's confirmation procedures.

Over the last several years, would-be thieves created fake Wells Fargo, U.S. Bank, Bank One, Citi Group and other banks' websites for their own gain, to steal important online banking information from customers. These fraudsters were even able to "highjack" and use an email with the real bank email extensions, a process called "phishing," and then direct bank customers to the fake websites. If the banks' own customers could not distinguish the real site from the fake site, auditors who might see this website only once a year may have trouble determining whether it is real or fake. Auditors may not be able to detect fake information unless they do more than a typical cursory review; they must take the time to validate a website's authenticity.

Validating the authenticity of a website, however, is extremely difficult and in some cases impossible. Fraudsters can purchase a website address, also known as a URL for \$35 with a name similar to the legitimate company's website, and pay an Internet Service Provider (ISP) less than a hundred dollars to host the website. Then the fraudster simply copies the source code from a legitimate website to create the replica site. (Once on a website, click your right mouse button and then select View Source from the drop down. Then highlight and copy the source code, and paste it into any website building software to create a replica of the legitimate website.) The new site might well contain a fake auditor log in section where audit confirmations are falsely responded to or provide "direct access" to the third-party database containing falsified information. The fake site can even provide the auditor with incorrect contact information, including email addresses, telephone and FAX numbers, and fake mailing addresses just in case the auditor attempts to validate the legitimacy of the website through



May 29, 2009

contacting the responding party. Because the fraudulent website is almost an exact replica of the original and valid website, the fraudulent website and email extension appear to be legitimate to those who do not have a day-to-day working relationship with that specific financial institution or responding company.

One way to discover who owns a website is to use the DNS (Domain Name Server) lookup feature available on the internet; however, the DNS lookup information is subject to being manipulated to appear legitimate, even stating the real names of executives at a bona fide company. There is no regulatory or governing body that proactively ensures the DNS information is correct. It is basically a self-regulated service. As a quasi-self-regulated service, fraudulent information is often used with DNS lookup information to prevent people from identifying the true owner of a URL. When a complaint is filed questioning a URL's DNS information, the owner of the URL is simply given the opportunity to update the DNS information over the Internet, using possibly false data again, and the process starts over.

Until a URL has received numerous complaints over an extended period, often many months, an extensive assessment may never take place. Fraudsters understand this process and use it to manipulate the system. They know that the amount of time and energy required to identify the true owner of the URL would be significant.

Email is Unacceptable

Email does not and should not constitute a confirmation. First, is email's lack of security and how simple it is to "sniff" an email. Because email is delivered over the open Internet and it bounces around from computer to computer before arriving at its destination, those looking to intercept email now use a technique called "sniffing" where a person can seek out and capture specific emails from or to certain people. In fact, a search on the term in both Google and YouTube provide "How To" instructions.

One suggestion of note is to use secure email to communicate securely with the responder; however, that would not necessarily detect fraud. Secure email only ensures that the two-way communication was done in a secure manner; it does not serve to authenticate the identity of the responder. That is because it is too simple for someone to "spoof" an email to make it appear that the confirmation response sent via email came from a particular individual or department within a responding company when in fact that person or that department did not respond. Therefore, email cannot be considered a valid confirmation for assurance purposes because of the inability of the auditor to validate the authenticity of an email.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

Confirmations using a properly controlled electronic process should be allowed within the standard. Like any confirmation process, confirmations sent through electronic means should be required to adhere to the tenants of a properly controlled confirmation process. Attachment 1 has been included as a sample evaluation form for assessing electronic confirmation processes.



May 29, 2009

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

The auditor should be required to authenticate that the confirmation is sent to and responded by the proper source, that the individual who responded is knowledgeable, free from bias and authorized to respond on behalf of that source.

Wayne Kolins, the National Director of Assurance for BDO Seidman stated at the PCAOB's June 2004 Standing Advisory Group¹ meeting that,

“I think the biggest problem that I see with confirmations is ‘who’ on the other side is actually signing the confirmations? Are they sufficiently knowledgeable? And is the auditor even thinking about that when he or she receives the confirmation? This is one of the most significant pieces of evidentiary matter that the auditors have (an audit confirmation) and to the extent that that is diluted is a significant detriment to the audit process.”

The auditor should also be required to provide assurance as to the integrity of the data throughout the entire confirmation process. Attachment 1 has been provided as a sample evaluation form to help the auditor assess the risk that the information is from the proper sources, and that the integrity of the data has not been compromised within an electronic confirmation process.

Looking at the definition of a properly controlled confirmation, as well as how audit confirmation frauds have happened or might happen, would be good ways to identify the proper suggested procedures as well. Examples might include:

Example 1 - Authenticate the Responding Source – Mark Morze, the CFO of ZZZZ Best Carpet Cleaning, used a friend’s home address for where a confirmation was sent.

Solution 1 - Independently look up the contact information (address, fax number, website, email, phone number) for every confirmation respondent before the confirmation is sent. The auditor should not rely on the client or client provided documentation or systems for the contact information of where to send a confirmation and to whom it should be addressed.

Example 2 - Validate the Respondent – during the Parmalat Fraud the bank that supposedly held the \$4.9 billion in cash has claimed that, though the name of the person who signed the confirmation was employed by the bank, she was not authorized to respond and she did not complete that confirmation. Or the CF Foods fraud where the owner of CF foods inflated receivables at certain customers and once those customers were chosen in the random sample selection, the owner of CF Foods simply called those customers, said that a mistake had been made, and could the customer please return the audit confirmation letter to the owner directly. The owner then completed the confirmation with the false information, signed his customer’s name and mailed it back to the auditor where the false balance matched exactly the fake documents that had been provided to the auditors.

Suggestion 2 – The auditor should call the individual who responded to the confirmation to verify that they did in fact complete the confirmation. The auditor should not ask the client for the contact information of that individual, but should instead independently look up that person’s contact information before contacting them.

¹ PCAOB Standing Advisory Group Meeting. June 21, 2004. Afternoon Session 1, timeslot 1:52:00/2:18:53. <http://www.connectlive.com/events/pcaob/>



May 29, 2009

Example 3 – Validate the Respondent is authorized to respond – during the Kmart, Ahold, and the Just for Feet audits where fraud occurred, the client directed the auditors to send the receivables confirmations to people like the National Director of Sales, the Corporate Account Managers, the Vice President of Business Development and other “relationship managers” instead of individuals within the Accounts Payable departments.

Suggestion 3 – The auditor should call the supervisor of the individual who responded to the confirmation to verify that the respondent is authorized to respond to an audit confirmation on behalf of that entity and the auditor should document that conversation. The auditor should not ask the client for the contact information of the supervisor, but should instead independently look up that person’s contact information before contacting them.

Example 4 – As part of their fraud, executives at HealthSouth manipulated the auditor’s confirmation process to inflate revenue almost \$400 million with the offsetting journal entry to Cash. It has been suggested that HealthSouth employees were familiar enough with the auditor’s confirmation procedures to understand that with several thousand bank accounts to confirm that the auditors did not send bank confirmations on accounts with less than \$10 million in the account. To conceal their fraud, HealthSouth allegedly created several hundred fake accounts that each contained less the \$10 million knowing that individually these accounts would not be selected for confirmation.

Suggestion 4 – It is understood that mailing confirmations is a tedious and time consuming process with 30-60 day turnaround times, however, the new secure electronic confirmation processes which reduce staff time and shorten turnaround times to 1-2 days can now be used in coordination with SAS No. 99’s requirement to alter the nature, timing and extent of the auditor’s procedures based on risk. In the confirmation area, auditors could now use electronic confirmations to increase their sample sizes and send confirmations more often throughout the year on a semi-annual or quarterly basis.

Additional guidance, like a Practice Alert or an addendum to the standard, might be used to more fully address many of these suggestions if there is not room within the body of the standard to provide complete guidance to the auditor.

5. Intentionally left blank.

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

The Board should require the auditor to also perform bank confirmations. Auditors must presume that there is a risk of fraud within Revenue during the mandatory brainstorming and planning session. To address the offsetting journal entry to Revenue within either Accounts Receivable or the Cash account, the auditor should be required to not only send receivable confirmations but also bank confirmations.

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?



May 29, 2009

Many auditors evaluate whether to send accounts receivable confirmations based on old confirmation processes and conclude that historically poor response rates and high error rates are indicative of the future and therefore conclude that accounts receivable confirmations are ineffective. However, auditors may inadvertently be drawing the wrong conclusion. Is it the accounts receivable confirmation that is broken, or the confirmation process they used that is broken? The PCAOB's research synthesis paper written by members of the American Accounting Association (AAA), as well as other more recent research, asserts that advances in new electronic confirmation processes are improving confirmation response rates while reducing the opportunity for fraudulent confirmations.

Additionally, it has been suggested that part of the motivating factor to label confirmations as ineffective has been the amount of time spent/wasted by auditors chasing confirmation responses.

While we do not support this approach to performing audits based solely on time and cost savings, we certainly understand the inefficiencies of outdated audit procedures. Therefore, we support the conclusion reached in the PCAOB commissioned research synthesis paper which states:

Technology offers the opportunity to authenticate confirmation responses and streamline the confirmation process.²

Evidence of how electronic confirmations have improved response rates, lowered error rates, and improved turnaround time is shown below in Table 1:

	Electronic Confirmations**				Mailed Paper
	2007	2008	2009	TOTAL	Confirmations
Response Rate*	100.00%	100.00%	100.00%	100.00%	71.55%
Reconfirmation Rate*	8.9%	8.3%	10.1%	9.9%	43.43%
Ave. Turnaround (days)	1.07	0.91	1.06	1.05	21.00
% Turned in 2 days	88.93%	92.47%	93.53%	93.05%	0%
% Turned in 3 days	94.15%	96.90%	95.94%	95.84%	0%
% Turned in 5 days	98.09%	98.57%	98.74%	98.67%	< 1%

* For Mailed Paper Confirmations, the results are the combined results from research studies looking at response rates: Davis et al. 1967; Sauls 1970; Hubbard & Bullington 1972; Armitage 1990; Engle 1991; Engle & Hutton 2001; Allen & Elder 2001; Elder & Allen 2005.

** For Electronic Confirmations, the results are weighted based on the number of electronic confirmations within each period through www.confirmation.com.

Copyright Capital Confirmation, Inc. 2009

8. Intentionally left blank.

9. Intentionally left blank.

² Caster, P., R. Elder, and D. Janvrin. 2006. A Summary of Research and Enforcement Release: Evidence on Confirmation Use and Effectiveness. (May): 23.



May 29, 2009

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirmation parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

In 1990 and 1991 when SAS No. 67 was being written, it was pointed out in an article titled Pitfalls in the Confirmation Process that the step of validating the mailing address was not written into the draft standard at the time. The response from those drafting the standard was that it was so obvious that validating the mailing address was a required part of performing the confirmation process correctly, that having to write this step into the standards would actually be an insult to the profession. However, today this step in the confirmation process is often not performed by auditors because of the time needed to perform this step correctly. We believe that the public, who relies on audit reports, would seriously question our audit approach if we as auditors chose not to do something as simple as validate a mailing address before we mailed a confirmation. Hindsight is 20/20, and while a jury may not understand off-balance sheet assets, they certainly understand not checking a mailing address. If our profession can't do what may seem simple to most, then how can we be trusted with the more complex aspects of the financial audit?

Yes, the auditor should be required to test all of the addresses (or other relevant contact information depending on the confirmation process used) for all of the auditor's confirmations. Independently validating all of the mailing addresses and contact information is part of performing the confirmation process correctly.

Take for example inventory counts. If there are a thousand SKUs and the statistical sample size selected is 126, the auditor is prohibited from counting just 63 of the SKUs and eyeballing the rest of the SKUs because it is too time consuming. The auditor must count all 126 SKUs selected as part of doing the inventory count correctly and for the sample to be a statistically valid representation of the entire population.

The same holds true for independently validating all of the mailing addresses for confirmations. Validating the mailing address is part of the auditor's responsibility to Control the confirmation process. If the auditor has a statement provided by the client, why send the confirmation at all if the auditor isn't going to validate the location for where the confirmation is sent? It is impossible for the auditor to place any reliance on the information provided in a confirmation response if the auditor can give no assurance as to the location of where the confirmation was sent.

P.O. Boxes

A P.O. Box as the mailing address for a confirmation is one of the "red flags" for auditors. Because places like The UPS Store, FedEx/Kinko's and other P.O. Box providers want to help small businesses look like larger business, they now offer "Real Street Addresses" as their #1 selling point in their marketing material (see Attachment 3) so that small businesses can appear bigger than they are. These providers also offer mail forwarding capabilities as well. While one of the providers has the tagline "It's our job to make your job easier," they might as well have told fraudsters "It's our job to make your *fraud* easier." Fraudsters can now provide the auditor with a real street address to limit suspicion. For a small cost, fraudsters can even set up multiple mail locations that appear to be legitimate customers or banks and simply have the store forward all the audit confirmations back to the fraudster. Then the fraudster can complete the confirmations with falsified information that matches the fake statements provided to the auditor.



May 29, 2009

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

Maintaining control of the confirmation process used to mean that auditors simply had to put the envelope in a blue U.S. Postal Service mailbox and that the response had to come back to our office, not the client's office. However, we as auditors are really losing control from the start because a large percentage of auditors continue to rely on their clients, or client provided systems or documentation, to tell them where and to whom to send the confirmation.

Regardless of the confirmation process used – mail, electronic, etc. – auditors need to perform the following steps to properly control the confirmation process to reduce the opportunity for their confirmation procedures to be circumvented by the client:

Properly control the process

1. Authenticate the identity and legitimacy of the responding source/entity;
2. Validate that the respondent is knowledgeable, free from bias, and authorized to respond on behalf of the responding source/entity;
3. Receive a direct, active response from the responding entity;
4. Ensure the integrity of the confirmation request and response throughout the process.

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

If the proper steps are followed to control the confirmation process then the type of process used – electronic, mail, etc. – should not matter. We do believe that the PCAOB could use additional guidance, such as practice alerts or an Electronic Confirmation Guide, to help the profession understand what procedures might be useful to ensure that the tenants of the confirmation process are adhered to.

One of the topics should cover the fact that each electronic confirmation service should have both a SAS 70 Type II and SysTrust certification because each is uniquely positioned to address different aspects of properly controlling an electronic confirmation process. For example, a SysTrust gives a higher level of assurance on security and data integrity than a SAS 70 Type II. A SAS 70 Type II is better than a SysTrust in evaluating the Authentication and Authorization procedures used by electronic confirmation services to authenticate the users and to define the access rights to the service. A SAS 70 Type II can also address items like insurances, service level agreements and background checks for those who oversee/manage the electronic confirmation service that are not addressed in a SysTrust.

A sample Electronic Confirmation Security Assessment is enclosed as Attachment 1 to this document.



May 29, 2009

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

The guidance regarding the auditor's responsibility for evaluating the reliability of the confirmation response should be reinforced by the updated standard. The auditor has to be responsible for evaluating and determining that the confirmation response is reliable. That is what the public expects and requires, anything less would result in the profession being seen as underperforming. If the auditor's procedures and control of the confirmation process do not provide the auditor with a high level of assurance as to the reliability of the confirmation response, then there is no real purpose in performing audit confirmations.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

Because direct online access to a third-party database does not involve an active response on the part of the responding party, according to the current guidance provided by the AICPA Updated Practice Alert 2003-01, direct online access to a third-party database does not constitute a confirmation for audit purposes.

We support the requirement that a valid confirmation process and response include an active response on the part of the responding third-party. Direct online access to a third-party database should continue to be defined as an alternative procedure.

When evaluating an electronic confirmation process, auditors should be required to ensure the electronic process adheres to the tenants of a properly controlled confirmation process.

Properly control the process

1. Authenticate the identity and legitimacy of the responding source/entity;
2. Validate that the respondent is knowledgeable, free from bias, and authorized to respond on behalf of the responding source/entity;
3. Receive a direct, active response from the responding entity;
4. Ensure the integrity of the confirmation request and response throughout the process.

We have provided a sample evaluation form as Attachment 1 that can be used by the auditor to address each of the tenants of a properly controlled confirmation process.

15. Are there factors other than those mentioned above that the auditor should consider when evaluation the reliability of electronic confirmations? If so, what are they?



May 29, 2009

Please see Attachment 1 which incorporates the factors the auditor should consider when evaluating the reliability of an electronic confirmation.

16. Intentionally left blank.

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses?

Yes, the auditor should be required to investigate exceptions identified as a result of confirmation responses. Not doing so will jeopardize the public's trust in the profession's audit procedures and will give opposing legal counsel room to criticize our professional judgment.

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses?

On September 22, 2004 Toby Bishop, a CPA and the then President and CEO of the Association of Fraud Examiners, said in a speech in Washington D.C. that:

"Fraudsters are the most reliable returners of auditors' confirmation letters, completed and signed without exception."

Toby was addressing the long overlooked fact that fraudsters understand that in order to cover up a fraud they must fool the auditor into believing the falsified financial statements. For audit assertions that are addressed through the use of audit confirmations, fraudsters know that auditors think the "red flags" in the confirmation process are (1) when a confirmation goes to a P.O. Box, (2) goes to an invalid address, (3) doesn't come back at all, or (4) comes back with different information than the auditor was provided by their client. This is why "Fraudsters are the most reliable returners of auditors' confirmation letters, (which are) completed and signed without exception." Fraudsters know that auditors will follow up if the address provided to the auditor is a non-existent address. Fraudsters know that the auditor will ask questions if the confirmation response provides different information than what was provided on the falsified bank statement or invoice. Fraudsters make sure that they can interfere with and circumvent the auditor's confirmation procedures in order to provide the auditor with a "signed" and "matching" confirmation that provides comfort to the auditor so that there are no "red flags" that lead to additional questions by the auditor.

In truth, confirmations that go to a nonexistent address or that come back with conflicting information are most often just errors. The real risk of confirmation fraud lies within the confirmations that come back signed and with matching information. To address the risk of confirmation fraud auditors should call the supposed responder back (using a phone number that the auditor has independently validated) and ask if that person really completed the confirmation and if the response information is correct. The auditor should also call the responder's supervisor to verify that the person who responded was authorized to respond on behalf of that entity.



May 29, 2009

19. Intentionally left blank.

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

By updating the confirmation process to be a properly controlled process, auditors should be extremely wary of a client who adamantly objects and refuses to allow the auditor to use the new confirmation procedures. Because the average fraud goes undetected for 18 months according to the Association of Certified Fraud examiners, in all likelihood, a client who has circumvented the auditor's confirmation procedures in the past will be extremely upset if the auditor incorporates an updated, more controlled process into their confirmation procedures.

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

Though some auditors don't realize it, the current Standard Bank Confirmation includes standard disclaimer language. Auditors should be encouraged to review such language and compare it to any additional disclaimers provided by the responding party.

Reviewing the current standard disclaimers may also reduce the chance that an auditor incorrectly relies on a confirmation response for more than the responder intended. For example, with bank confirmations, some auditors assume the bank is required to provide the auditor with information about additional accounts the client may have with the bank that the auditor did not list on the confirmation request. However, this is not true according to the agreed upon language between the accounting profession and the banking industry on the Standard Bank Confirmation form.

Standard Client Statement:

"Although we do not request nor expect you to conduct a comprehensive, detailed search of your records..."

Standard Bank Response:

"Although we have not conducted a comprehensive, detailed search of our records..."

Because of Sarbanes-Oxley and the enforcement of SEC Rule 13b2-2 which allows the SEC to bring charges against companies with employees who provide misleading confirmation responses to a public company's auditors, accounting firms should expect that the legal counsel for any company responding to an auditor's confirmation requests will contain new, additional disclaimer language. The recommended alternative to these disclaimers suggested by many law firms to their clients is to simply stop responding to audit confirmation requests because there is no law requiring them to respond to an audit confirmation request. A paper was written and published that was directed to those who respond



May 29, 2009

to audit confirmation letters encouraging them to participate in the audit confirmation process, and why “controlling the process” on their side was a better approach to reduce their risk of litigation than a “No Response.” That paper is included as Attachment 2.

During the April 2, 2009 Standing Advisory Group (SAG) meeting several of the members stated that the SEC should require that public companies respond to audit confirmations. We support the approach to require public companies to respond to confirmation requests and that non-public companies should be required to respond to audit confirmation requests from the auditors of public companies.

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

Because there may be certain circumstances where negative confirmations might be preferred over positive confirmations, we support the idea that the PCAOB should seek to limit the use of negative confirmations and should provide guidance to auditors as to when negative confirmations may be used.

23. Intentionally left blank.

Thank you for the opportunity to provide input into the standard setting process and we hope that our views will be helpful to the PCAOB as it deliberates on the final version of this proposed standard. If you have any questions relating to our comments in this letter, we would be please to discuss them with you.

Sincerely,

Brian Fox

Brian Fox, CPA
Vice President



ATTACHMENT 1 Electronic Confirmation Security Assessment

May 29, 2009

	Required for		Reviewed, Appropriate & In Place			
	In-Network	Out-of-Network	Yes	No	Notes	Reviewer
1. SAS 70 Type II						
1.01	Performed every 6 months	√	√			
1.02	Controls for Organization & Administration	√	√			
1.03	Controls for Systems Development & Change Management	√	√			
1.04	Controls for Computer Operations	√	√			
1.05	Controls for Physical Access & Environmental Controls	√	√			
1.06	Controls for Authenticated Proper Source	√	N/A			
1.07	Controls for Authorized Users	√	N/A			
1.08	Controls for Proper Client Authorization	√	√			
1.09	Controls for Data Integrity & System Transmission Integrity	√	√			
1.10	Controls for Electronic Signatures	√	√			
1.11	Controls for Backup & Recovery/Data Retention	√	√			
2. SysTrust Certification						
2.01	Performed every 6 months	√	√			
2.02	Includes Principle of Availability	√	√			
2.03	Includes Principle of Confidentiality	√	√			
2.04	Includes Principle of Processing Integrity	√	√			
2.05	Includes Principle of Security	√	√			
2.06	Includes Principle of Privacy	√	√			
3. Privacy Policy						
3.01	Certified by recognized 3rd Party (e.g. TRUSTe)	√	√			
3.02	Includes EU Safe Harbor Certification (highest available)	√	√			
4. Website Authentication						
4.01	Extended Validation SSL Certification by recognized 3rd Party (e.g. VeriSign)	√	√			
5. Disaster Recovery Plan						
5.01	Tested at least Quarterly	√	√			
6. Hosting Facilities						
6.01	Primary Hosting Facility with SAS 70 Type II or ISO Certification, minimum Tier 4 facility	√	√			
6.02	Separate Backup Hosting Facility with SAS 70 Type II or ISO Certification, minimum Tier 4 facility	√	√			
7. Insurances						
7.01	Rating A+ or better in the current Best's Insurance Reports published by A. M. Best Company	√	√			
7.02	E-commerce Technology Liability	√	√			
7.03	User Privacy Protection to cover 1 year worth of Consumer Credit Monitoring in the event of a Security Breach	√	√			
7.04	Commercial General Liability	√	√			
7.05	Professional Practice	√	√			
7.06	Umbrella Coverage	√	√			
8. Security						
8.01	Compliant with ISO 27001 Control Objectives					
8.02	All IT infrastructure & access limited to only company employees (e.g. including System Administration/Root Access)	√	√			
8.03	Physical and logical access control is a managed process (e.g. access control lists, change management, monitoring & logging)	√	√			
8.04	Only dedicated servers are utilized (e.g. no shared computing environments)	√	√			
8.05	All company employees have Federal & State background checks, annual drug testing, and are fingerprinted	√	√			
8.06	Sensitive confirmation data stored using cryptographic algorithms minimum key length 192-bit (e.g. Triple DES)	√	√			
8.07	Confirmation Data is transmitted with a minimum of 128-bit SSL using recognized 3rd Party encryption certificate (e.g. Verisign)	√	√			
8.08	Intrusion Presentation System (IPS) and Intrusion Detection System (IDS) are both deployed for security	√	√			
8.09	Web Application Firewall for HTTPS traffic inspection	√	√			
8.10	Defense in Depth strategy deployed	√	√			
8.11	External Vulnerability & Penetration Testing performed by recognized 3rd Party (e.g. McAfee Secure)	√	√			
8.12	Internal Vulnerability & Penetration Testing performed using industry standard tools (e.g. AppScan, Webinspect)	√	√			
8.13	Virus protection runs on all servers	√	√			
9. Electronic Confirmation Process						
9.01	A user cannot electronically sign someone else's name on the confirmation	√	√			
9.02	User activity is logged	√	√			
10. Additional Items						
10.01	Defined Service Level Agreement with Escalation Procedures	√	√			
10.02	Review Service Agreement	√	√			
10.03	Review Privacy Policy	√	√			

In-Network – Electronic confirmation service where responding companies have proactively signed up for a confirmation service where the confirmation service guarantees the Authentication of the responding party and has verified the Authorization of the responding individual ensuring they are knowledgeable, free from bias and authorized to respond on behalf of the responding entity.

Out-of-Network – Electronic confirmation service where the auditor Authenticates the responding party and determines the Authorization of the responding individual ensuring they are knowledgeable, free from bias and authorized to respond on behalf of the responding entity.

ATTACHMENT 2

YOUR COMPANY COULD BE AT RISK... AND NOT EVEN KNOW IT



*Chris Schellhorn, CEO of
Capital Confirmation, Inc.*

*“Why, you may ask,
would an employee
falsely respond to an
audit confirmation
request?”*

Being involved in a confirmation fraud will cost your company; and, the cost will be time and resources to defend your company and its name in a court of law – and in the court of public opinion. Just this year, several articles have been written warning companies about the risks of falsely responding to third-party audit confirmations.

Fraud incidents at Ahold, Kmart and Just for Feet are just some of the examples cited wherein employees at each of these companies persuaded employees at other companies to respond falsely to auditors’ confirmation requests.

Motivation to Participate in Fraud

Why, you may ask, would an employee falsely respond to an audit confirmation request? Normally, external pressure leads someone to the point where they become involved in a fraud. A financial incentive has been identified as the cause in many confirmation response fraud cases reviewed by the authors of this article. The threat of losing a large business account or one’s job has also been determined to play a role in this type of fraud.

For example, in the Kmart confirmation response fraud case, Kmart convinced employees (all sales and relationship managers) from at least four Fortune 1000 companies to respond falsely to an auditor’s confirmation request. The key fraudsters from within Kmart threatened outside relationship managers with loss of a Kmart account if the relationship managers did not

participate in the fraud. In two cases, Kmart employees threatened to transfer business to a customer’s archrival if they chose not to participate in the confirmation fraud.

Historically, the primary individuals who have participated in confirmation fraud are key employees in the sales and marketing areas, or key relationship managers, for the audited company.

The SEC’s Role

Companies continue to see that the SEC (Securities and Exchange Commission) files charges against the third-parties who participated in deceiving auditors with false confirmation responses, and point out the SEC’s ability to pursue these participants under Rule 13b2-2. This rule gives the SEC authority to pursue anyone doing business with a public company who knew, or should have known, the information provided to the public auditors would be misleading or false. The SEC’s trend in going after co-conspirators in a confirmation fraud is likely to continue.

In an attempt to control who has the ability to respond to confirmation requests, industry experts and law firms are advising companies to route the confirmations they receive to the accounting department, not through sales and marketing. Therefore, the responding company can be certain information provided to the auditors is accurate. This is a good step forward, but the question remains how to effectively accomplish this task.



Simply Centralizing the Response Won't Work

It seems obvious that a simple solution is to communicate a corporate policy to employees stating that all third-party audit confirmation requests are to be internally forwarded to a central response center. Normally, this would be the AP department, since that is where the knowledge resides regarding outstanding balances on accounts. While this is the correct department to respond, channeling the confirmation requests alone will not solve the problem.

Traditionally, auditors ask the audit client to provide a name and address to which the confirmation should be sent. And, audit clients normally provide their relationship manager's information. An employee at your company who is conspiring with the audited company to commit fraud will not forward the confirmation request to the AP department for response. The employee will, instead, sign the name of an AP staff member and send the fraudulent confirmation back to the public auditor. Instead of properly filing their fraudulent response, he/she will shred, burn, or throw away the copy of the response in an effort to hide his/her involvement.

While a central response center is a must, controlling how, and to whom, an auditor sends a confirmation is the key.

Errors, the Irrational Fear

Many authors and lawyers give stern warnings that you should consider a "No Response" policy to audit confirmations, for fear that an error will result in a legal liability for misleading a public auditor. This fear, however, is tenuous. When an auditor receives a confirmation response, the response is not simply taken at face value and booked to the audited company's financial statements. Instead, auditors compare the invoices and statements that were provided by the audited company to the confirmation response. The two documents must match before the auditor considers the confirmation response valid. If the invoice provided by the audit client and the confirmation response provided by your company do not

match, the auditor will contact your company to ascertain why there is a difference. The difference could be the result of a timing issue with booked entries, an unapplied



credit, or it may simply be an error. Regardless of the cause, the auditor determines the correct number and moves on with the audit. (Note: Because of the frequency of inaccurate responses, auditors are accustomed to receiving confirmation responses that do not match the statement they have been given by the audited company.)

Fraud, the Rational Fear

Though it may seem counterintuitive, confirmation fraud occurs when the auditor compares the invoices provided by the audited company to the confirmation response and the two numbers match – because unknown to the auditor, the number on both the invoice statement and on the confirmation response is fraudulent. Auditors are thrilled when numbers agree, and this is where fraudsters take advantage of the audit confirmation process. That is why it is more important for your company to fear the rogue employee who intentionally responds falsely and why you should not be concerned about an error in the confirmation response.

Solution

Your company should consider a confirmation response solution that allows for the following:

- 1.) Receiving control over how, and to whom, the auditors send confirmation requests.

- 2.) Centralized response center, which is usually the AP department.
- 3.) Automatic signature of the employee who responds to the confirmation, eliminating the ability for a rogue employee to sign the name of someone else on the confirmation response.
- 4.) Review storage that allows you to review all responses sent out by your company (this feature in concert with the automatic signature feature serves as a deterrent to an employee who even considers falsely responding because they know the false response will be tracked back to them).
- 5.) Response control that ensures your confirmation response is sent back to the public auditor and not the audited client.


Capital Confirmation Inc., has created a solution, called CONFIRM™, that adheres to the above criteria. CONFIRM™, was launched in 2003 and has been used successfully by Fortune 1000 companies to control confirmation responses. The service is delivered over the Internet; so, there is no hardware to buy or software to install.

About the Authors: Chris Schellhorn, CEO of Capital Confirmation Inc. has over thirty years experience delivering technology solutions to businesses and is well equipped to work with companies in the rapidly changing regulatory environment created by Sarbanes Oxley. Brian Fox, CPA & Associate Member of the Association of Certified Fraud Examiners, is the founder of Capital Confirmation Inc. Dave Malone, Vice President of Capital Confirmation Inc., is an industry veteran in technology based process improvement services. |APP



ATTACHMENT 3

May 29, 2009



Every aspect of your business matters. Including the address.

The UPS Store™

A number of advantages... all in one mailbox.

Mailbox services at The UPS Store offer convenience, professionalism, and an array of benefits to make your life easier.

- A real street address, not a P.O. box: A private mailing address gives your business the professional image you want.
- Package acceptance from all carriers: We'll hold your packages in a secure location for pickup at your convenience.
- Package notification: We'll let you know when a package arrives for you.
- Call-in MailCheck™: Save a trip... call to find out if you have new mail.
- Mail holding and forwarding: Just let us know when and where.

Your business address speaks volumes about who you are—and what your company is about. When you don't want to use your home address, but a P.O. box doesn't project the professional image you need, we have the solution.

Mailbox services from The UPS Store. We give you a real street address, not just a box number. And that's only the beginning. From convenient Call-in MailCheck™ to 24-hour access and much more, we invite you to discover the many services you'll receive as a mailbox holder with The UPS Store.

- Receipt of oversized parcels: Large packages are no problem for The UPS Store.
- 24-hour access: Pick up your mail and postal deliveries any time, day or night.
- Peace of mind: You no longer have to wait at home for a package delivery or risk having valuable shipments left on your doorstep.
- Convenience: The UPS Store also provides copying, binding, printing and a variety of document finishing services... so you can take care of business while you take care of the mail.

Mailbox services are provided at every one of our locations. You'll also find most of the postal products and services you need at your neighborhood The UPS Store. Ask us for details.

* Additional fees may apply.
** Available at participating locations.

The UPS Store centers are independently owned and operated by licensed franchisees of Mail Boxes Etc., Inc., an indirect subsidiary of United Parcel Service of America, Inc., a Delaware corporation. Certain restrictions of operation may vary by location.
©2004 United Parcel Service of America, Inc.



May 29, 2009

EXECUTIVE DIRECTOR

Cynthia M. Fornelli

GOVERNING BOARD

Chairman
James S. Turley, Chairman and CEO
Ernst & Young LLP

Vice Chair
Michele J. Hooper, Co-Founder
& Managing Partner
The Directors' Council

Vice Chair
Barry C. Melancon, President and CEO
AICPA

Charles M. Allen, CEO
Crowe Horwath LLP

Harvey J. Goldschmid, Dwight Professor of Law
Columbia University

Dennis M. Nally, Chairman and Senior Partner
Pricewaterhouse Coopers LLP

Ed Nusbaum, CEO and Executive Partner
Grant Thornton LLP

Lynn S. Paine, John G. McLean Professor
Harvard School of Business

Barry Salzberg, CEO
Deloitte LLP

Dave Scudder, Managing Partner
McGladrey & Pullen, LLP

John B. Veihmeyer, CEO
KPMG LLP

Jack Weisbaum, CEO
BDO Seidman, LLP

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

Re: Request for Public Comment: *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* - PCAOB Rulemaking Docket Matter No. 028

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization serving investors, public company auditors and the capital markets. The CAQ's mission is to foster confidence in the audit process and to aid investors and the markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants. The CAQ appreciates the opportunity to respond to the Public Company Accounting Oversight Board (PCAOB or Board) *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (the Concept Release). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member.

OVERALL COMMENTS ON THE CONCEPT RELEASE

We support the PCAOB's potential standard-setting project to amend AU Section 330, *The Confirmation Process*. We commend the PCAOB for soliciting input at an early stage in its standards-setting process. This Concept Release will enable the PCAOB to consider valuable input while it deliberates proposed changes to the existing standards. We encourage the PCAOB to continue to use concept releases or other means to obtain input on relevant issues for use in drafting proposed standards or revisions to existing standards.

Principles-based standards that support professional judgment

While we agree with the overall goal of updating existing auditing standards regarding confirmations, we are concerned that the Concept Release suggests that the Board may be considering a prescriptive approach. A number of the questions raised by the Board discuss potential new "requirements" that might be included in revised standards as opposed to guidance that would allow auditors to exercise appropriate professional judgment. We strongly encourage the Board to adopt a principles-based approach to the revisions of its confirmations standard. Such an approach is consistent with encouraging the use of the auditor's professional judgment in planning and performing audit procedures that are appropriately responsive to risks that the auditor has identified.

We believe new presumptive requirements should be avoided for the following reasons. Presumptively mandatory requirements would undoubtedly necessitate additional documentation and could have the unintended consequence of encouraging a checklist mentality, rather than increasing audit quality through the exercise of the auditor's professional judgment. One factor that has caused the Board to reconsider the auditing standards for confirmations is the changing methods of conducting business and evolving technology. Adopting a principles-based approach will allow for application of the revised standards to future changes in the way business is conducted and as technology evolves. Therefore we believe a better approach to improve audit quality is for the revised standard to provide guidance that aids auditors in making appropriate decisions.

Additionally, because third parties are not obligated to respond to an auditor's confirmation request, we caution the Board against expanding current unilateral requirements imposed solely on auditors (i.e., without the existence of obligations on third parties from whom confirmations are sought).

Consideration of relationship of confirmations to assertions

We believe the revised standard should acknowledge that confirmations are not always the response that will provide the most appropriate audit evidence. The proposed standard should include guidance about those assertions for which confirmations may provide little (if any) audit evidence, while also indicating those other assertions that are particularly suited to auditing with confirmations. For example, although a confirmation may provide significant audit evidence regarding existence of investments in securities, it may or may not provide evidence regarding the

valuation assertion depending on its nature, particularly in the absence of a readily determinable fair value.

Convergence of Auditing Standards

As indicated in several of our recent comment letters on the Board's proposed standards, we support the Board's consideration of the work of other standard setters, most notably the International Auditing and Assurance Standards Board (IAASB) and the AICPA's Auditing Standards Board (ASB). We strongly encourage the PCAOB to accelerate its efforts towards convergence by using the International Standards on Auditing (ISAs) as the base from which to develop standards (in this case, ISA 505 (Redrafted), *External Confirmations* (ISA 505)) and adding to or modifying the ISA wording for specific requirements and guidance deemed necessary for the purposes of auditing U.S. public companies.

We understand that the PCAOB has considered the ASB's current project to converge its confirmation standard with ISA 505. The ASB will shortly expose a proposed standard for public comment and a number of the issues addressed in this Concept Release have been considered by the ASB and related task forces. We encourage the PCAOB to specifically consider the ASB's proposed standard and the extant guidance in recently updated AU Section 9330, *The Confirmation Process: Auditing Interpretations of Section 330*, of the AICPA Professional Standards (vol.1). This interpretation addresses some of the auditing challenges relating to electronic confirmations.

Further study of audit confirmation process

Although it may delay slightly the standard-setting process, we recommend that the PCAOB conduct a study regarding the efficiency, effectiveness and reliability of confirmations, including third-party intermediaries, methods of increasing response rates and effects of technology. Specifically, we recommend that the PCAOB assemble a working group of auditors, issuers, banking regulators, bankers, other service providers and IT experts to discuss best practices available to auditors in improving the confirmation process, including designing confirmation requests, maintaining control over confirmation requests and responses and providing for the reliability of confirmation responses (including situations involving potential fraud). This working group also could address the issue of disclaimers or other restrictive language used by respondents and how such language could be modified or possibly eliminated.

SPECIFIC OBSERVATIONS

In the remainder of our letter, we have organized our observations with respect to questions posed in the Concept Release around the following topical areas:

- Objective and definition
- Determining when to use audit confirmations
- Exceptions and non-responses



- Consistent application of standards
- Use of third-party intermediaries
- Management requests not to confirm
- Disclaimers and restrictive language in confirmation responses
- Negative confirmations

Objective and Definition: The objective of a revised confirmation standard should be that as a result of the auditors' risk assessment process, when the auditor has determined that confirmations are appropriate, the procedures are designed and performed to obtain reliable audit evidence. The suggested objective in the Concept Release could be interpreted that the auditor should perform confirmations in all cases; we don't believe this is the intention of the Board, nor do we believe such an approach is appropriate. The PCAOB also should consider amending its proposed risk assessment standards to require the auditor to consider whether confirmations are appropriate (consistent with the requirement in ISA 330, paragraph 19).

In defining a confirmation, we encourage the PCAOB to more closely align its definition to that being used by the IAASB and the ASB. However, we do not believe that the definition should be limited by referring to a particular form of confirmation. We note also that the definition should address the situation where the auditor is provided with direct access to the information held by a knowledgeable third party (as is the case in some evolving electronic confirmation processes) instead of receiving a direct written response. With respect to "direct on-line access" as defined in Footnote 21 of the Concept Release, we agree that the auditor would need to use a separate password provided by the third party in order to independently confirm information held by the third party. If the auditor were to use a client's password, it would not serve as a confirmation, but rather as an alternative procedure.

In addition to providing an objective and a definition, the proposed standard should provide guidance on evaluating the relevance and reliability of responses to confirmations, including email, facsimiles, and other electronic responses from knowledgeable third parties. This guidance should include practical examples. In considering this guidance, we recommend that the Board refer to the guidance in ISA 505, paragraphs A12-14 and in AU Section 9330, *The Confirmation Process: Auditing Interpretations of AU Section 330* of the AICPA Professional Standards (vol.1). We also recommend that the Board solicit input from experts in electronic information exchange to identify potential avenues of manipulation in an exchange of information through direct online access, including how the occurrence of manipulation might be prevented or detected. Insights obtained might then form the basis for guidance about what the auditor could consider and how the auditor might respond.

We also do not believe that the definition of a confirmation should be expanded to include oral responses. An oral response often provides audit evidence, but should not constitute a "confirmation."

Determining when to use audit confirmations: We believe that the Board should focus on providing guidance to auditors to consider for determining *when* confirmations should be used (i.e., when confirmations might provide an appropriate source of audit evidence given the facts and circumstances), instead of creating presumptive requirements requiring their use. We do not believe the revised guidance should provide prescriptive requirements regarding what data should be confirmed. For example, we do not believe that the requirement to confirm accounts receivable should be expanded to require in all circumstances confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. Rather, the necessity of using confirmation procedures, as opposed to other available audit procedures, should be based on the auditor's professional judgment, guided by his or her risk assessments, and the consideration of the potential sources of audit evidence.

Exceptions and non-responses: We believe that auditors should resolve exceptions and follow up on non-responses; however the nature of those procedures should be determined by the auditor based on specific facts and circumstances. We believe the revised standard should continue to allow for the omission of alternative procedures in the circumstances described in Footnote 30 of the Concept Release.

Consistent application of standards: In considering a revised standard—particularly aspects that address recipient address validation, confirmation control and authentication of responses—we recommend that the PCAOB provide consistent guidance regarding the ultimate objectives for both manual and electronic confirmations. For example, the fact that more procedures can be performed to authenticate an electronic confirmation does not mean that it is necessary to perform all of them to achieve the objectives. The objectives that must be achieved for electronic and manual communications are the same in both cases, although the techniques may vary. As indicated above, we believe that the requirements in the revised standard should not be overly prescriptive, nor should they be focused on the form of the confirmation. Instead, guidance could be provided as to how to evaluate relevance and reliability of audit evidence from confirmations whether from electronic or paper sources.

Use of third-party intermediaries: The use of an intermediary introduces additional risk relating to the reliability of confirmations, including that the information may not be obtained from an authentic source, the respondent may not be knowledgeable about the information to be confirmed or the integrity of the information may be compromised. When a third party facilitates the confirmation process between the auditor and the respondent, the auditor should understand the role of the third party. The auditor may determine it to be necessary to evaluate and/or test controls when assessing the reliability of confirmations received through third parties. The Board may therefore want to consider whether and how an assurance trust services report (for example, SysTrust), or another type of auditor's report on that process, may assist the auditor in assessing the design and

operating effectiveness of the electronic and manual controls, and include appropriate guidance within its revised standard.

Management requests not to confirm: Due to the risk associated with a request by management not to confirm certain items, we support the inclusion of the following procedures for the auditor to consider (see paragraphs 8 and 9 of ISA 505):

- Inquire as to management’s reasons for the request, and seek audit evidence as to their validity and reasonableness;
- Evaluate the implications of management’s request on the auditor’s assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures;
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence;
- Communicate with those charged with governance if management’s request cannot be validated, is determined to be unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative procedures; and
- Evaluate the implications on the audit and audit opinion.

Disclaimers and restrictive language in confirmation responses: We agree with the Board’s observation that depending on the nature of the risk, a disclaimer or the use of restrictive language may limit the amount of evidence that is provided by a confirmation. While it would be valuable for the standard to remind auditors of this, we are concerned that any new detailed requirements, which by their nature would not address all situations or types of disclaimers, might tend to replace professional judgment with a mechanical approach. However, more guidance on how disclaimers and other restrictive language might be considered in connection with the auditor’s assessment of the relevance and reliability of audit evidence provided by confirmations would be useful.

Additionally, the fact that some respondents use disclaimers and other restrictive language highlights a fundamental flaw of imposing unilateral requirements on auditors without first addressing respondents’ obligations and mechanisms that might reinforce their responsibilities relating to responding to confirmation requests, which is a broad and complex policy issue. At a minimum, and as an important first step, we strongly encourage the Board to work proactively with organizations that represent issuers, banking regulators, the SEC and others to develop a solution to this issue that is in the public’s best interest, while being sensitive to the respondents’ liability concerns. This issue must be addressed at its root cause; an approach that only places additional requirements on auditors when confirmations are received with disclaimers and restrictive language is not in the public interest.



Negative confirmations: We believe that the evidence provided by negative confirmations is limited and less persuasive than the evidence provided by positive confirmations. Nevertheless, we believe the use of negative confirmations should continue to be allowed. Based on auditor judgment relative to audit risk, the use of negative confirmations represents an audit technique that, in limited circumstances, may provide an appropriate source of audit evidence, and as a matter of practicality, may be the only type of substantive procedure that could be performed without undue audit effort and associated cost. As a result, we are supportive of the requirements and guidance regarding negative confirmations in the PCAOB's extant confirmations standard (which also are consistent with ISA 505) being included in its new confirmations standard.

* * * * *

We appreciate the opportunity to comment on the Concept Release and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc: PCAOB

Mark W. Olson, Chairman
Daniel L. Goelzer, Member
Willis D. Gradison, Member
Steven B. Harris, Member
Charles D. Niemeier, Member
Martin F. Baumann, Chief Auditor and Director

cc: SEC

James Kroeker, Acting Chief Accountant



CENTER FOR AUDIT QUALITY

**Deloitte & Touche LLP**

Ten Westport Road
Wilton, CT 06897-0820
USA

Tel: +1 203 761 3000
Fax: +1 203 761 3013
www.deloitte.com

May 29, 2009

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

Re: PCAOB Release No. 2009-002, Rulemaking Docket Matter No. 028

Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations

Deloitte & Touche LLP is pleased to respond to the request for comments from the Public Company Accounting Oversight Board ("PCAOB" or the "Board") on its *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*, PCAOB Release No. 2009-002, PCAOB Rulemaking Docket Matter No. 028 (April 14, 2009) (the "Concept Release"). We hope that this submission will be useful to the Board as it considers the direction of a proposed standard-setting project on audit confirmations. The response is divided into two sections: a general comments section and a section with our responses to the specific questions posed in the Concept Release.

General Comments

We commend the PCAOB for considering revisions to its audit confirmations standard (PCAOB interim standards AU 330) given the significance of the changes in the environment since its adoption, particularly the advances in technology since that time.

Use of Concept Releases to Seek Public Comment

We particularly commend the PCAOB for its decision to seek early input to its standard setting activity in the form of the Concept Release. We strongly encourage the PCAOB to continue to use concept releases or other similar mechanisms to obtain input and solicit viewpoints from stakeholders as future auditing standards are developed or existing standards are revised.

Notwithstanding that soliciting input through the use of a concept release (or by other means) represents an additional step in the process to issue a final standard, we think it may actually result in shortening the overall time taken to finalize a new standard or to revise an existing one. Involving the public early in the standard-setting process will provide potential respondents with the opportunity to surface significant issues and concerns early in the process. The PCAOB will thereby be provided the ability to be aware of such issues and concerns and take appropriate action to address them in a proposed standard. As such, the use of the concept release (or something similar) should reduce the extent of significant comment on an exposure draft of a proposed standard. Fewer and less significant comments will expedite the PCAOB staff's process of considering comments and revising a proposed standard as necessary before finalization. Obtaining feedback early in the process could also prevent

having to re-expose proposed standards as significant issues will have likely have had an opportunity to be surfaced, deliberated and addressed.

Convergence of Auditing Standards

As discussed in detail in our comment letters to the PCAOB on the Proposed Auditing Standards, *The Auditor's Assessment of and Response to Risk* and the Proposed Auditing Standard, *Engagement Quality Review*, we strongly encourage that the PCAOB, in revisiting its existing standards or in considering new standards, adopt an approach where consideration is given to the activities of other standard setters, most notably the International Auditing & Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB). We recommend that wherever feasible, the PCAOB converge its standards with those of the IAASB by using the equivalent International Standard on Auditing (ISA) as the base for a revised or new standard. As the Board continues in its efforts to revise the confirmations standard, it should converge the standard with ISA 505 (Redrafted), *External Confirmations* (ISA 505). In addition, we are aware that the ASB will soon expose a proposed standard on audit confirmations that has been converged with ISA 505. Many of the issues and questions raised in the Concept Release have been debated and discussed by the ASB during the drafting of its proposed standard. We encourage the PCAOB to consider the guidance that has been incorporated into the ASB's proposed standard, including the guidance in AU Section 9330, *The Confirmation Process: Auditing Interpretations of Section 330*, of the AICPA Professional Standards (vol.1) ("AU Section 9330"). This interpretation addresses issues relating to the use of electronic processes for confirmations.

Principles versus Prescriptive Requirements

In acknowledging our strong support for converging with the ISAs, we wish to particularly acknowledge our support for "principles-based" rather than "rules-based" standards, and in particular the principles-based approach in ISA 505. The use of principles-based standards results in less prescriptive requirements and also in fewer requirements. The application of such standards provides for, and necessitates a greater level of professional judgment to be used by the auditor. We are concerned that the questions posed in the Concept Release suggest the PCAOB is considering more "requirements" for audit confirmations (i.e., a "rules-based" approach) as opposed to an approach that would better support the use of auditor judgment in determining whether (and the extent to which) to use confirmations. We believe that establishing overall requirements and then providing guidance to the auditor on items to consider when applying those overall requirements is a more effective method of developing standards and is consistent with a risk-based audit model.

Other issues also exist with respect to creating additional requirements relating to use of confirmations. Establishing more requirements to obtain confirmations may create the impression that confirmations are more reliable than other forms of audit evidence. Confirmations may not however always be the most appropriate audit procedure in the circumstances because, as acknowledged in the Concept Release, confirmations have limitations. Adding detailed requirements to confirm specific balances or transactions and to perform specific procedures relating to confirmations in all circumstances, in addition to being inherently inconsistent with acknowledging that confirmations have shortcomings, also limits the auditor in determining whether confirmations would be the most effective audit procedure given the risks identified. Additional presumptively mandatory requirements to obtain confirmations for specific areas could potentially create a mechanical process where the auditor "checks off" the procedures stated in the requirements as opposed to evaluating whether confirmation

procedures would be appropriate in the circumstances. This may also contribute to auditors over-relying on confirmations when other procedures would have been more effective.

We acknowledge that a “principles-based” approach to standard setting increases the challenges for those who are reviewing the work that has been performed in terms of such standards (e.g., engagement quality review, inspection) when compared to the challenges of reviewing or inspecting work performed under more rules-based standards. The review or inspection of the application of professional judgment is complex and in and of itself necessitates significant judgment in evaluating whether and how the requirements have been satisfied through the work the auditor has performed. However, notwithstanding these challenges, we believe that the application of principles rather than rules when performing an audit more appropriately recognizes the diversity and complexity of financial reporting that exists today and the related complexity that needs to be considered in planning and performing appropriate audit procedures that are responsive to the associated risks.

Limitations and Other Challenges Related to Reliability of Evidence Provided By Confirmations

As noted above, confirmations have inherent limitations and are subject to manipulation, possibly in an attempt to conceal fraud from an auditor. Additionally, we have noted that respondents are increasingly reluctant to respond to confirmation requests. We also see an increasing trend towards the inclusion of disclaimers and restrictive language in confirmations, which may impact their reliability as audit evidence. Including additional requirements in a revised audit confirmations standard as to when confirmations would be required would only serve to compound these issues.

We believe that it would be in the public interest for respondents to confirmation requests to be more accountable for responding promptly, accurately and completely to confirmations and without using unnecessary restrictive language. We realize that addressing respondent’s obligations and the mechanisms that might be put in place to reinforce their responsibilities is a broad and complex issue. We recommend that the PCAOB consider taking the lead in an effort to work with issuers, the SEC, banking and other regulators, auditors, investors and others with the objective of surfacing and discussing the issues and collectively developing a mutually acceptable approach to improving the effectiveness of the confirmation process.

Evolving Trends Impacting Reliability of Confirmations

As acknowledged in the Concept Release, significant advances in technology are continuing to impact the manner in which confirmations are performed. These new approaches may improve response times and may claim to increase the reliability of responses, however, at the same time they also give rise to new risks that responses might not be reliable; for example, new risks that responses might not be from a proper or authentic source, that the respondent might not be knowledgeable about the information being confirmed and that the integrity of the information may have been compromised. We believe that it would be very helpful for the revised standard to include guidance for the auditor relating to the types of risks that might present themselves and which the auditor would need to consider as part of satisfying the more overarching requirement to evaluate the reliability of the evidence obtained through a confirmation. To this end, we recommend that the Board consider establishing a working group comprised of auditors and information technology experts to consider the various confirmation response models that have evolved (and that are continuing to evolve) and how these models impact the risks discussed above and the auditor’s ability to obtain reliable audit evidence.

Responses to Questions in the Concept Release

Objective

1. *Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?*

We believe that the objective of the confirmation standard needs to be premised on the auditor having already made the determination that confirmations will be used in obtaining audit evidence for a particular assertion for a significant account balance or disclosure. Without this premise, an objective such as the one proposed could be interpreted as requiring the auditor to design and perform confirmation procedures in all cases. Once it is determined that confirmation procedures will be performed, then the confirmations standard should address designing and performing such procedures to obtain relevant and reliable audit evidence. This is made clear in the ISAs through (1) the inclusion of a requirement for the auditor to consider whether confirmation procedures should be performed as substantive audit procedures in paragraph 19 of ISA 330, *The Auditor's Responses to Assessed Risks*, and (2) the manner in which the objective is drafted in ISA 505.

We therefore recommend that:

- A requirement similar to paragraph 19 of ISA 330 be incorporated in the Board's proposed risk assessment standard, *The Auditor's Responses to the Risks of Material Misstatement* (i.e., PCAOB Release No. 2008-006, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*, Appendix 4), and
- The objective of the PCAOB's revised audit confirmations standard be consistent with ISA 505, as follows:
 - "The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence."

Please note that we specifically recommend using the terminology "relevant and reliable audit evidence" and not "sufficient, competent audit evidence" as suggested in the question in order to maintain consistency with the ISA as well as the PCAOB's proposed auditing standard, *Audit Evidence*, which requires that the auditor obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion and sets forth that "to be appropriate, audit evidence must be both relevant and reliable."¹

Definition of confirmation

2. *Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, e-mail, responses processed through third-party service providers, and direct online access to information held by a third party? Why or why not?*

¹ PCAOB Release 2008-006, Appendix 7 – Proposed Auditing Standard, *Audit Evidence*, paragraph 6.

The definition of an external confirmation should be principles-based and should not attempt to include all the various ways in which a confirmation response might be received. We also believe strongly that it would be desirable for there to be convergence between the PCAOB's standards and the ISAs on the definition of an external confirmation. ISA 505 defines an external confirmation as "audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium." This definition does not specifically provide for the advances in technology that have given rise to the emerging practice whereby the auditor does not receive a direct written response but rather, is provided secure access to the information that the auditor is seeking to confirm (e.g., through a secure website or other means.) We note that the Board is considering expanding the definition of an external confirmation to address this situation and we are supportive of doing so. Consequently we recommend that the Board consider the following proposed definition of an external confirmation:

"Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form or by electronic or other medium or through the auditor's direct access to information held by a third party"

We do not agree that the definition of an external confirmation should be expanded to include oral responses, particularly if the basis for doing so is to address the risk that auditors might otherwise be discouraged from using external confirmations. As noted in the Concept Release, ISA 505 states that an oral response to a confirmation request is not an external confirmation because it is not a direct written response to the auditor. We believe appropriately documented oral responses to confirmations contribute to audit evidence. We would therefore be supportive of the PCAOB's confirmations standard including guidance to clarify that oral responses contribute to the auditor's overall evidence, but would need to be supplemented with additional procedures in order to support a conclusion that sufficient appropriate audit evidence has been obtained. Guidance should also be included to address what documentation would be expected to be included in the audit working papers. By providing guidance of this nature, the Board would be addressing the situation sometimes encountered in practice where only an oral response has been received and it is not practical or possible to obtain a written response, given time or other constraints in the circumstances.

3. *What direction should the standard include regarding the use of electronic confirmations and third-party service providers?*

We encourage the PCAOB to include guidance in its proposed standard to assist the auditor when he or she uses electronic confirmations and third-party service providers in performing confirmation procedures. This guidance should focus on considerations relevant to maintaining control over the confirmation process and evaluating the reliability of the responses. We recommend that the PCAOB refer to the guidance in ISA 505 (paragraphs A12 - A14) and in AU Section 9330, both of which address the use of electronic confirmations and third-party service providers. Please refer to our suggestion in the Overall Comments section about establishing a working group to provide input to the PCAOB on this matter.

4. *What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?*

We believe that the revised standard should include principle-based requirements addressing the auditor's evaluation of the reliability of responses (see for example paragraphs 10 and 11 of ISA 505), rather than detailed and granular requirements specific to performing procedures to address the risks that information is not from a proper source and that the integrity of the data has been compromised. Guidance may however be developed that specifically addresses these two risks, as well as other risks that might affect the reliability of responses to confirmation requests. Examples of such guidance can be found in AU Section 9330.

Requirement to Confirm

5. *Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?*

Please refer to our comments in the Overall Comments section. We are not supportive of expanding the presumptively mandatory requirement to request confirmation of accounts receivable to other areas. Given the diversity and complexity of different entities and industries, the different nature of risk assessments made by auditors and the merits of using different audit strategies, the use of a confirmation in a particular circumstance may not be the most appropriate audit response.

6. *Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?*

Consistent with our remarks in the Overall Comments section, under a risk-based audit model, auditors should be allowed to exercise judgment when deciding whether confirmations are the most appropriate audit evidence to seek for a particular assertion. The use of a confirmation for all or part of the audit evidence may be the most effective audit strategy in some cases, but in other cases a confirmation may not be the most appropriate audit response. The standard should provide principle-based guidance on the factors which would make confirmation an effective audit strategy, on its own or in combination with other audit procedures (see paragraphs A48-A51 of ISA 505).

7. *Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?*

The PCAOB's current standard provides the framework to evaluate whether confirmation of accounts receivable would be ineffective and requires the auditor to document how he or she overcame the presumptive requirement (see PCAOB interim standards at AU 330.34.) We believe this framework is adequate, appropriate to retain, and that no additional procedures should be required.

8. *Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?*

See our response to question 5. We don't believe that it is necessary for the revised auditing standard to attempt to provide further direction on this matter.

Designing confirmation requests

9. *Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?*

We recommend that the revised standard include (1) an overall requirement similar to ISA 505, paragraph 7(c) regarding designing the confirmation requests including that they are properly directed to the confirming party, and provide for being responded to directly to the auditor and (2) supporting guidance similar to that in ISA 505, paragraphs A3-A6.

10. *Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?*

We believe that testing the addresses of the confirming parties is part of satisfying the requirement in paragraph 7(c) that is referred to in our response in question 9. We do not therefore believe that an additional requirement to this effect is necessary; rather, the revised standard should include guidance similar to that in ISA 505, paragraph A6. Such guidance may also be expanded to address e-mail addresses or other electronic processes.

Maintaining control over confirmation requests and responses

11. *What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?*

We recommend that the revised standard adopt the requirement in ISA 505, paragraph 7 and the guidance in paragraphs A1-A7.

12. *What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?*

See answer to question 10. We are supportive of additional guidance regarding maintaining control over confirmations in electronic form being provided. We recommend that the PCAOB refer to and adopt the guidance in AU Section 9330.

Reliability of confirmation responses

13. *What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?*

The overall assessment of reliability of audit evidence is addressed in paragraph 8 of the PCAOB's proposed standard on *Audit Evidence* (Appendix 7 of PCAOB Release No. 2008-006.) This is similar to the requirements in ISA 500 *Audit Evidence*. We recommend that the PCAOB therefore include requirements similar to ISA 505, paragraphs 10 and 11, in its revised confirmations standard to specifically address evaluating the reliability of confirmation responses. These requirements support the overarching requirement in the PCAOB's proposed standard on audit evidence. Including more prescriptive requirements for evaluating the reliability of confirmations could create a double-standard for audit evidence obtained from confirmations in that a higher quality of audit evidence would be necessary for confirmation responses when compared to other types of audit evidence. We further recommend that the PCAOB include guidance similar to paragraphs A11 through A17 of ISA 505. These paragraphs in ISA 505 include reliability considerations for electronic responses; the PCAOB may also refer to AU Section 9330 for additional guidance.

In addition, paragraph 9 of the PCAOB's proposed standard on *Audit Evidence* (Appendix 7 of PCAOB Release No. 2008-006) notes that "the auditor is not expected to be an expert in document authentication." We agree with this statement in that the auditor is not trained in data authentication procedures and thus should not be expected to detect intentional manipulation of confirmation responses. Providing additional guidance regarding the auditor's evaluation of the reliability of confirmation responses (as opposed to detailed requirements) supports the concept that the auditor is not an expert in document authentication.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

Additional guidance should be provided for these types of situations as opposed to additional requirements. The PCAOB should refer to and adopt the guidance in AU section 9330.

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

We believe the factors mentioned in the Concept Release are appropriate factors that the auditor may consider when evaluating the reliability of electronic confirmations. Consistent with prior comments, we do not believe that the revised standard should include incremental requirements to this effect.

Exceptions and non-responses

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

We believe the standard should require the performance of alternative procedures for non-responses to positive confirmation requests. If the auditor does not perform such procedures on non-responses, the auditor will not have a basis for concluding whether there is a misstatement related to the selection for which no response has been received and consequently will not be

able to conclude as to the results of the test overall. Non-responses may also be indicative of a previously unidentified risk of material misstatement that would need to be assessed by the auditor. The auditor's assessment could result in a modification to his or her audit procedures. We are also supportive of including the guidance in PCAOB interim standards AU 330.31, which addresses the very limited circumstances when the omission of alternative procedures may be acceptable, although it could be argued that following the guidance in this paragraph already represents alternative procedures that the auditor is performing.

17. *Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?*

The revised standard should (similar to ISA 505, paragraph 14) require the auditor to investigate all exceptions identified to determine whether they are indicative of misstatements, and if so, should consider whether the misstatement is indicative of a fraud. See also guidance in ISA 505, paragraphs A21-A22.

18. *Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?*

We believe the auditor's consideration of previously unidentified risks of misstatement, including fraud risks, is addressed by the requirements in the PCAOB's proposed standard Identifying and Addressing Risks of Material Misstatement (Appendix 3 of PCAOB Release 2008-006.) We therefore recommend that a reference be included to such requirements rather than creating incremental and redundant requirements in the revised confirmations standard.

19. *Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?*

As discussed in the answer to question 16, the standard should require alternative procedures for non-responses; however the standard should not specify the required alternative procedures to be performed by the auditor for non-responses when the auditor is confirming significant terms of unusual or complex agreements or transactions. Because the nature of unusual or complex agreements or transactions could vary significantly, it would be difficult to determine procedures that would address every type of situation. As noted in question 8 above, we do not think "unusual" or "complex" transactions should be defined in the standard because of their nature. It may however be helpful to include *guidance* as to procedures that the auditor *may* consider performing.

Management requests not to confirm

20. *Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions,*

agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

We believe the revised standard should include required procedures for the auditor to perform to address situations in which management requests the auditor not to confirm certain items. We believe the procedures included in the Concept Release are appropriate, yet we recommend the PCAOB be consistent with the requirements in ISA 505 related to this topic. We specifically recommend the inclusion of a requirement that the auditor communicate with those charged with governance when the auditor concludes that management's refusal is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures.

Disclaimers and restrictive language

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

We are supportive of additional guidance being provided about the possible impact that disclaimers and restrictive language included in confirmation responses may have on the relevance and reliability of audit evidence obtained there from. Providing guidance with respect to disclaimers would support principle-based requirements for evaluating reliability (as discussed in question 13 above.) We do not believe, however, that additional requirements should be established. It should also be noted that the auditor's proficiency is in auditing and accounting matters, not legal matters, and as such, including requirements for auditors to evaluate disclaimers or restricted language would not be appropriate. Our experience is that disclaimers have become more commonplace in recent years by respondents wishing to limit their legal liability or provide a legal defense for the respondent in the future. In some cases, disclaimers which may potentially impact the auditor's reliance on the confirmation can be addressed through performing additional audit procedures. The guidance provided by the PCAOB may address the types of disclaimers or restrictive language that might be encountered, and may also suggest, but not require, consultation with the auditor's counsel.

Negative confirmations

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

We have concerns about the significant limitations of negative confirmations and believe that in almost all cases, other substantive audit procedures are more effective, and can be performed without undue effort and cost. However, we realize that in limited circumstances, negative confirmations may be the substantive audit procedure that the auditor in his/her judgment determines appropriate to perform in the circumstances (e.g., when seeking evidence about existence of direct deposits of a financial institution). We therefore agree that it would not be

appropriate for an auditing standard to preclude the use of an audit technique that may in such limited circumstances be effective. We are therefore supportive of the revised standard continuing to allow for use of negative confirmations in circumstances in those limited circumstances in which the auditor concludes that use of negative confirmations are appropriate to obtain relevant and reliable audit evidence, subject to the framework in the extant standard that limits their use (and which is also consistent with ISA 505.) Additional guidance with examples of when the use of negative confirmations is appropriate may be helpful to include in the standard.

We would be pleased to discuss our letter with you at your convenience. If you have any questions, please contact Jim Schnurr (203-761-3539), John Fogarty (203-761-3227), or Megan Zietsman (203-761-3142).

Sincerely,

/s/ Deloitte & Touche LLP

cc:

Mark W. Olson, PCAOB Chairman
Daniel L. Goelzer, PCAOB Member
Bill Gradison, PCAOB Member
Steven B. Harris, PCAOB Member
Charles D. Niemeier, PCAOB Member
Martin F. Baumann, Chief Auditor
Mary L. Schapiro, SEC Chairman
Luis A. Aguilar, SEC Commissioner
Kathleen L. Casey, SEC Commissioner
Troy A. Paredes, SEC Commissioner
Elisse B. Walter, SEC Commissioner
James L. Kroeker, Acting Chief Accountant
Paul A. Beswick, Deputy Chief Accountant for Professional Practice



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: 212 773 3000
www.ey.com

Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

29 May 2009

PCAOB Rulemaking Docket Matter No. 028
Concept release on possible revisions to the PCAOB's standard on audit confirmations

Dear Mr. Seymour:

Ernst & Young LLP (Ernst & Young) is pleased to submit comments on the Public Company Accounting Oversight Board's (PCAOB or the Board) concept release on possible revisions to the standard on audit confirmations (the Concept Release). PCAOB interim auditing standard AU section 330, *The Confirmation Process*, was adopted based on the US Auditing Standard that was written and adopted for fiscal periods ending after June 15, 1992. Since that time, advances in technology have expanded and transformed the ways in which businesses communicate and have provided auditors with additional techniques when using audit confirmations to gather audit evidence. These additional techniques present potential for significant benefits but also present circumstances and risks not previously contemplated by the interim auditing standard. For these reasons, we support the Board's objective to revise its existing interim standard with respect to confirmations.

We believe revisions to the existing standard should focus on improving the audit confirmation process and provide for the use confirmations to obtain audit evidence based on the auditor's professional judgment and his or her assessment of risk. Requiring the auditor to use confirmations is inconsistent with the premise that the auditor should use professional judgment and tailor his or her audit procedures to be responsive to the assessed risks. A high quality audit is not a predefined set of steps that are applied to each and every engagement, but a customized set of procedures designed to be responsive to the risks identified. Accordingly, standards should not represent a checklist of requirements, but a collection of guiding principles for the auditor to apply to the particular facts and circumstances of a given audit.

We also support the Board's objective to update its existing interim standard as an opportunity to clarify the responsibility of and the relationship between the respondent and the auditor. In our view, Section 303 of the Sarbanes Oxley Act of 2002 has been largely misunderstood by some confirmation recipients. Although Section 303 applies to the relationship between the auditor and their client, we observe that would-be respondents frequently do not complete or fully respond to audit confirmation requests based on the potential risk of violating the provisions of Section 303.

We have observed declining response rates to requests for confirmation and an increase in the number of responses containing disclaimer or other restrictive language. Clarification of the responsibility that a respondent bears when replying in good faith to a confirmation request might assist in improving the effectiveness of the confirmation process.

There currently are no obligations on respondents to respond to an auditor's confirmation request. Therefore, we caution the Board against expanding confirmation requirements on auditors through a revised auditing standard without also considering how the PCAOB and others might collaborate on obliging third parties from whom confirmations are sought.

The Board indicates in the Concept Release that it has considered the International Auditing and Assurance Standards Board's (IAASB) recently revised auditing standard, *External Confirmations*, (ISA 505). We continue to urge the Board to use the ISAs as a baseline for its standard-setting process. We believe doing so will accelerate the Board's efforts to converge U.S. and international auditing standards where appropriate. Some of the aspects of ISA 505 are referred to below in this letter.

Confirmation objective

The confirmation objective can be categorized into two fundamental components: (1) the decision by the auditor to use confirmations to obtain audit evidence and (2) considerations for performing confirmation procedures in an appropriate manner (i.e., the confirmation process). We believe the determination as to whether to use confirmations to obtain audit evidence should be a function of the auditor's risk assessments and the auditor's judgment regarding the nature and extent of procedures necessary to obtain sufficient appropriate audit evidence. Therefore, we believe that these requirements should more appropriately reside in auditing standards relating to responding to assessed risks and audit evidence. We believe this view is consistent with paragraph 5 of the PCAOB's proposed auditing standard, *Audit Evidence*, which describes the sufficiency or quantity of audit evidence as being affected by the risk of material misstatement and quality of evidence obtained. Upon determining to use confirmations to gather audit evidence, the revised auditing standard should address aspects of, and considerations related to, the confirmation process, including the design of confirmations to support specific assertions and the design and execution of confirmation procedures to produce reliable audit evidence.

Accordingly, we recommend that the objective of the audit confirmation standard should be focused on the confirmation process once the decision to send confirmations has been made. We suggest that the objective of the confirmation be defined, consistent with ISA 505, paragraph 5, as follows: "The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence."

Definition of confirmation

Paragraph 4 of PCAOB AU section 330 currently defines confirmation as "the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions." We believe this current definition should be revised by adding the word "written" after the word "direct" to indicate that

communications from third parties need to be in writing. We believe this revised definition would be consistent with the definition in paragraph 6(a) of ISA 505, which defines an external confirmation as “audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.” The revised definition would serve to indicate that an oral response does not constitute a confirmation, but a lower level of audit evidence.

We believe this revised definition would be preferable to crafting a definition that attempts to specifically encompass various alternative forms of confirmations. We encourage the Board to instead provide examples of possible forms of confirmations that are consistent with the revised definition. Example forms of confirmations might include the following:

- where the respondent responds directly to the auditor through a written response mailed to the auditor
- where the respondent provides direct access to information (e.g., read-only website access) in response to an audit confirmation request
- where the respondent directly responds to an auditor using electronic medium
- where a respondent responds to an auditor through a third-party service provider

While we believe the revised definition of the confirmation process provided above would be appropriate, we recommend that the revised standard provide a broadened discussion of the design and execution of the confirmation process to include alternate forms of written confirmations that may be “other than in a written communication mailed to the auditor.” Please refer to the section, *Designing the confirmation process*, below for further discussion on the considerations for leveraging technology in the confirmation process.

Requirement to confirm

We believe that auditing standards that either require the auditor to use confirmations or establish a rebuttable presumption that the auditor will use confirmations to address certain assertions is inconsistent with the premise that the auditor should use professional judgment and tailor his or her audit procedures to be responsive to the assessed risks. Rather than require the use of confirmations, we recommend that the Board instead provide application guidance for determining the various types of confirmations that auditors may want to consider using when planning their procedures, including, among other possible items, confirmation of the existence and terms of material complex or unusual agreements or transactions.

Designing the confirmation process

The confirmation procedures described in the current standard reflect the most appropriate considerations for the confirmation process when it was drafted. Subsequent advances in technologies available to the auditor serve as an impetus to revisit the confirmation process as described in the existing standard. We believe there is significant opportunity to leverage

technology to increase efficiencies without sacrificing the reliability of the confirmation process and the evidence obtained. We believe that the benefits gained with a properly designed electronically-enabled confirmation process can increase efficiencies and, in some cases, can be more secure than a traditional paper-based confirmation and may result in higher response rates. We observe that the workplace has become more accepting of electronic forms of communication and we believe that a properly designed confirmation process can leverage technology and result in reliable audit evidence.

We believe a revised standard should address aspects of the appropriate design of confirmation requests as well as their distribution, collection and evaluation. We also believe the fundamental considerations for the proper design of a confirmation process are the same regardless of the medium or extent of use of technology; however, there may be differing risks that would need to be addressed in the confirmation process. Confirmations also should be designed so that the respondent has the ability to positively respond to the confirmation request. The auditor should not attempt to confirm information for which the respondent would have no basis for a response.

We believe there are three key considerations of the confirmation process that could serve as principles within the standard:

1. Direct the confirmation to a third party that the auditor believes is knowledgeable about the information to be confirmed and maintain control over the confirmation request.
2. Receive the confirmation directly from the respondent or through a third-party service provider.
3. Evaluate whether the response can be relied upon.

The auditor should consider the risks that the three key considerations of the confirmation process may not be satisfied. Each of these three considerations is discussed in more detail below. The discussion below may be useful as supporting guidance for these principles.

Direct the confirmation to a third party that the auditor believes is knowledgeable about the information to be confirmed and maintain control over the confirmation request. The auditor should be satisfied that the confirmation request is delivered to the intended recipient. Depending on the method of distribution (e.g., paper or electronic) the validation of this information may take several different forms. If using e-mail, some of the various forms of validation may include:

- A conversation with the intended recipient to validate the recipient's e-mail address,
- Agreement of the individual's e-mail address to the recipient's letterhead or business card, or as posted to the company website¹ or trade directory,

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

- Agreement of the domain of the e-mail address to the company's domain (e.g., @ey.com is a domain for Ernst & Young) based on a company's letterhead, business card, website¹, website certificate¹, domain registration information¹ or other reliable identifying source, or
- Other procedures to validate the propriety of the e-mail address of the recipient or the recipient's organization.

The nature and extent of the validation should be a function of risk and therefore also be a matter of professional judgment.

Receive the confirmation directly from the respondent or through a third-party service provider.

The auditor should obtain the confirmation directly from the respondent or from a third-party conduit. We believe this consideration applies equally to traditional and electronic forms of confirmation.

Evaluate whether the response can be relied upon. We note that the Board has suggested communications through e-mail and confirmation responses processed through third-party service providers would be acceptable forms of confirmations. While we agree that these mediums are acceptable, it is the proper design and execution of the confirmation process as a whole that ultimately determines whether an e-mail or a response from a third-party service provider represents a confirmation.

As part of the confirmation process, the auditor should implement measures to determine that the confirmation response can be relied upon. This will necessitate that the auditor design the confirmation process so that he or she can later evaluate the responses and conclude as to whether the confirmation is authentic. For example, e-mail address spoofing can mask the senders' information. As part of determining that the confirmation request is delivered to the intended recipient (see discussion above), the auditor might establish an authentication feature (i.e., a unique code) with the recipient that he or she may later use to verify that the response came from the intended recipient.

Consideration of a third-party service provider

A third-party service provider may take several different forms. The Concept Release suggests that a third-party service provider may facilitate the confirmation process between an auditor and a respondent, or a third-party service provider may maintain certain information that could be used to respond to a confirmation request.

Whenever a third-party service provider acts as an intermediary between the auditor and the respondent, the auditor should understand the role of the third party in the confirmation process and obtain information about the nature of the process and related controls at the third-party service provider that persuade the auditor that the process will generate reliable information. While a Sys-Trust, Web-Trust or other report relating to the controls of a service provider may be useful in assisting the auditor in determining the reliability of a service provider, the lack of such report would not preclude an auditor from being able to form an understanding of the processes

and related controls of the service provider or to conclude that confirmations processed through or obtained by the service provider represent reliable audit evidence.

We note that “third party,” as used in the Concept Release, appears to refer to both the third-party confirmation respondent as well as the third-party confirmation service provider. We recommend the Board add appropriate clarification when referring to a third-party in different contexts.

Alternative procedures

A non-response is the failure of a confirming party to respond, or fully respond, to a positive confirmation request. Confirmation procedures are typically based on a sample of key or representative items, or both, and accordingly each item in the sample is individually important to the conclusion on the results of the confirmation procedures. An auditor should perform alternative procedures for non-responses to positive confirmation requests to obtain other corroborating evidence; however we believe the revised standard should continue to allow for the omission of alternative procedures in the circumstances described in paragraph 31 of PCAOB AU section 330. If a non-response is not able to be tested or is otherwise not tested, the item for which confirmation was requested should be considered an exception.

Exceptions are differences between the item being confirmed and the information contained in the response. We believe that the auditor should be required to resolve exceptions and consider the effect of an exception on the confirmation process; however the nature of those procedures should be left to the auditor based on specific facts and circumstances. We believe electronic confirmations may improve the ability to follow up with the respondent in obtaining clarifying information or when further exploring exceptions.

If a confirmation is returned undeliverable, the auditor should have a higher level of professional skepticism when performing alternative procedures and evaluating the propriety of the item being confirmed.

Disclaimers and restricted language

We observe with increasing frequency that responses to confirmation requests bear various forms of disclaimers and restrictive language that may raise questions about their value as audit evidence. The auditor should evaluate whether such language limits the reliability of the confirmation with regard to the purpose for which it was requested. A disclaimer as to the accuracy of the information with respect to the assertion being addressed by the confirmation would call into question the quality of the evidence provided by the confirmation response; however, much like an oral response it would constitute a form of audit evidence, albeit less persuasive than a valid confirmation. The auditor would evaluate the evidence the confirmation response provides and determine what other procedures, if any, to perform. Alternatively, a disclaimer with respect to information contained in the confirmation that is not relevant to the purpose for which confirmation was requested ordinarily would not call into question the quality of the evidence.

The existing auditing standard does not address disclaimers and restrictive language. We believe that the Board may be in a particularly unique position to address the issue of disclaimer language in certain types of confirmation responses, such as those received from financial institutions regarding cash, debt, and investment balances. We urge the Board to work with members of the relevant trade organizations of the financial profession to co-develop expectations for auditor confirmation requests and for financial institution responses with respect to the use of disclaimers and restrictive language.

Management requests not to confirm

When an auditor has designed audit procedures that include using confirmations to gather evidence about one or more account assertions and management requests that the auditor either not send confirmations or not send confirmations to a particular entity or class of entities, the auditor should have a higher level of professional skepticism with respect to the confirmation procedures and the given assertion. We recommend the Board incorporate those requirements of paragraphs 8 and 9 of ISA 505 that require the auditor to evaluate the implications of management's refusal on his or her assessment of the relevant risks of misstatements and to perform alternative procedures.

Negative confirmations

While a positive confirmation is a useful technique in testing the existence assertion for assets given the associated risk of overstatement, a negative confirmation can be a useful technique in obtaining audit evidence in conjunction with other procedures when testing the completeness assertion for liabilities considering that the associated balance sheet risk is understatement of the corresponding account balances. We believe that the nature, timing and extent of testing is a matter of professional judgment and auditing standards should not preclude an auditor from using a particular type of audit procedure when executing an audit. We believe paragraphs 15 and A23 of ISA 505 provide appropriate cautionary language and an appropriate balance as to the extent of reliance an auditor should place on negative confirmations.

* * * * *

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

Sincerely,

Ernst & Young LLP



Federation of European Accountants
Fédération des Experts comptables Européens

29 May 2009

Mr. J. Gordon Seymour
Office of the Secretary
Public Company Accounting Oversight
Board
1666 K Street, NW
Washington DC 20006-2803
USA

Email: comments@pcaobus.org

Ref.: AUD/HvD/HB/SH

Dear Mr. Seymour,

Re: FEE Comments on PCAOB Release No. 2009-002, Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations

- (1) FEE is pleased to provide you below with its comments on the Public Company Accounting Oversight Board (PCAOB) Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations (the Concept Release).
- (2) FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.
- (3) FEE's objectives are:
 - To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
 - To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
 - To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
 - To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise



Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;

- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.

The benchmark auditing standards are the clarified International Standards on Auditing (ISAs)

For over ten years, FEE has been advocating the use of the (clarified) ISAs in the European Union (EU). The worldwide use of the ISAs has steadily expanded over the last few years, making them the global benchmark auditing standards. We support the clarified ISAs, have commented on each of them, and support further convergence.

Therefore, we welcome this Concept Release and the PCAOB's initiative to align its standards with the clarified ISAs as a step towards the ultimate worldwide application of one set of auditing standards for both capital market entities and other entities.

In an environment of convergence of accounting standards, the globalisation of auditing standards will facilitate consistency in the auditing of financial statements. The alternative is cumbersome questionnaires covering differences in auditing standards that detract from an efficient and effective audit.

We recognise that, currently, the PCAOB issues standards which differ from those of the International Auditing and Assurance Standards Board (IAASB) because the PCAOB standards need to take into account U.S. securities law and U.S. Securities and Exchange Commission (SEC) and other PCAOB rulemaking on these laws. Additionally, because the PCAOB has chosen an integrated audit approach on both the financial statements and the internal controls of an entity, this leads to differences between the PCAOB auditing standards and the (clarified) ISAs.

However, we believe that it is not conducive to international convergence of auditing standards for the PCAOB to write auditing standards that differ from the (clarified) ISAs at a technical level for other reasons: the (clarified) ISAs are the product of an intensively overseen and thorough due process involving considerable consultation at an international level.

In relation to the Concept Release for a standard on audit confirmations, it is particularly relevant to note the following:

- Although the PCAOB has recently proposed auditing standards related to the auditor's assessment of and response to risk, the many questions in the Concept Release as to whether auditors should be required to perform specific procedures appear to diverge from a risk-based approach;
- This usually encourages a rules-based and mechanical and procedural approach to auditing standards;
- For external audit confirmations, the PCAOB appears to retain its presumptively mandatory requirement for external audit confirmations of accounts receivable, but possibly extending the scope of this presumption. In contrast, the IAASB refers to the risk assessment to determine when external audit confirmation ought to be performed: The auditor is responsible to design and implement overall responses to address the assessed risks of material misstatements at the financial statement level. Therefore,



the auditor designs and performs substantive procedures for each material class of transactions, account balance and disclosure and requesting external audit confirmations as substantive procedures can form part of this;

- This more rules-based approach might discourage the use of professional judgement, which may, in comparison with an effective application of a truly risk based approach, have an adverse affect on audit quality.

It might therefore be useful to emphasise that external audit confirmation should not be conducted routinely for the sake of it and to put additional focus on alternative audit procedures, as adequate responses of third parties to all external audit confirmation can currently not be taken for granted.

Question 1

Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

As noted above, the PCAOB appears to want to stick to its presumptively mandatory requirement for external audit confirmations. Subsequently, the objective as proposed is worded as one which would lead to a requirement to use confirmations to respond to all relevant identified risks.

We are of the opinion that auditors should be allowed to use professional judgment to determine whether to use external audit confirmations as an audit procedure in an individual engagement. Therefore, we support the objective as that set forth in ISA 505 (Revised and Redrafted): "The objective of the auditor, **when using** external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence."

We invite the PCAOB to reword its objective accordingly.

Question 2

Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct on-line access to information held by a third party? Why or why not?

Yes, we agree that confirmation procedures should be expanded and, in doing so, that the "new" situation facing auditors due to advances in technology which facilitate direct confirmation with a third party needs to be dealt with.

However, one cannot assume that 'other' responses are any more inherently reliable than traditional mailed responses. They may be more unreliable, and there may be less high quality documentation to support them, depending on circumstances.



Question 3

What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

The control objectives relevant to electronic confirmations and third-party service providers are the same as those relevant to more traditional methods; mainly completeness, existence and accuracy, including reliability. The overarching control procedures within the control environment implemented to achieve those objectives are also similar. The differences arise at a lower level.

If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further evidence to resolve those doubts. Responses received electronically, for example, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect.

Reference is made to the requirements in paragraphs 10 and 11 of ISA 505 and the Application Material applicable to these paragraphs, especially A12 and A13.

Question 4

What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

Reference is made to our response to Question 3 and to paragraphs 10 and 11 of ISA 505 and the Application Material applicable to these paragraphs.

Question 5

Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

No, the objective ought to be the same as that in ISA 505: to design and perform the confirmation procedures, *when used*, to obtain relevant and reliable audit evidence.

The auditor is responsible for designing and implementing overall responses to address the assessed risks of material misstatements at the financial statement level. Therefore, the auditor designs and performs substantive procedures for each material class of transactions, account balance and disclosure and requesting external audit confirmations as substantive procedures can form part of this.

Including confirmation of significant terms of complex or unusual agreements or transactions are not necessarily associated with heightened risk (as noted on page 11 of the Concept Release).

Reference is also made to paragraph 3 of ISA 505.



Question 6

Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

No, external audit confirmations should not be required. However, external audit confirmation procedures are *frequently* performed to confirm or request information regarding account balances and their elements. They *may also be used* to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement”.

Reference is made to paragraph A1 of ISA 505.

Question 7

Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

No, as noted above we do not support retention of the extant presumption. In our view, the auditor should assess the relevant risks of material misstatement and design audit procedures accordingly. If the auditor concludes that the confirmation of accounts receivable is likely to be ineffective, the auditor should perform alternative audit procedures to obtain the audit evidence he requires. Specific procedures are not necessary and are likely to enable auditors to hide behind them rather than justify their decisions.

Guidance might be useful in this respect in which it could be explained that the auditor *may*, for accounts receivable balances, be able to examine specific subsequent cash receipts, shipping documentation, and sales near the period-end as such alternative audit procedures, depending on the engagement circumstances. The main point is that the auditor needs, irrespective of the procedures applied, to obtain sufficient appropriate audit evidence.

Question 8

Should the Board include direction in the standard on what constitutes “unusual” or “complex” agreements or transactions, including revenue transactions? If so, what should that direction include?

No, auditors should be allowed to use a risk based approach to unusual or complex agreements, and thus be able to use their judgement to determine what is unusual or complex without direction or requirements in this area.

Question 9

Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

No, although the design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses, the benefit of such standardisation derives from recipients being a homogenous group subject to regulation, for instance financial institutions or insurance companies. This is not the case with recipients of requests for confirmation of accounts receivable.



Guidance would be useful in this respect as provided in paragraph A4 of ISA 505, which includes factors to consider when designing confirmation requests.

Question 10

Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

When using external audit confirmation procedures, the auditor should be required to maintain control over external audit confirmation requests, including designing the confirmation request, which also includes determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor.

In line with the risk-based approach, guidance would be useful in this respect as provided in paragraph A6 of ISA 505, which specifies that determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation request before they are sent out.

Question 11

What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

No direction is needed in the form of requirements, although guidance in this respect might be useful. The auditor *may* send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. Reference is made to paragraph A7 of ISA 505.

Question 12

What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

We believe that any additional direction should be kept to a minimum. ISA 505 does not include requirements related to maintaining control over confirmations in electronic form. However, it includes guidance in paragraph A12 where reference is made to reliability of electronic confirmations because proof of origin and authority of the respondent may be difficult to establish and alterations may be difficult to detect.

Question 13

What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

In line with the risk-based approach and the application of professional scepticism, we believe that a general requirement as in paragraph 10 of ISA 505 is useful that, *if* the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts.

Further guidance would be useful in this respect as provided in paragraph A14 of ISA 505, which specifies that the auditor may choose to verify the source and contents of a



response to a confirmation request by electronic mail, the auditor may telephone the confirming party to determine whether the confirming party did, in fact, send the response.

Question 14

When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

Third party service providers and the use of third-party databases are complex areas. It is essential that the auditor be satisfied with the controls over information delivered to the third party provider or database, the controls applied to the data during processing, and the control of information returned to the entity from such third parties. Given this complexity, confirmation provided by such third party service providers and databases might need to be considered as relatively weak, or less reliable audit evidence. Therefore, in such circumstances confirmations might not be the most efficient approach to obtaining audit evidence and alternative procedures may need to be considered.

Question 15

Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

Responses received electronically involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect.

Reference is made to our response to Question 2 indicating that the risk of manipulation and fraud might be greater than with traditional mailed confirmations.

Question 16

Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

Yes, as per the requirement in paragraph 10 of ISA 505, where no response is received, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.

It is particularly important to include such requirement in a standard on external audit confirmations as a non-response to a confirmation request may indicate a previously unidentified risk of material misstatement as per paragraph A19 of ISA 505. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation.



Question 17

Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

Yes, as per the requirement in paragraph 14 of ISA 505, the auditor shall investigate exceptions to determine whether or not they are indicative of misstatements. As per paragraphs A21 and A22 of ISA 505, exceptions noted in responses to confirmation request may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required to evaluate whether such misstatement is indicative of fraud. However, some exceptions do not represent misstatements.

Question 18

Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

Yes, reference is made to our responses to Questions 16 and 17.

Question 19

Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

Yes, as per the requirement in paragraph 10 of ISA 505, in the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.

Question 20

Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Yes, as per the requirements in paragraphs 8 and 9 of ISA 505, if management refuses to allow the auditor to send a confirmation request, the auditor shall:

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.



The auditor uses his professional judgement to determine whether there are valid reasons for management's request or refusal not to confirm.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance. The auditor also shall determine the implications for the audit and the auditor's opinion.

Question 21

Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

Disclaimers and restrictive language are increasingly common and are understood to be mainly included for legal reasons. Therefore, they should be *addressed* in a standard on external audit confirmations.

The legal validity or otherwise of confirmations may vary depending on the jurisdiction in which the confirmation response was provided. Currently, in some European jurisdictions, disclaimers and restrictive language are considered to impair the value of the evidence provided. However, this might not be the case in other jurisdictions. As explained in paragraph A16 of ISA 505, restrictive language regarding the use of a response to a confirmation does not necessarily invalidate the reliability of the response as audit evidence.

However, the practical effect of a disclaimer or restrictive language in particular circumstances is likely to require a legal analysis that is not within the auditor's competence.

Question 22

Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

Yes, we agree that the use of negative form requests should not be forbidden, although reference is made to paragraph 15 of ISA 505 which specifies that negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless this risk was assessed to be low and determinate preconditions are fulfilled as stated in the final part of paragraph 15 of ISA 505.

Question 23

Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

Yes, reference is made to our response to Question 22 and to paragraphs 15 and A23 of ISA 505.



For further information on this letter, please contact Mrs. Hilde Blomme at +32 2 285.40.77 or via email at hilde.blomme@fee.be from the FEE Secretariat.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', written over a light blue horizontal line.

Hans van Damme
FEE President



May 29, 2009

Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Audit - Tax - Advisory

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687

T 312.856.0200

F 312.565.4719

www.GrantThornton.com

Re: PCAOB Rulemaking Docket Matter No. 028, *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*

Dear Board Members and Staff:

We appreciate the opportunity to comment on the *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* ("Concept Release"). We agree with the Public Company Accounting Oversight Board's ("Board" or "PCAOB") conclusion that AU sec. 330, *The Confirmation Process*, would benefit from review, especially given the significant advances in technology in the 15 years since it became effective. We also support the practice of issuing a concept release, such as this one, seeking input on high-level issues prior to the issuance of an exposure draft of a proposed standard. We expect you will find the input you receive useful, and hope you continue the practice going forward.

As independent, third-party evidence, confirmations may be an important source of the evidence that auditors obtain as part of an audit of a company's financial statements. However, to provide relevant audit evidence, confirmations must be an appropriate response to an identified risk of material misstatement. Also, auditors must use professional judgment in deciding when to request confirmations, and professional skepticism in evaluating confirmation responses. A standard that fails to emphasize these points will increase the risk that confirmations will be regarded by auditors as reliable audit evidence in cases where they are not.

Objective

We generally are comfortable with the objective of the confirmation standard. In particular, we believe that it is important for the objective to link to the response to identified risks, as it does. However, to be consistent with *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* and *Proposed Auditing Standard – Engagement Quality Review*, we suggest that the objective be phrased in terms of "the objective of the auditor," as opposed to "the objective of the confirmation standard." Also, based on the identified risks, auditors often will be unable to obtain *sufficient* competent audit evidence through the design and performance of confirmation procedures alone. In many cases, auditors may need to obtain other, corroborating evidence. In

those cases, the auditor will not have met the proposed objective. We would suggest the following objective:

The objective of the ~~confirmation standard [is] for the auditor~~ **is** to design and perform confirmation procedures to obtain ~~sufficient, competent~~ **relevant and reliable** audit evidence from knowledgeable third parties outside the company in response to identified risks.

Definition of confirmation

The benefit of a confirmation comes from a third party, knowledgeable of the subject matter being confirmed, exerting the discipline to confirm, in writing, to the auditor, the terms of a particular agreement or transaction, or that a particular account balance is correct. The form of writing (facsimile, e-mail or other electronic medium) is not important, nor is the fact that the client has outsourced the processing of confirmations to a third-party service provider. We believe the situation where a bank maintains a website whereby the auditor has direct access to bank records, meets the definition of a “confirmation,” because we believe that the personnel maintaining the website are “knowledgeable third parties,” and the direct access serves as the communication in writing. If the access is not direct (for example, via the client’s access), then the procedure provides audit evidence, but it is not a confirmation because the client’s access undermines the role of the third party.

An oral response is a response to an inquiry, which may be valuable audit evidence, but it does not have the benefit of the same discipline as a written response, and therefore, should be treated as an inquiry, but not as a confirmation.

Regardless of the form of confirmation, the auditor needs to consider the risk that the results will be compromised because of interception, alteration, or fraud. When responding to a risk that a paper confirmation may not be reliable, the auditor has some “hard” evidence in the form of the confirmation itself to consider. We suggest that the Board consider the Auditing Standards Board’s interpretation to AU sec. 330, *Use of Electronic Confirmations*, which suggests one way that the auditor may respond to a risk that an electronic confirmation may not be reliable.

Requirement to confirm

We believe that prescriptive requirements may result in procedures being performed in situations where a more effective or efficient procedure might be appropriate; require additional, unnecessary documentation; and undermine the exercise of the auditor’s judgment in responding to identified risks of material misstatement. We would be concerned about an expansion of the presumptively mandatory requirement to request confirmation of accounts receivable to include confirmation of the significant terms of complex or unusual agreements or transactions. Similarly, we would be concerned about requirements for the auditor to confirm other items, or to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective.

A presumptive requirement to request confirmations in certain situations implies a presumption that confirmations will provide competent audit evidence in those situations. We do not believe

that this is always an appropriate presumption. In fact, confirmations have many limitations as audit evidence, of which the auditor should be mindful.

Auditing literature has long maintained the tenet that evidential matter obtained from an independent party outside the entity is more reliable than that secured solely within the entity. This tenet is reinforced by the presumptively mandatory requirement to confirm accounts receivable. The auditing literature sets confirmations up as unquestioned high-quality audit evidence when, in fact, we believe that the standards should provide guidance to the auditors in using professional judgment regarding when it is appropriate to request confirmations, and professional skepticism when evaluating the reliability of confirmations as audit evidence.

Confirmations should be considered as audit evidence in the context of the auditor's risk assessment, including the strengths or weakness of controls and the inherent risk of misstatement related to the assertion. Perhaps one of the most important aspects of AU sec. 330 that should be updated is the relationship between the fraud risk assessment and confirmations. In some cases, confirmations can be a very effective response to an identified risk of material misstatement, whether due to error or fraud. In other cases, however, confirmations can be used to conceal fraud. Certain fraud risk factors might point to whether confirmations would serve as an effective response to an identified risk, or as a way to conceal a fraud. The possibilities, including the possible responses to the risk of a fraudulent confirmation response, might be part of the discussion in the brainstorming session.

Designing confirmation requests

We caution the Board against setting too many prescriptive requirements regarding the design of confirmation requests. The types of information that it is appropriate to confirm vary so widely that it would be very difficult for the Board to draft prescriptive requirements regarding how to perform confirmations that would be appropriate in all cases. We believe that the guidance in extant AU sec. 330 regarding the design of confirmation requests is appropriate.

It would be helpful to provide guidance regarding the fact that there are some assertions for which confirmations provide little (if any) audit evidence. For example, although a confirmation may provide significant audit evidence regarding existence of investments in securities, it may provide much less evidence regarding valuation, particularly where a readily determinable fair value does not exist.

Testing of addresses

We acknowledge that one of the biggest limitations regarding confirmations is the fact that the confirmation may not reach the intended recipient, particularly since technology provides additional opportunities for skilled individuals to intercept confirmation requests. However, we caution the Board against requiring the testing of some or all of the addresses. With respect to traditional paper confirmations, a requirement to test all addresses would be onerous on large audits. Furthermore, a requirement to test addresses only provides limited assurance as to whether the confirmation reached the intended, knowledgeable party within an organization.

In the case of electronic confirmations, it is more difficult for the auditor to test addresses. If the auditor believed it necessary to respond to a risk that a confirmation did not come from the proper source, it might be more effective for the system or process that facilitates the electronic confirmation to be tested. We suggest that the Board consider the guidance in the Auditing Standards Board's interpretation to AU sec. 330, *Use of Electronic Confirmations*.

In either case, we believe that the auditor might consider testing addresses in response to an identified risk. For example, an auditor might be more likely to test the address of a party confirming a large, unusual transaction, and less likely to test the addresses of parties confirming many, small account balances.

Maintaining control over confirmation requests and responses

We believe the guidance in AU sec. 330 requiring the auditor to maintain control over the confirmation requests and responses is appropriate. We suggest that the Board consider the guidance in the Auditing Standards Board's interpretation to AU sec. 330, which provides guidance on maintaining the required control in the case of electronic confirmations.

Reliability of confirmation responses

We support the inclusion of more specific requirements for the auditor to evaluate the reliability of confirmations in a manner that is similar to the guidance in revised and redrafted International Standard on Auditing (ISA) 505, *External Confirmations*.

Exceptions and non-responses

We support the inclusion of more specific requirements for the auditor to deal with exceptions and non-responses in a manner that is similar to the guidance in ISA 505.

Management requests not to confirm

We support the Board's proposal to provide additional guidance to the auditor in situations when management requests that the auditor not confirm selected accounts, transactions, agreements, or other items. We believe that the procedures listed in the concept release are appropriate. We would add to the list:

- Evaluating the implications of management's request on the audit report, particularly whether a limitation on the scope of the audit exists; and
- Communicating with the audit committee.

Disclaimers and restrictive language

We appreciate the Board's concerns regarding the effect that disclaimers and restrictive language may have on whether the responses provide competent audit evidence. This is a practice problem with which firms are struggling. On the one hand, it is difficult to accept, as competent audit evidence, a confirmation that, on its face, states that it may not be competent audit evidence. On the other hand, confirming parties generally respond to confirmation requests as a matter of courtesy, and cannot be compelled to respond at all, much less not to try to limit their liability with disclaimers.

We caution the board against requiring the auditor to perform specific procedures to evaluate the effects of disclaimers and restrictive language on confirmation responses. Similarly, we caution the Board against requiring alternative procedures in all cases where confirmations contain disclaimers or restrictive language. First, requiring additional evaluations and alternative procedures will affect severely the value of confirmations as an audit procedure, particularly as disclaimers and restrictive language become more common. Second, it has been our experience that there is a “continuum” of disclaimers and restrictive language. On one extreme, some language appears to be “boilerplate” legal language, intended to protect the confirming party in an abstract way. On the other extreme, some language appears seriously to call into question the value of the specific confirmation received. We do not believe that a single set of procedures is appropriate in all cases. It would be unfortunate if the Board required specific procedures in cases where the restrictive language was “boilerplate,” thus limiting the value of otherwise valuable audit evidence.

We believe that the auditor’s response to disclaimers or restrictive language should be based on the nature of the language, and the identified risks associated with the assertion in question. General, boilerplate language on confirmations of a large number of small account balances would be dealt with differently by the auditor than specific restrictive language on a confirmation of an unusual transaction. The question goes to whether the effect of the disclaimers or restrictive language is to deny that the confirmation response has been provided by a knowledgeable third party.

The PCAOB, in conjunction with groups that represent confirming parties, such as the American Banking Association, should develop guidance in this area, similar to the agreement that was reached between the American Bar Association and the AICPA in the development of AU sec. 337, *Inquiry of a Client’s Lawyer Concerning Litigation, Claims and Assessments*. Hopefully, such guidance would make bankers and other respondents to confirmation requests more comfortable in providing full responses. Such guidance could be based on the most recent developments, and could be issued as a staff alert, which could be more easily kept current than an auditing standard.

Negative confirmations

Given that an auditor can always do more than what is required by a standard, we do not understand how the Board could prohibit the use of negative confirmations. We do, however, believe that the standard should make clear, as does ISA 505, that negative confirmations provide less persuasive audit evidence than do positive confirmations.

Convergence with international standards

We would like to again express our recommendation that the Board consider the feasibility of adopting the ISAs as a base. In doing so, PCAOB standards can be focused on the incremental requirements that would be necessary for audits of issuers. ISA 505 recently has been updated. We believe it provides an appropriate base from which to start, incorporating recent thinking on confirmations, including electronic confirmations.

We would be pleased to discuss this letter with you. If you have any questions, please contact Mr. John L. Archambault, National Managing Partner of Professional Standards, at (312) 602-8701.

Sincerely,





May 29, 2009

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is appreciates the opportunity to provide its perspective on the Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations.

The Committee is a voluntary group of CPAs from public practice, education and industry. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of our Committee are outlined in Appendix A to this letter.

We appreciate the PCAOB providing their views in this concept release instead of immediately providing a proposed auditing standard. The method of preparing a concept release and inviting feedback should help you to move quickly to a proposed standard and then to a final auditing standard. The concepts were provided in a good format and allowed a great forum for discussion of the concepts.

Following are the Committee's responses to the questions included in the Appendix:

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

We feel the objective is reasonable. The reference to the "outside the company" qualifier may be redundant since the objective states the evidence would be obtained from third parties.

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party? Why or why not?

The definition of confirmations should absolutely allow for responses other than mailed documents. Some members of the committee believe these should include

all of the examples provided above, while others felt that the definition of confirmation should not include oral responses.

In today's electronic world, the use of other methods of confirming information allows the auditor to utilize different means to obtain audit evidence. Providing alternatives to traditional confirmations allows the auditor to assess the proper method to use in each situation.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

The standard should only provide general directions regarding the use of non-traditional responses. This will allow the standard to be useful as new types or methods of confirmation of audit evidence evolve.

The Board should also consider providing supplemental guidance to assist the auditor in determining the proper type of confirmation to be used and the evaluation of the reliability of the responses. This will enable the auditor to evaluate whether a particular type of confirmation is responsive to the risks and complexity of the account or assertion

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

The auditor should perform certain procedures to verify that the documents originated from the proper source and that they have not been compromised. These types of procedures could range from verbally confirming with the individual to assessing the controls over the data transmission.

These risks are definitely evident in electronic confirmations but also similarly exist in traditional confirmations.

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

The Board should not expand the presumptively mandatory requirement to request confirmations of accounts receivable. We would also request the Board to reconsider its position to continue the presumptively mandatory requirement to confirm accounts receivable.

With today's technology and access to a variety of information, it seems antiquated to continue to require accounts receivable confirmation. The auditor should be able to assess whether confirming accounts receivable is the best

approach to the identified risks and obtaining audit evidence. In certain circumstances, procedures other than confirmations may provide a better course of action and yield a higher level of audit evidence.

We feel the Board should reconsider adopting the approach of ISA 505 and not requiring the confirmation of any specific accounts, terms or transactions. We feel the presumptively mandatory requirement to confirm accounts receivable is outdated, and the requirement should be modified or removed.

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

We feel the Board should not require the auditor to consider confirming other items. The auditor should assess the risks and audit evidence required and conclude on the proper course to obtain these items.

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

No specific procedures should be required.

8. Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?

We do not feel the Board should require confirming unusual or complex agreements. However, if the Board does require this confirmation process, it would be extremely helpful to have the Board include direction on the terms "unusual" and "complex." Such direction would be principles-based and not a prescriptive definition of terms that are designed to incorporate the auditor's judgment. The direction should discuss examples of items that would fall into these categories. A framework for the requirement would help the auditor assess when this might be required and what types of arrangements or transactions would fall into this category.

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

No additional direction is needed in designing confirmation requests.

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

Testing some of the addresses of the confirming parties would greatly increase level of audit evidence obtained. This procedure seems to be necessary to verify the confirmations are in fact sent to the appropriate third party, and this would reduce the risks associated with fraud in the confirmation process. Testing the entire population of confirmations does not seem necessary. Instead, the auditor should test a portion of the confirmations to verify the addresses are correct.

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

We feel that the Board should look to the International Standards on Auditing for direction on controlling confirmation requests and responses.

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

The risk of unauthorized individuals obtaining access to the confirmation process exists in both electronic and manual forms of confirmations. This risk could be mitigated by maintaining control over the process. However, this risk could not be eliminated by the highest level of controls. The standard should discuss this risk and provide discussion that confirmations should not be assumed to be absolutely correct. Therefore, the auditor should also consider performing alternative procedures on certain items even though a confirmation was obtained to verify the evidence obtained in the confirmation process is accurate.

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

No changes are deemed necessary.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

The auditor should control the process of obtaining the information. In addition, the auditor should assess the objectivity and competence of the third-party service provider.

In certain audit scenarios, it might require obtaining a service auditor's report from the third-party service provide to verify the entities controls are in place and potentially working properly. Obtaining a service auditor report should only be used when the information obtained in a confirmation process is extremely important and other procedures can't be performed to verify the information received from the service organization.

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

We did not note any additional factors to consider.

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

The auditor should be required to perform alternative procedures for non-responses. The failure to obtain a response does not provide sufficient audit evidence to be used to address the risks identified. In order to obtain value out of the audit process, alternative procedures should be performed for all non-responses. The auditor should conclude on the alternative procedures that are required based on the level of audit evidence required.

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

The auditor should consider the need to investigate the exceptions identified during the confirmation process. However, this should not be a requirement.

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

The auditor should consider these factors when performing alternative procedures.

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

If the auditor is required to confirm significant terms of unusual or complex agreements or transactions, it does not seem feasible that alternative procedures should be performed for non-responses in all circumstances. The most common alternative procedure would be to obtain written evidence of the agreement preferably through a mutually signed document.

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

The standard should include specific procedures that need to be performed when management requests certain items not be confirmed. This automatically increases the level of risk associated with these accounts or transactions. The auditor should perform specific procedures to reduce the risk.

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

The auditor should not be required to perform specific procedures to evaluate the effect of disclaimers or restrictive language.

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

The auditor should be allowed to use negative confirmations in situations that the auditor deems appropriate for the level of audit evidence required.

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

This determination should be left to the auditor's judgment.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

Jon R. Hoffmeister, CPA, MST
Chair, Audit and Assurance Services Committee

Kevin V. Wydra, CPA
Vice Chair, Audit and Assurance Services Committee

APPENDIX A

ILLINOIS CPA SOCIETY
 AUDIT AND ASSURANCE SERVICES COMMITTEE
 ORGANIZATION AND OPERATING PROCEDURES
 2008 – 2009

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from public practice, education and industry. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint.

Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:**Large:** (national & regional)

Peggy L. Brady, CPA	McGladrey & Pullen LLP
Matthew L. Brenner, CPA	PricewaterhouseCoopers LLP
Jeffrey A. Gordon, CPA	KPMG LLP
Jon R. Hoffmeister, CPA	Clifton Gunderson LLP
Neil F. Finn, CPA	Deloitte & Touche LLP
William P. Graf, CPA	Deloitte & Touche LLP
Michael J. Pierce, CPA	McGladrey & Pullen LLP
Kevin V. Wydra, CPA	Crowe Horwath LLP

Medium: (more than 40 employees)

Damitha N. Bandara, CPA	Blackman Kallick LLP
Sharon J. Gregor, CPA	Selden Fox, Ltd.
Stephen R. Panfil, CPA	Bansley & Kiener LLP
Jennifer E. Sanderson, CPA	Frost, Ruttenberg & Rothblatt, P.C.

Small: (less than 40 employees)

James R. Adler, CPA	Adler Consulting Ltd.
Scott P. Bailey, CPA	Bronner Group LLC
Loren B. Kramer, CPA	Kramer Consulting Services, Inc.
Andrea L. Krueger, CPA	Corbett, Duncan & Hubly P.C.
Ludella Lewis	Ludella Lewis & Company
Richard D. Spiegel, CPA	Steinberg Advisors, Ltd.

Industry:

Nicole G. Kiriakopoulos, CPA	Stericycle, Inc.
Janis D. Potter, CPA	MTL Insurance Co.

Staff Representative:

Paul E. Pierson, CPA	Illinois CPA Society
----------------------	----------------------



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

By E-mail: comments@pcaobus.org

May 29, 2009

541

Dear Sir(s):

**Re.: PCAOB Rulemaking Docket Matter No. 028
 PCAOB Release No. 2009-002
 Concept Release on Possible Revisions to the PCAOB's Standard
 on Audit Confirmations**

The Institut der Wirtschaftsprüfer in Deutschland [Institute of Public Auditors in Germany], the professional organization representing public auditors in Germany, appreciates the opportunity to comment on the above-mentioned Concept Release.

We have chosen not to respond to each of the individual questions posed in the paper. However, our comments do address a number of the issues raised. We submit our comments as follows:

Proposed Retention of the Presumption in the Board's Interim Standards

We agree with the comments of those members of the PCAOB's SAG who, according to footnote 22 of the Concept Release, indicated that auditors should determine which procedures to perform based on the assessed level of risk for the relevant assertions for each account.

Institut der Wirtschaftsprüfer
 in Deutschland e.V.

Wirtschaftsprüferhaus
 Tersteegenstraße 14
 40474 Düsseldorf
 Postfach 32 05 80
 40420 Düsseldorf

TELEFONZENTRALE:
 +49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
 +49 (0)211 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
 Deutsche Bank AG Düsseldorf
 BLZ 300 700 10
 Kto.-Nr. 7480 213

GESCHÄFTSFÜHRENDER VORSTAND:
 Prof. Dr. Klaus-Peter Naumann,
 WP StB, Sprecher des Vorstands;
 Dr. Klaus-Peter Feld, WP StB CPA;
 Manfred Hamannt, RA



Page 2 of 5 to the letter dated May 29, 2009, to the PCAOB

Our main concerns at the proposed approach to the current presumption discussed in the Concept Release are threefold:

Firstly, retention of the current presumption that accounts receivable will be subject to the auditor's confirmation procedures, even if extended to include specific additional matters, may concentrate auditors' attention unduly on accounts receivable and the specific additional matters such that other matters may not be given the attention they deserve.

Secondly, depending on the particular engagement circumstances there are potentially many other items for which confirmation may be an appropriate audit procedure. Indeed, we believe drawing up a comprehensive list of all such matters as a presumption is unlikely to prove feasible.

Thirdly, despite the fact that the presumption in the PCAOB's interim standards that accounts receivable will be subject to the auditor's confirmation procedures can be overcome in some circumstances, the PCAOB approach is overly rules-based.

In our opinion, the more principles-based ISA requirement in ISA 330.20A, which follows the audit risk approach, whereby the auditor has to "... consider whether confirmation procedures are to be performed..." has the advantage that an auditor must give due consideration to a comprehensive range of possible confirmations relevant in the particular engagement circumstances, and their consideration will not be biased by presumptions or lack of presumptions, respectively, but constitutes instead a response to the assessed risk of material misstatement. The application of an auditor's professional judgment in determining the appropriateness and scope of confirmations to be sought, when applied properly, will enhance audit quality more than the "tick the box" approach likely to result from a widening of the extant presumption on the part of the PCAOB.

Expansion of the Definition of "Confirmation" in Recognition of Technological Developments

We agree that the definition of confirmation procedures should be expanded in response to "new" situations such as those discussed in the Concept Release resultant from advances in technology that face, or will soon face, many auditors. Irrespective of the method by which auditors may seek confirmation, the auditor's objective remains the same, i.e., to obtain relevant and reliable audit evidence from those confirmation procedures used.



Page 3 of 5 to the letter dated May 29, 2009, to the PCAOB

Therefore, when confirmation procedures deviate from the hitherto commonly applied methods, the auditor's procedures will likewise need to differ in response. Given the technological advances that facilitate direct confirmation with a third party, the auditor will need to perform procedures directed at ensuring the security and integrity of the auditor's direct interaction with that third party, i.e., procedures to determine whether the third party supplied link is secure and cannot be subject to manipulation and whether access granted by that third party does indeed relate to all the information requested. Such measures would aim to ensure the authenticity and completeness of information confirmed by an auditor's direct interaction. It would be useful if a revision of the PCAOB's interim standard were to cover such aspects.

In our opinion, the use of a client's password would not constitute an external confirmation.

Confirmation Requests in the Negative Form

Both the interim PCAOB Auditing Standard and ISA 505 (Revised and Redrafted) allow confirmation requests in the negative form. The Concept Release discusses whether to retain their use, and, if so, whether to require they be supplemented by other substantive procedures. In our view, the use of negative form requests should not be forbidden. However, because of the drawbacks mentioned in the Concept Release, we believe they should be used only under certain conditions. In this context, we refer to paragraph 15 of ISA 505 (Revised and Redrafted), which excludes their use as a sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level with specific exceptions.

Management's Refusal to Cooperate in Confirmation Procedures

We would support the inclusion of additional material (over and above that presently included in the PCAOB's interim standard) dealing with management refusals to allow an auditor to send a confirmation request. Such material should be based on paragraphs 8 and 9 of ISA 505 (Revised and Redrafted) and accompanying application material.

Third Party Cooperation in Confirmation Procedures

As page 4 refers to the fact that low response rates, respondent errors and directional bias in detecting errors are key barriers to confirmation effectiveness,



Page 4 of 5 to the letter dated May 29, 2009, to the PCAOB

we would like to suggest the Board consider whether, in future, legislative or regulatory measures might be taken to improve third party cooperation with requesting auditors. For example, we wonder whether consideration ought to be given to the possibility that the SEC could specifically require all registrants to cooperate with auditor requests for confirmations.

Reliability of Confirmation Responses

We note that although consideration of the reliability of confirmations is mentioned in AU330.33 as a part of the auditor's evaluation of the results from confirmation procedures, the PCAOB's interim standard does not specifically require the auditor respond to any identified factors that give rise to doubts about the reliability of confirmation responses. In our opinion, any new PCAOB standard should require the auditor pursue such matters as appropriate in the individual engagement circumstances. In this context, we refer to paragraphs 10 and 11 of ISA 505.

We also support the fact that the inclusion of disclaimers and other restrictive language in responses to confirmation requests is also discussed in the Concept Release. We note that this is an aspect that ISA 505 (Revised and Redrafted) does not cover. However, not least because the legal validity or otherwise of confirmations varies depending on the jurisdiction from which the confirmation response was provided, we believe that this issue ought to be addressed in any new PCAOB Standard through guidance without recourse to detailed rules.

Omission of Alternative Procedures in Case of Non-Responses

We note that in case of non-response, the PCAOB's interim standard allows the auditor to omit alternative procedures in some circumstances. We welcome the discussion in the Concept Release on disallowing this omission. In contrast to the PCAOB's interim standard, paragraph 12 of ISA 505 requires the auditor perform alternative procedures to obtain relevant and reliable audit evidence in the case of each non-response. As requests for confirmation may constitute either substantive tests or tests of controls, we suggest that the Board tighten this aspect, such that in the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. Furthermore, we believe there is a need for any future standard to cover the auditor's procedures in specific circumstances; firstly, when the auditor has determined that a response to a positive confirmation request is necessary to obtain



Page 5 of 5 to the letter dated May 29, 2009, to the PCAOB

sufficient appropriate audit evidence and no response can be obtained; and, secondly, when confirmation responses reveal exceptions – paragraph 14 of ISA 505 specifically requires the auditor to investigate exceptions to determine whether or not they are indicative of misstatements. Any new PCAOB standard should be clear in specifying that auditors investigate significant exceptions. We agree with the statement at the top of page A-14 of the Concept Release “Performing alternative procedures for non-responses and investigating exceptions to confirmation requests may result in the identification of previously unidentified risk of material misstatements, including previously unidentified fraud risk factors that require evaluation.” However, we would caution that care needs to be taken not to create an expectation that it would be practicable for auditors to actively seek out fraud risk factors in following up non-responses and exceptions. Rather it is more a question of auditors using professional skepticism in performing such procedures that may or may not lead to such identification of fraud risk factors which then should be pursued.

The Objective of Audit Confirmations

In general, we support the PCAOB including an objective in its Auditing Standards. In our opinion, the objective of any new standard on audit confirmations ought to be substantially the same as that set forth in ISA 505 (Revised and Redrafted): “The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.”, as this is sufficiently flexible to allow the auditor to exercise professional judgment in determining whether to use audit confirmations as an audit procedure in the individual engagement circumstances. We believe that the way the objective is proposed by the PCAOB would lead to a requirement to use confirmations to respond to all relevant identified risks, and therefore we would not support the PCAOB’s proposed wording.

We hope that our comments are useful for the Board’s further deliberations. Should you have any questions about our comments, we would be pleased to be of assistance.

Yours very truly,

Klaus-Peter Feld
Executive Director

Wolfgang Böhm
Director International Affairs

From: Tim Young [mailto:TimYoung@decosimo.com]
Sent: Monday, April 20, 2009 10:25 AM
To: Comments
Subject: PCAOB Rulemaking Docket Matter No. 028

Banks are requiring us now to provide specific account information (Account number etc). This limitation does not allow us to confirm unrecorded liabilities the client has not disclosed to us.

Accounts Receivables should be confirmed as to the balance not an individual item (Invoice etc.). This would require the responder to note any agreements that may not have been disclosed by the client.

Tim Young, CPA

Joseph Decosimo and Company, LLC
109 West Morris Street
PO Box 769
Dalton, Georgia 30722-0769

Phone: (706) 278-7100
Fax: (706) 278-1799
Toll Free:(800)342-6252

TimYoung@decosimo.com

If you are not the intended recipient of this email, please notify the sender by reply and delete the email from your system. Any use or distribution of information in this email by an unintended recipient is not authorized and may be unlawful. Decosimo does not provide official advice or opinions by email. Do not rely on advice or opinions in this email without obtaining a formal communication.



KPMG LLP
757 Third Avenue
New York, NY 10017

Telephone 212-909-5600
Fax 212-909-5699
Internet www.us.kpmg.com

May 29, 2009

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

Re: Request for Public Comment: *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* - PCAOB Rulemaking Docket Matter No. 028

Dear Mr. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (the Board) *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (the Concept Release). We support a project to amend AU section 330, *The Confirmation Process*, or issue a new auditing standard on audit confirmations to reflect advances in technology since the original standard was written and respond to recent challenges auditors are facing with designing and performing confirmation procedures.

While we agree with the objective of revising existing guidance on audit confirmations, we are concerned that the Board may be considering a prescriptive approach in the Concept Release, which may limit the auditor's ability to exercise professional judgment in the selection of audit procedures that address the risks of material misstatement in the financial statements in the most effective and efficient manner. Many of the questions included in the Concept Release suggest potential new requirements as opposed to allowing exercise of professional judgment. We believe an auditing standard should contain the principles an auditor should follow, allowing for judgment in the selection and performance of audit procedures in response to the risk of material misstatement of the financial statements. The auditor's risk assessment should be the foundation for the auditor's determination of when, and if, to use confirmations to address the assessed risk associated with one or more relevant assertions. Requiring that certain confirmation procedures be performed (1) does not contemplate the effectiveness of confirmations for various assertions, the risk associated with those assertions or the challenges sometimes associated with evaluating the reliability of the confirmation responses, (2) discounts other audit procedures, which may provide more persuasive audit evidence than confirmation procedures, (3) could lead auditors to inappropriately rely on a confirmation response when another procedure might have been more effective, and (4) burdens the auditor with the inefficient task of documenting why confirmation procedures were not performed if the auditor determines that other procedures would be more effective.

Additionally, as the Board considers whether to impose new requirements for the auditor to seek confirmation, we believe it is important to keep in mind that third parties are not obligated to respond to



Office of the Secretary
Public Company Accounting Oversight Board
May 29, 2009
Page 2

an auditor's confirmation request and some third parties choose not to respond. Accordingly, there is likely to be increased effort and associated cost, following up on non-responses and performing alternative procedures. Whether or not the Board imposes any new confirmation requirements, we believe the Board should play an active role in trying to increase both the response rate and quality of the responses to auditor requests for confirmation. Leadership in this area might include encouraging relevant constituency organizations, such as banking associations and organizations of accounting and finance officers, to remind their constituencies of the importance of auditor confirmations and the need for them to provide accurate and timely responses.

We also note that the Board has referred to provisions in International Standard on Auditing 505 (ISA 505), *External Confirmations*, in the Concept Release. We urge the Board to continue its consideration of auditing standards convergence, with the overarching objective of enhancing audit quality around the world.

Converged auditing standards will serve to enhance auditors' understanding, implementation, and consistent application of standards on *all* audits, beyond those subject to the Board's oversight. Enhanced understanding, implementation, and consistent application of auditing standards will serve to improve the quality of audits on a broad basis. Additionally, appropriate convergence affords auditing firms the ability to avoid redundant costs, for example, by allowing for synergies related to training, implementation, and the development and maintenance of quality control systems that accommodate the standards of the various standards-setting bodies.

We understand that the Board has considered the Auditing Standards Board's (ASB) current project to converge its confirmations standard with ISA 505. The ASB will soon expose a proposed standard for public comment, and a number of the issues addressed in this Concept Release have been deliberated by the ASB. We encourage the Board to specifically consider the ASB's proposed standard and the extant guidance, updated in November 2008, in AU Section 9330, *The Confirmation Process: Auditing Interpretations of Section 330*, of the AICPA Professional Standards (vol.1). This interpretation was updated to address some of the challenges related to electronic confirmations.

In addition to our overall comments above, the remainder of this letter provides comments on the following specific areas noted in the Concept Release:

- Objective and Definition of Confirmations
- Requirement to Confirm
- Use of Third-Party Intermediaries
- Management Requests Not to Confirm
- Disclaimers and Restrictive Language
- Negative Confirmations



Office of the Secretary
Public Company Accounting Oversight Board
May 29, 2009
Page 3

Objective and Definition of Confirmations

The proposed objective should be that *when the auditor has determined that confirmations are appropriate*, the procedures are designed and performed to obtain sufficient appropriate audit evidence. The suggested objective in the Concepts Release could be interpreted to mean that the auditor should perform confirmation procedures when those procedures may not be the most effective to obtain sufficient appropriate audit evidence. The Board's Proposed Auditing Standard, *Audit Evidence*, already requires that an auditor design and perform audit procedures to obtain sufficient appropriate audit evidence, and presents external confirmation as a procedure to be considered.

We encourage the Board to conform its definition of confirmation to that used by the IAASB except as noted below. We understand that the ASB recently expanded the definition of an external confirmation from ISA 505 in a soon-to-be-exposed proposed standard, *External Confirmations*. Accordingly, we recommend using the ASB's expanded definition as follows: "Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form, or by electronic or other medium, or through direct access by the auditor to information held by a third party."

When expanding the definition beyond traditional mailed responses, we recommend that the Board provide additional guidance and examples to assist auditors in evaluating the relevance and reliability of the confirmation responses. We recommend that the Board consider the guidance in ISA 505, paragraphs A12-A14, and AU Section 9330, *The Confirmation Process: Auditing Interpretations of AU Section 330*.

We do not believe oral responses should be included in the definition of confirmations. An oral response often provides audit evidence, but would not constitute a "confirmation" as the oral response process might not be as disciplined as a written confirmation.

Requirement to Confirm

We agree with retaining the presumptively mandatory requirement to request confirmation of accounts receivable. However, we do not believe that the requirement should be expanded to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. As discussed in our overall comments above, such a requirement is inconsistent with a principles-based approach to standard setting, particularly given the subjectivity of "*significant terms of complex or unusual agreements or transactions*." Instead, the auditor should apply professional judgment in the decision to confirm these items based on the risk of misstatement of the relevant assertions and the sufficiency and effectiveness of other procedures considered by the auditor.

We believe that auditors should be required to resolve exceptions and perform alternative substantive procedures on non-responses to positive confirmation requests; however the nature of those procedures should be left to the auditor based on specific facts and circumstances. We believe the revised standard should continue to allow for the omission of alternative procedures in the circumstances described in Footnote 30 of the Concept Release.



Office of the Secretary
Public Company Accounting Oversight Board
May 29, 2009
Page 4

Use of Third-Party Intermediaries

The use of an intermediary introduces additional risk relating to the reliability of confirmations, including that the information may not be obtained from an authentic source, the respondent may not be knowledgeable about the information to be confirmed, or the integrity of the information may be compromised. When a third party facilitates the confirmation process between the auditor and the respondent, the auditor should understand the role of the third party. The auditor may wish to evaluate and/or test controls when assessing the reliability of confirmations received through third parties. The Board may want to consider whether and how an assurance trust services report (for example, SysTrust), or another type of auditor's report on that process, may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls, and include appropriate guidance within its revised standard.

Management Requests Not to Confirm

Although we believe requests by management not to confirm to be infrequent, we support the inclusion of the following procedures to consider (see paragraphs 8 and 9 of ISA 505):

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- Evaluate the implications of management's request on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing, and extent of other audit procedures;
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence;
- Communicate with those charged with governance if management's request cannot be validated, is determined to be unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative procedures; and
- Evaluate the implications for the audit and audit opinion.

Disclaimers and Restrictive Language

We strongly encourage the Board to address confirmation disclaimers and restrictive language by working with regulators, issuers, and others to develop an approach that is in the public's best interest, while being sensitive to the respondents' liability concerns. As the use of ever more restrictive disclaimers increases, it will become unreasonable for the auditor to be able to effectively address each unacceptable disclaimer that is received. In all likelihood, the only reasonable course of action will be for the auditor to substantially discount the value of the response and perform alternative procedures. Accordingly, this issue must be addressed at its root cause; an approach that only places additional requirements on auditors when confirmations are received with disclaimers and restrictive language is not in the public interest.

In conjunction with the Board's assessment and response to the broader root cause issue, and due to the recent proliferation of disclaimers and restrictive language, we agree with the inclusion of guidance to evaluate whether such responses provide sufficient appropriate audit evidence. While a clarification of the risk that exists when disclaimers or restricted language are present would be helpful, it is important



Office of the Secretary
Public Company Accounting Oversight Board
May 29, 2009
Page 5

that any guidance follow a principles-based approach and not prescribe additional requirements for auditors to follow, thus replacing the professional judgment of the auditor.

Negative Confirmations

We believe that the evidence provided by negative confirmations is limited and less persuasive than the evidence provided by positive confirmations. Nevertheless, we believe the use of negative confirmations should continue to be allowed. Based on auditor judgment relative to audit risk, the use of negative confirmations represents an audit technique that, in limited circumstances such as testing bank deposit liabilities for understatement, may provide an appropriate source of audit evidence, and as a matter of practicality, may be the only type of substantive procedure that could be performed without undue audit effort and associated cost. We are supportive of the requirements and guidance in the Board's extant confirmations standard (which are also consistent with ISA 505) being included in a new confirmations standard.

If you have any questions or comments regarding information included in this letter, please contact Walt Conn at (201) 505-2615 or Glen Davison at (212) 909-5839.

Very truly yours,

KPMG LLP

cc: Mr. James Kroeker, Acting Chief Accountant – Securities and Exchange Commission

From: mark.a.lyle@us.pwc.com [mailto:mark.a.lyle@us.pwc.com]
Sent: Monday, May 18, 2009 4:25 PM
To: Comments
Subject: PCAOB Rulemaking Docket Matter No. 028

In regards to question 10, "Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?"

The auditor should absolutely test addresses provided to the engagement team to confirm whether the addresses are valid. Particularly when confirming balances held in foreign institutions where the auditor may be unfamiliar with the standard address format of that country, the auditor should take measures to ensure that the provided address is accurate. I have found numerous errors in client-provided addresses that would have resulted in a non-response had the error not been identified before the confirmation was sent. Simple research to identify whether provided addresses match the actual addresses provided by the confirming party's website or other objective means is a fast and relatively easy way to ensure confirmations are sent to the true location of the intended recipient.

Regards,
Mark Lyle

Mark A Lyle | Atlanta TFS | PricewaterhouseCoopers | Telephone: +1 678 419 1799 | Facsimile: +1 813 393 3201 | mark.a.lyle@us.pwc.com

The information transmitted is intended only for the person or entity to which it is addressed and may contain confidential and/or privileged material. Any review, retransmission, dissemination or other use of, or taking of any action in reliance upon, this information by persons or entities other than the intended recipient is prohibited. If you received this in error, please contact the sender and delete the material from any computer. PricewaterhouseCoopers LLP is a Delaware limited liability partnership.

From: dan.mahaffey@novelis.com [mailto:dan.mahaffey@novelis.com]
Sent: Wednesday, April 15, 2009 5:34 PM
To: Comments
Subject: Docket 28

My personal comments regarding audit confirmations:

As a practitioner who has worked for Big 4, large regional, and local CPA firm, and also worked in government, Fortune 200 industry, and small industry, I have seen the auditing profession from a number of different angles. Over the years, I have seen the audit process morph and adapt to the times, but I feel the current audit process relies too much on what I call "conversational auditing", and little hard-nosed auditor work. The current process is primarily geared towards identifying "issues" that the client self-identifies, and little work is done by the auditor to identify issues on their own.

I think anyone who looks at the economics of this process would understand why the auditors would naturally migrate to the current process. I can see three reasons: income, comfort zone, and staff retention.

For example, the pocket book issue of talking about "issues", which drives consulting fees and result in higher overall fees than just audit fees. The daily stress issue which makes it easier to talk about a client's "issues", resulting in a daily routine that is more comfortable and doesn't look like the auditor fails to trust the client. Finally, the new college recruits that make up the audit staff would rather work the client's "issues", so this means that it is easier to retain staff, than when they are relegated to doing confirmations.

All of this means the current process relies heavily on trust:

1. Trust that the client is competent enough to identify the proper issues. Some clients do a better job of hiring competent staff than others.
2. Trust that the client has the resources to gather the right facts. In this international world, with many times zones, language barriers, cultural differences, competitive cost issues, etc. that may be a stretch.
3. Most of all, trust that the client does not have any intent of fraud. Granted, a smart sophisticated criminal mind can make it difficult to detect fraud, but I feel the auditing profession has almost given up on even looking for fraud, or even plain human errors.

When I was a staff person in public accounting, I can't tell you how many issues the audit confirmations identified. Sometimes they were dead ends, but sometimes not. I personally identified a case of fraud thru confirmations and related audit techniques. Are the audit confirmations a pain for everyone involved? You bet. Is it worth the effort to our collective investing society? You bet. So we should focus on the material items, to minimize the pain.

Does this call into play that level of trust between a client and their auditor? It shouldn't. I think everyone realizes that trust between these parties is needed in order for it to be an effective and efficient audit. But since the investing public relies upon the audit process to work, and their expectation is that there is more audit work, it would seem appropriate that any reliance upon the client's representations are substantiated by something more than conversation. My own thoughts are that the process works best when defined by the phrase "Trust,..... but verify". Audit confirmations should be an important part of the audit verification process and the auditor role.

Dan Mahaffey



Paris La Defense, May 29, 2009

Public Company Accounting Oversight Board

Office of the Secretary

1666 K Street, N.W.

Washington, DC 20006, USA

Attention: J. Gordon Seymour, Secretary, and the Members of the Board

Re: PCAOB Rulemaking Docket Matter No. 028 - Mazars comments on the PCAOB proposed concept release on possible revisions to the PCAOB's standard on audit confirmations - PCAOB Release No. 2009-002 April 14, 2009

Dear Sirs,

Mazars is a unique integrated partnership of European origin, specialized in audit, accounting, tax and advisory services. It assembles more than 10,500 professionals operating in 50 countries, led by more than 560 partners, and there are 12 additional countries where Mazars is present through correspondents and joint ventures (see Mazars annual report and its IFRS joint-audited consolidated financial statements on <http://www.mazars.com>). Moreover, via the Praxity Alliance of which Mazars is a founding member, Mazars can access the skills and expertise of a further 13,800 professionals in another 23 countries, all of whom possess a common desire to adhere to strong quality guidelines and a collective determination to exceed technical and ethical standards.

In North America, Mazars has a long standing presence via Mazars USA (created in 1988/1989, and registered with the PCAOB). As a natural extension of its development strategy, Mazars formed several joint ventures with members of Moores Rowland International (MRI) since 2000 to assist its clients in various corners of the world. At the end of 2006, Mazars and the American members of MRI, 5 well known US firms, decided to optimize their relationship, and signed an agreement to launch a new international alliance between independent structures, named Praxity, an international non-profit association registered in Belgium, which became operational in 2007.

As at 31 December 2008, Praxity had 109 participating firms in 72 countries, with more than 24,800 personnel and an aggregated fee income of US\$ 3.2 billion (Euro € 2.3 billion), including Mazars Group. Praxity is the world's largest alliance of independent accounting firms and is ranked in 8th position overall (International Accounting Bulletin's survey of Networks and Associations).

We want to preface our comments with general consideration that we fully support implementation of rules strengthening the audit quality, and the contribution of these rules to restore the public confidence in financial reporting and in the world's capital markets. Mazars is therefore fully committed to support PCAOB initiative, as well as those of IFAC, European Commission and other key European or national regulators or oversight that have been already doing good work and are implementing stronger controls in these areas of common concern.



We are pleased to submit this letter in response to the PCAOB's invitation to comment on its proposed concept release on possible revisions to the PCAOB's Standard on Audit Confirmations.

We respectfully submit our detailed comments below. We commend the Board for the transparency of its rule deliberation process and for considering the work of the IFAC IAASB's Clarity Project in its new standard-setting process.

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

Mazars generally agrees with the Board that this proposed standard should include an objective requiring the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks. Including a clear objective on top of the auditing standard is consistent with the IAASB¹ and the ASB²'s Clarity Projects and the new PCAOB's proposed standard, such as the Engagement Quality Review.

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party? Why or why not?

Mazars agrees with the Board that given the emergence of new communication technologies since the drafting of AU sec. 330 back in the 90's, any new definition of confirmation should allow for responses originating from other sources such as facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party.

We have strong reservations about oral confirmation. It is extremely difficult for auditors to evaluate via professional judgment, the reliability, credibility and integrity of the confirming party using verbal means. Accepting oral confirmations alone raises the specter of fraud tremendously. We would propose that oral confirmations, if agreed upon, be combined with other specific procedures such as inspection of relevant documentation and inquiry of appropriate personnel.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

In general, Mazars agrees with the notion that a new standard on confirmation process should take into account some of the new tools derived from advances in communication technologies and practices such as direct website links into electronic records of an audit client's customer, bank, or other confirming party or "direct access to information held by a third party" or "read-only direct

¹ IAASB – IFAC International Auditing and Assurance Standard Board

² ASB – Auditing Standard Board (AICPA)



website links into electronic records of an audit client on-line access”, or “direct online access”. Mazars believes that a new guidance on confirmation process should be in tune with the business practices of the new internet age.

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

The auditor should devise specific IT controls (website access, information retrieval, and validation protocols, etc) to ensure the adequacy and the integrity of information. Direct follow-up calls to the third parties to verify the source and reliability of data may also be considered for emailed, faxed, and oral confirmations.

However, Mazars believes that auditors should not be required to check the authenticity of documents in this area any more than in any others, unless auditors are put on notice that documents may not be authentic. Professional skepticism does not extend to an assumption that documents lack authenticity. Any revision should make this clear.

Auditing guidance to date has generally either been silent on what to do when auditors’ suspicions are aroused regarding the authenticity or integrity of data, or restricted to a requirement for auditors to resolve any uncertainties and inconsistencies, and failing that, to qualify their audit opinion on the basis of a limitation in the scope of the audit. In practice, unless a fraud trial has been conducted and a court of law determined the outcome, auditors can only seek additional or alternative evidence to corroborate their assessments where evidence presented is doubtful. This is a matter that is already dealt with in auditing standards on audit evidence. To require a different standard of evidence here would require consideration for the need for a different standard of evidence in many other areas.

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

Mazars would strongly support the Board in its proposal to expand the presumptive mandatory perimeters of audit confirmations to include not only accounts receivable but confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. Reference to assessed risk is important and should be raised in order to avoid confirmations being mandatory in all areas where the additional work could be for no benefit

Mazars agrees with the Board that revenue recognition is a critical audit area that is often subject to a potentially greater risk of material misstatement due to fraud as well as failure by auditors to audit it sufficiently. In its most recent report on audit deficiencies³, the PCAOB indicated that:

³ Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms - PCAOB Release No. 2008-008 December 5, 2008: http://www.pcaobus.org/Inspections/Other/2008/12-05_Release_2008-008.pdf



“Inspectors also observed deficiencies when firms were auditing issuers that had more complex revenue-generating transactions or processes. These included the failure to adequately test or evaluate whether (a) the estimated fair values of all elements in multiple-element arrangements governed by Statement of Position (“SOP”) 97-2, Software Revenue Recognition, as amended, were reasonable, (b) the estimated total costs to complete long-term contracts subject to SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts were reasonable, and (c) the estimated fair values of all elements in arrangements with multiple deliverables governed by Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables were reasonable.”

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

The Board should consider requiring the confirmations of other items such as cash, investments, credit facilities, and debt agreements that could provide auditors with adequate, sufficient and competent audit evidence in order to support financial statement assertions. The selection of these additional items for confirmation should be risk-based and cost-effective.

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

Mazars agrees with the notion that the proposed guidance should require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective. These specific procedures should include: assessing the benefits and costs of performing audit confirmations of AR, and determining the financial statement assertions to be met, determining the probability of non-response rate, which should be supported by historical responses rates for the specific engagement in question. If the auditor arrives at the conclusion that the confirmation of AR should be ineffective, then using alternative procedures (example: tracing subsequent cash receipts) is required.

8. Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?

Mazars would support the Board’s proposal to include in new guidance a clear definition of what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions. As we shown in our response to Question # 5, in general the most frequent audit deficiencies come from the most unusual and complex audit areas such as revenue recognition, accounting for estimates, fair value measurements, income taxes, etc. Thus, adding definitions of unusual and complex agreements and transactions, including revenue transactions, in a new audit confirmation guidance could serve as additional alert and give notice to auditors that further due diligence is required.



5

The most useful direction for that guidance would be providing factors to consider when evaluating whether or not a transaction may be considered unusual or complex along with examples to help guide the auditor in his determination. In the same time, we should avoid a checklist in which an item that is not listed is not deemed to be complex or unusual.

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

Mazars would support the Board in regard to guidance in designing confirmation requests that meet audit objectives and financial statement assertions. This direction could include key factors to consider when designing a confirmation to meet the required objective of the confirmation. This guidance could be not only divided by theme, but also by audit assertion. Standardized confirmations for area such as banks are beneficial and can facilitate more consistent responses. However, in areas such as accounts receivable, guidance rather than templates would be preferable.

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

Mazars would support the inclusion in the proposed standard of a requirement for the auditor to test only a sample of the addresses of confirming parties for significant account balances, transactions, or complex agreements. Testing all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients would be a burden for the auditor.

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

Mazars believes that the current guidance as stated in AU sec. 330.28, on how the auditor should maintain adequate control over confirmation requests and responses, should be supplemented with IT control considerations to address communication technology issues (internet). Mazars would also support the Board's re-emphasis on consideration of fraud during the audit planning phase in order to properly assess the "tone at the top" as well as management's integrity (management collusion issue).

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

As stated above, this proposed guidance should be mindful of technological advances that is leading to an increased of fraud risk, including management collusion. The auditor should be required to maintain tight and systematic control and supervision over the audit confirmation



process in electronic form. In order to reduce the risk of interception of confirmation requests, there could be an audit trail and traceability of the confirmation requests. Example: A Fedex shipment can be followed and trailed from drop-off to pick-up on the internet. In order to reduce the risk of alterations of the confirmation responses, alternative audit procedures should be considered to assess the reliability of the confirmation responses.

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

Mazars agrees with the Board that the proposed standard should require an auditor to perform procedures to address the reliability of responses when alternative forms of communication are used.

The Board should consider adopting requirements similar to those in ISA 505, paragraphs 10 and 11 which state that:

- *"If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts."*
- *"If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud and on the related nature, timing and extent of other audit procedures".*

We also agree with the proposed requirement that when a third-party service provider is used to respond to confirmation requests and if the auditor relies on its system or process, the equivalent of a SAS 70 report should be required to assist that auditor in assessing the design and operating effectiveness of the electronic and manual controls that address the reliability of the information being confirmed.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third party database or provided by the third-party service provider is reliable?

Mazars would favor a requirement that a significant third party database or a significant third-party service provider's internal control systems that respond to confirmation requests be audited⁴ so that an auditor could rely upon these audited systems and processes to assess the reliability of the electronic information being confirmed.

⁴ Please refer to Proposed Statement on Auditing Standards, Audit Considerations Relating to an Entity Using a Service Organization (Redrafted) http://www.aicpa.org/download/auditstd/SAS_ED_Service_Organizations.pdf



7

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

Mazars believes that the design and operating effectiveness of a third party service provider's systems and processes that are a part of a confirmation process as described here are adequate.

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

Mazars would strongly support maintaining the requirement that the auditor perform alternative procedures for non-responses to positive confirmation requests. Inherently, non-response to positive confirmation requests call for actions on the part of the auditor as this is the primary third party evidence to be relied upon.

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

Mazars strongly believes that the new guidance should clearly mandate the auditor to investigate exceptions identified during the audit confirmation process. This requirement would allow the auditor to determine whether the auditing standard's objective on top was met as well as whether the financial statement assertions were met for audit confirmations of accounts receivable and other complex transactions or account balances to be confirmed.

We propose that the Board clearly defines what an exception is using ISA 505.6(e) as a starting point and including electronic confirmations from third-party database or third-party service provider.

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

Mazars agrees with the requirement that the auditor consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses. This is consistent with the risk-based approach as recommended by AS 5.

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

Mazars agrees with the requirement that the proposed standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of



unusual or complex agreements or transactions. The alternative procedures may include using the work of specialists; extended testing of revenue recognition surrounding these contracts using whatever third party evidence available; requesting copies of the contracts and all amendments be sent directly to the auditor from the third party; considering a scope limitation, etc.

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Mazars would not support having the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items. Mazars strongly believes that at inception, the engagement letter should clearly state that no audit areas are off-limits to audit procedures. Mazars strongly believes that management integrity issue is raised anytime that management tries to limit the scope of audit procedures. Not confirming certain accounts, transactions, agreements, or other items under management is tantamount to limiting audit scope.

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

Mazars would not support requiring an auditor to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses. This would put another burden on the auditor. Disclaimers and restrictive language on confirmation requests are increasingly common now in response to bank confirmations and legal confirmation requests and the view is taken that of themselves, they do not significantly impair the value of such evidence. Furthermore, the practical effect of a disclaimer or restrictive language is likely to require a legal analysis that is not within the auditor's competence.

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

Mazars would support the continuing use of negative confirmations as currently stated in AU sec. 330.17-20. We believe that there are situations in which negative confirmation may provide additional comfort over balances, especially when they are not used in conjunction with other forms of audit evidence. For example, when auditing deposit accounts for a banking institution, positive confirmations may not be the most efficient or effective method, however, a combination of testing of the internal control system, positive and negative confirmations could provide the appropriate level of comfort needed. We believe that clear guidance is needed in the use of negative confirmations and the audit evidence obtained from them.



9

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

Mazars believes that the current requirement as recommended by AU sec. 330.51 is sufficient.

We hope that our comments above will be helpful and we remain available for further considerations. Please feel free to contact us again if you would like to discuss our submission further.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'J-L Barlet'.

Jean-Luc Barlet

Mazars

Risk Management & Audit Quality

McGladrey & Pullen

Certified Public Accountants

3600 American Blvd West
Third Floor
Bloomington, MN 55431
O 952.835.9930 F 952.921.7704

May 29, 2009

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

Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations

RE: PCAOB Rulemaking Docket Matter No. 028

McGladrey & Pullen, LLP appreciates the opportunity to comment on the PCAOB's *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (the Concept Release). McGladrey & Pullen is a registered public accounting firm serving middle market issuers.

OVERALL COMMENTS ON THE CONCEPT RELEASE

We support the PCAOB's potential standard-setting project to amend AU Section 330, *The Confirmation Process* and believe that soliciting input and feedback at an early stage of the standard-setting process will result in a more effective process. We support the PCAOB's use of Concept Releases to obtain input on relevant issues for use in drafting proposed standards or revisions to existing standards.

Principles-based standards that support professional judgment

We are concerned the Concept Release suggests the Board may be considering a prescriptive, more rules-based, approach. Some of the questions included in the Concept Release discuss the inclusion of potential new "requirements" as opposed to guidance that would allow auditors to exercise appropriate professional judgment. We encourage the Board to adopt suggested revisions of its confirmations standard that supports and enhances the use of auditors' professional judgment. Such an approach is consistent with encouraging the use of the auditor's professional judgment in planning and performing audit procedures that are appropriately responsive to risks the auditor has identified. Additionally, because third parties are not obligated to respond to an auditor's confirmation request, we are concerned about the Board furthering current unilateral requirements imposed solely on auditors (i.e., and not also on third parties from whom confirmations are sought).

Convergence of auditing standards

We support the Board's consideration of the work of both the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB). We are in favor of convergence of auditing standards by using the International Standards on Auditing (ISAs) as the base from which to develop standards (in this case, ISA 505 (Redrafted), *External Confirmations* (ISA 505)) and adding to or modifying the ISA wording for specific requirements and guidance deemed necessary for the purposes of auditing issuers.

We understand the PCAOB has considered the ASB's current project to converge its confirmations standard with ISA 505. The ASB will shortly expose a proposed standard for public comment and a number of the issues addressed in this Concept Release have been discussed by the ASB and related task forces. During its standard-setting process, we encourage the PCAOB to consider specifically the ASB's proposed standard and the existing guidance in AU Section 9330, *The Confirmation Process: Auditing Interpretations of Section 330*, of the AICPA Professional Standards (vol.1). This interpretation was issued as a result of some of these debates and addresses some of the challenges relating to electronic confirmations.

Further study of audit confirmation process

We recommend the PCAOB conduct studies regarding the efficiency, effectiveness, and reliability of confirmations, including third-party intermediaries, methods of increasing response rates and effects of technology. We believe the PCAOB should put together a group of auditors, issuers, banking regulators, bankers, other service providers and IT experts to discuss best practices available to auditors in improving the confirmation process, including designing confirmation requests, maintaining control over confirmation requests and responses and ensuring reliability of confirmation responses.

OTHER OBSERVATIONS AND CONCERNS

Objective and definition

The suggested objective in the Concept Release could be interpreted to mean that performance of a confirmation procedure would provide sufficient, competent audit evidence in all cases. We believe the objective should be that *when the auditor has determined that confirmations are appropriate*, the procedures are designed and performed to obtain reliable audit evidence.

We also recommend the Board provide guidance regarding evaluating the reliability of information obtained through the confirmation process, including practical examples. In considering this guidance, we recommend the Board refer to the guidance in ISA 505, paragraphs A12-14 and in AU Section 9330. Further, we recommend the Board seek to obtain input from specialists in electronic information exchange to identify potential avenues of manipulation in an exchange of information through direct online access, including how the occurrence of manipulation might be prevented or detected. Insights obtained might then be included in the guidance as part of the practical examples.

Determining when to use audit confirmations

We believe the Board should provide more guidance to auditors to assist in the determination of *when* confirmations might be used (i.e., when confirmations would provide an appropriate source of audit evidence given the facts and circumstances), instead of creating presumptive requirements. We do not believe the revised guidance should provide prescriptive requirements regarding what data should be confirmed. For example, we do not believe the requirement to confirm accounts receivable should be expanded to require in all circumstances confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. Rather, the necessity of using confirmation procedures, as opposed to other available audit procedures, should be considered by the auditor using professional judgment based on risk assessments and the consideration of the potential sources of audit evidence. Additionally, the use of words such as "significant terms," "complex," or "unusual" are subjective in nature and very possibly may lead to inconsistent application by auditors.

Exceptions and non-responses

Auditors should be required to resolve exceptions and follow up on non-responses; however, the nature of those procedures should be left to the auditor based on facts and circumstances. We believe the revised standard should continue to allow for the omission of alternative procedures in the circumstances described in Footnote 40 of the Concept Release.

Consistent application of standards

In drafting a new standard, especially aspects that address recipient address validation, confirmation control, and authentication of responses, we recommend the PCAOB ensure consistency regarding the ultimate objectives for both manual and electronic confirmations. The objectives that should be achieved for electronic and manual communications are the same, although the techniques may vary. We believe the requirements in the revised standard should not be overly prescriptive or focused on the form of the confirmation.

Use of third-party intermediaries

The use of an intermediary introduces additional risk relating to the reliability of confirmations, including that the integrity of the information may be compromised. When a third party facilitates the confirmation process between the auditor and the respondent, the auditor should understand the role of the third party. The auditor may wish to evaluate and/or test controls when assessing the reliability of confirmations received through third parties. The Board should consider whether and how an assurance trust services report (for example, SysTrust), or another type of auditor's report on that process, may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls, and include appropriate guidance within its revised standard.

Management requests not to confirm

Because of elevated risk associated with a request by management not to confirm certain items, we support the inclusion of the procedures to consider as identified in ISA 505, paragraphs 8 and 9.

Disclaimers and restrictive language in confirmation responses

We believe that depending on the nature of the risk, a disclaimer or the use of restrictive language may limit the amount of evidence that is provided by a confirmation. While the standard should remind auditors of this, we are concerned that any new detailed requirements, which by their nature would not address all situations, might tend to supplant professional judgment. However, more guidance on how disclaimers and other restrictive language might affect the auditor's assessment of the relevance and reliability of audit evidence provided by confirmations would be useful.

Additionally, the fact that some respondents use disclaimers and other restrictive language indicates a flaw of imposing unilateral requirements on auditors without addressing respondents' obligations and mechanisms that might be put in place to reinforce their responsibilities relating to responding to confirmation requests. We encourage the Board to work with organizations that represent issuers, banking regulators, the SEC, and others to develop an approach that is in the public's best interest, while being sensitive to the respondents' liability concerns.

Negative confirmations

We believe the evidence provided by negative confirmations may be limited and might be less persuasive than the evidence provided by positive confirmations. However, we believe the use of negative confirmations should continue to be permitted because in certain circumstances, negative confirmations may provide an appropriate source of audit

evidence, and may be the only type of substantive procedure that could be performed without undue audit effort and associated cost.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to either Bruce Webb (515-281-9240) or Bob Dohrer (919-645-6819).

Sincerely,

A handwritten signature in cursive script that reads "McGladrey & Pullen, LLP".

McGladrey & Pullen, LLP

From: Howard Levy [mailto:hlevy@pbt.com]
Sent: Wednesday, September 02, 2009 6:45 PM
To: Comments; mirandogould@pcaobus.org; David, Christopher
Subject: PCAOB Rulemaking Docket Matter No. 028

Ladies and Gentleman:

We are aware that the comment period has expired with respect to the Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations issued April 14, 2009, and regret that we were unable to comment within the allotted time. Nevertheless, we thought our comments recently presented to AICPA's Auditing Standards Board in response to its proposed SAS, *External Confirmations*, about what we regard as serious issues overlooked by that body might likely be of interest to those deliberating similar issues at the PCAOB. Accordingly, we are attaching that comment letter for your information and consideration before a proposed standard is exposed by the PCAOB for further comment.

Very truly yours,



Howard B. Levy, CPA
Senior Principal
Director, Technical Services

6100 Elton Ave, Ste 1000
Las Vegas, NV 89107-0123
702.384.1120 Fax: 702.870.2474
Mobile: 702.279.5389
E-mail Address: hlevy@pbt.com
www.pbt.com

IRS Circular 230 (Regulation) disclosure: To ensure compliance with requirements imposed by the IRS, Piercy Bowler Taylor & Kern informs you that any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (I) avoiding tax related penalties under the Internal Revenue Code or (II) promoting, marketing or recommending to another party any transaction or matter addressed herein.

Confidentiality Statement: This e-mail contains confidential information which also may be privileged. Unless you are the addressee (or authorized to receive for the addressee), you may not copy, use, disclose or distribute the e-mail message or any information contained in the message. If you have received the e-mail message in error, please advise the sender by replying to this e-mail message or by telephone and then promptly delete it.

PIERCY BOWLER TAYLOR & KERN

Certified Public Accountants • Business Advisors

August 28, 2009

Sherry Hazel, Administrative Secretary, Audit and Attest Standards
 American Institute of Certified Public Accountants
 Transmitted by e-mail to: shazel@aicpa.org

Re: Proposed Statement on Auditing Standards; *External Confirmations*

Dear Ms. Hazel:

We are pleased to have the opportunity to respond to the request for comment on the exposure draft, "Proposed Statement on Auditing Standards, *External Confirmations*" (the ED or the proposed SAS).

Our comments are focused primarily on what is not in the ED rather than what is. Quite frankly, we find the so-called "issues for consideration" set forth in the accompanying Explanatory Memorandum to be rather trivial in the absolute and certainly in relation to what is omitted, which we believe to be the most significant issue relative to the use of confirmations to have faced our profession in the last 70 years. Consequently, we are not responding directly to the questions posed in the "Guide for Respondents" section of the ED.

As suggested in the Explanatory Memorandum, the proposed SAS "is not expected to change practice in any significant respect," nor does it add any substance to the current standard or related other guidance now available. Accordingly, we believe the ED, as written, does not justify the issuance of a new standard at this time.

On the other hand, the one significant emerging issue omitted from the ED does, in our opinion, warrants addressing at the standard-setting level. That is the use of third party service providers to process electronic confirmations.

Use of third party service providers to process electronic confirmations. The AICPA attempted to address questions from practitioners on such practices raised through its Audit and Attest Hotline in an informal and virtually irretrievable "Communication to AICPA Members Regarding Electronic Confirmations" posted on its website February 10, 2009. Besides being virtually irretrievable and anonymous as to its source and certainly not authoritative, this communication is extremely superficial; it fails to address the principal issues we have identified and with which we are concerned about in connection with this growing practice. Like AU9330.-.03 and .06* and PITF Practice Alert 03-1, to which it refers, the communication speaks primarily to the security of electronic data transmission and not to any of the critical issues listed below:

- An auditor's use of a third party service organization to control, mail, receive and process electronic confirmations, often including verification of names and addresses of intended recipients, is, in fact and substance, the delegation of audit procedures to a third party (like another auditor) that are to be performed on the auditors' behalf. However, there is no literature, authoritative or not, that makes an analogy to or discusses the applicability or inapplicability of AU 543. Nevertheless, auditors need to be told that they have a responsibility to assess the competence of assigned service organization personnel, the quality of supervision that they receive, and their independence from the audit client. , and to make audit scope judgments based on such assessments.

* In fact, it is only AU 9930.07 that is somewhat relevant to the use of third party service organizations, but it falls far short of dealing with the principal issues identified herein. It does recommend consideration of a report based on an assurance service called SysTrust for assessing the reliability of a system for processing confirmations. Few auditors, however, are familiar with SysTrust or are able to distinguish a SysTrust or similar report or the related assurance service from those that are associated with a SAS 70 audit engagement discussed herein. Such a distinction is made in another virtually irretrievable (except by internet search engine) and anonymous AICPA online document available at <http://www.sas70.com/systrust.html>.

Sherry Hazel, Administrative Secretary
AICPA Audit and Attest Standards

August 28, 2009
Page 2

- Many auditors seem to be of the mistaken notion that a SAS 70 (AU 324) audit report from an auditor engaged by one of these service organization serves as useful evidence as to reliability of the service provided. These auditors do not seem to understand that SAS 70 is intended to deal solely with the objective of obtaining an understanding or establishing the reliability (depending on whether one gets a type 1 or type 2 report) of controls exercised by the third party service organization on a client's behalf in the execution or processing of the client's transactions. A SAS 70 report is not intended to afford a basis for relying on *audit work performed by others* in support of one's audit opinion, as AU 543 is.
- The February 10, 2009, communication from the AICPA indicates that it was precipitated by the position taken by a major bank (and probably others) that it will not process requests for confirmations unless made electronically through a specified third party service organization with which it has contracted. However, if a third party service organization is to be used to service the auditor, it should be the auditor's sole judgment that dictates what organization is to be selected and to what extent it is to be relied upon. This is an audit scope decision that should not be made by a bank. In our opinion, allowing a bank to make such a decision without allowing the auditor the opportunity to evaluate the service organizations qualification or make scope adjustments based on the results of such evaluation, may likely constitute a significant scope restriction that should be dealt with as such as guided by other applicable literature.

The February 10, 2009, communication refers to an auditing interpretation in process that will further address "evolving practices related to the use of electronic confirmations." It appears that this is not referring to the subject ED, but we believe that guidance as to all of these significant matters is urgently needed and, therefore, should be addressed now and at the standard level.

Other matters. We have two comments that do address matters that are contained in the ED. The first deals with negative confirmations. Paragraphs 15c and 15d repeats the requirements of the extant standard that to use negative confirmations, an auditor must expect a low rate of exceptions and (expressed in the negative) have no reason to believe that requests for such negative confirmation would be disregarded by recipients. We believe that, like paragraph 15c, paragraph 15d should be expressed as a positive expectation. We also believe that these are risk assessments that, to be consistent with the principles of the risk assessment standards, should be based on objective audit evidence that should be documented and that the final standard should say so. Moreover, we believe that these criteria, and the need for supporting evidence in their evaluation, should be discussed in greater detail in or near paragraph A26 in the final standard.

Our second comment relative to the content presented in the ED is a minor one. We believe that the term "external confirmation," used in the title of and throughout the proposed standard and the appendix is awkward and redundant, that is not consistent with the ASB's stated intent with regard to convergence, *i.e.*, "to use terms or phrases that are more common in the United States," and that it should be reduced, therefore, to merely "confirmation."

A courtesy copy of this letter is being sent directly to Charles Landes. Please also forward one to each of the other copy recipients named below. Questions about our comments may be addressed to the undersigned at hlevy@pbt.com or by telephone at 702/384-1120.

Very truly yours,



Howard B. Levy, Sr. Principal and
Director, Technical Services

cc: Charles E. Landes, Vice President, Professional Standards
Harold L. Monk, Chair, Auditing Standards Board
Megan F. Zeitsman, Chair, External Confirmations Task Force



PricewaterhouseCoopers LLP
400 Campus Dr.
Florham Park NJ 07932
Telephone (973) 236 4000
Facsimile (973) 236 5000
www.pwc.com

May 29, 2009

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

RE: PCAOB Rulemaking Docket Matter No. 028, *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*

Dear Sir:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Public Company Accounting Oversight Board's (PCAOB or the "Board") Release No. 2009-002: *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (the "Concept Release").

We support the Board's continuing effort to promulgate auditing standards that promote audit quality. In the past, we have encouraged the Board to increase the depth and accelerate the timing of public involvement in its standard-setting process, and believe that the issuance of a concept release is a positive step towards this goal. We believe that the use of a concept release has the potential to provide increased transparency to the Board's standard setting agenda and will provide early input as the Board considers a new standard. We view the use of a concept release to be an important and welcomed improvement to the Board's standard setting process and suggest that concept releases be used in the future. We recommend, however, that the Board consider release at a time closer to the beginning of a standard setting project (e.g., in 2004 in the case of the audit confirmations project). Doing so will help to ensure that a concept release and responses thereto serve to accelerate rather than potentially delay the progress of the project.

While the Board's issuance of a concept release helps to increase the depth and accelerate the timing of input, we continue to believe that the quality of the standard-setting process could also be significantly enhanced by creating task forces or otherwise more directly involving experienced members of the auditing profession in the development of standards. We believe that such a process would enhance the quality, timeliness and efficiency of the development process and complement the role of the Standing Advisory Group and the other forums that currently inform the Board's standard-setting activities.

Lastly, before responding to the specific questions raised by the Board and in light of the increasing global acceptance of the International Standards on Auditing ("ISAs"), we continue to encourage the Board to provide a detailed comparison of its proposed standards and those of the International Auditing and Assurance Standards Board ("IAASB"). When the Board moves forward with an exposure draft on Audit Confirmations, we suggest that the Board provide a marked comparison of the proposed standard to ISA 505, *External Confirmations* (revised and redrafted) ("ISA 505"), in order to highlight differences between the two standards. We suggest that significant differences be discussed in the Board's release. By highlighting differences, we believe commenters will be able to more readily and thoroughly analyze the Board's proposal and therefore be able to provide quality feedback without undue effort.



In the remainder of our letter, we have provided our responses to each of the 23 questions posed in the Board's Concept Release.

Objective of the confirmation standard

Question 1 - Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

Consistent with ISA 505.5 and the proposed SAS that the Auditing Standards Board (ASB) has voted to expose (AICPA's proposed SAS on Audit Confirmations), the standard should include an objective. We offer the following suggestion of an objective for the audit confirmations standard:

The objective of the auditor is to use external confirmations in appropriate circumstances in response to assessed risks and to design and perform such confirmation procedures to independently obtain relevant and reliable audit evidence from knowledgeable third parties.

Our proposed objective is different from that suggested by the Board in its question in two important ways. First, it includes the auditor's consideration of when to use confirmations since we believe, as further discussed in other parts of our letter, that the Board's standard should provide guidance, as opposed to new presumptions, that will assist auditors in making this determination. Second, it replaces the objective of obtaining "sufficient competent" audit evidence with the objective of obtaining "relevant and reliable" audit evidence since confirmations may not be the sole source of audit evidence for a particular account or assertion.

Definition of confirmation

Question 2 - Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party? Why or why not?

Yes. In light of the evolution of methods of communication since Statement on Auditing Standards No. 67, *The Confirmation Process* (AU 330) was written over a decade ago, we believe that the definition of confirmation should be updated to specifically include electronic responses and responses received through third parties. Further, we believe that the standard should provide appropriate guidance regarding the consideration of proper control and use of electronic confirmations as discussed in our response to Question 3. The use of electronic media (e.g., web sites, email, fax) for obtaining confirmations has become increasingly relevant to auditors. Over the past few years, financial institutions have introduced electronic confirmations as an option for auditors to confirm bank balances and some even now require the use of electronic confirmation requests and/or responses. Additionally, certain financial institutions have partnered with third-party electronic confirmation service providers to facilitate receipt of confirmation inquiries and delivery of a response.

However, we don't believe that access to a client's account information should constitute "confirmation" unless both (a) the third party has knowledge of the auditor's request and intended use, and (b) the auditor's access is provided by the third party (i.e., as opposed to the client simply sharing their access to third party information). We believe AU 330.04 appropriately provides that audit confirmation is a process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions. We believe that it is important for a third party to be aware that an auditor intends to rely upon the information for the



information to constitute an "audit confirmation." Important audit evidence can be obtained when the client provides the auditor with "access" to a bank website in order to view client account balances without the third party's knowledge; however, we do not believe that this should constitute a "confirmation" under PCAOB standards.

We believe it is important to acknowledge that oral responses to written confirmation requests do provide audit evidence; however, we agree with ISA 505.A15 which states that, "on its own, an oral response to a confirmation request does not meet the definition of an external confirmation." As a result, we believe that the following guidance on oral responses from AU 330.29 is appropriate:

There may be situations in which the respondent, because of timeliness or other considerations, responds to a confirmation request other than in a written communication mailed to the auditor. When such responses are received, additional evidence may be required to support their validity. For example, facsimile responses involve risks because of the difficulty of ascertaining the sources of the responses. To restrict the risks associated with facsimile responses and treat the confirmations as valid audit evidence, the auditor should consider taking certain precautions, such as verifying the source and contents of a facsimile response in a telephone call to the purported sender. 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 confirmations is significant, the auditor should request the parties involved to submit written confirmation of the specific information directly to the auditor.

Question 3 - What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

We believe that the recently issued AICPA Interpretation No. 1, "*The Use of Electronic Confirmations*" of AU 330 (AU 9330) provides guidance that the PCAOB should consider. It states the following:

The auditor's consideration of the reliability of the information obtained through the confirmation process to be used as audit evidence includes consideration of the risks that

- *the information obtained may not be from an authentic source;*
- *a respondent may not be knowledgeable about the information to be confirmed; or*
- *the integrity of the information may have been compromised.*

No confirmation process with a third party is without some risk of interception or alteration, including the risk that the confirmation respondent will not be the intended respondent. Such risk exists regardless of whether a response is obtained in paper form, by electronic correspondence, or through some other medium. Factors that may indicate increased risk relating to the reliability of a response include that it

- *was received by the auditor indirectly; or*
- *appeared not to come from the originally intended confirming party.*

Responses received electronically, for example by facsimile or e-mail, involve risks relating to reliability because proof of origin and knowledge of the respondent may be difficult to establish and alterations may be difficult to detect. An electronic confirmation process that creates a secure confirmation environment may mitigate the risks of interception or alteration. The key to creating a secure confirmation environment lies in the process or mechanism used by the



auditor and the respondent to minimize the possibility that the results will be compromised because of interception or alteration of the confirmation.

The PCAOB should also consider the application guidance in paragraph A12 of the AICPA's proposed SAS on Audit Confirmations, which notes the following:

Responses received electronically, for example by facsimile or electronic mail, involve risks relating to reliability because proof of origin and knowledge of the respondent may be difficult to establish, and alterations may be difficult to detect. An electronic confirmation process that creates a secure confirmation environment may mitigate the risks of interception or alteration. The key to creating a secure confirmation environment lies in the process or mechanism used by the auditor and the respondent to minimize the possibility that the results will be compromised because of interception or alteration of the confirmation. If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced. Various means might be used to validate the source of the electronic information and the respondent's knowledge about the requested information. For example, the use of encryption, electronic digital signatures, and procedures to verify Web site authenticity may improve the security of the electronic confirmation process.

Question 4 - What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

We believe that the auditor should be required to assess the risk and determine the extent to which procedures should be performed, rather than be required to perform a specific set of procedures that would be required in every circumstance. In this regard, we believe that the guidance in AICPA AU 9330 and application guidance in paragraph A15 of the AICPA's proposed SAS on Audit Confirmations is appropriate and should be considered by the Board as it allows the auditor to apply judgment depending on the specific facts and circumstances. The auditor may be able to use an assurance trust services report (for example, Systrust) or a SAS 70 report to assess the design and operating effectiveness of the electronic and manual controls with respect to electronic confirmations if a system or process that facilitates electronic confirmation is in place. In some cases, for example if a Systrust or SAS 70 report is unavailable, the auditor may determine that it is appropriate to address the risks related to reliability of transmission of the information received electronically by directly contacting the purported sender (for example, by telephone) rather than by using alternative means.

Paragraph A15 of the AICPA's proposed SAS on Audit Confirmations states the following:

"The auditor is required...to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence. In some cases, the auditor may determine that it is appropriate to address the risks related to the reliability of the information received electronically by directly contacting the purported sender (for example, by telephone) rather than by using alternative means to validate the source of the electronic information. For example, if significant information is provided via an e-mail response, the auditor may perform alternative procedures, including procedures to verify the authenticity of information such as the e-mail address of the purported sender. The auditor may also contact the purported sender directly by telephone to verify that the information received was sent by the confirming party and also that what was received by the auditor corresponds to the information transmitted by the purported sender. When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than to the auditor), the auditor may request the confirming party to respond in writing directly to the auditor.



Confirmations obtained electronically may be considered reliable audit evidence if the auditor is satisfied that (a) the electronic confirmation process is secure and properly controlled, (b) the information obtained is a direct communication in response to a request, and (c) the information is obtained from a third party who is the intended respondent."

Requirement to confirm

Question 5 - Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

Question 6 - Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

No. Various factors may affect an auditor's risk assessment, including: materiality, nature of the transaction, business purpose, historical information, relationship/frequency of transaction with the counterparty, subsequent information, etc. Paragraph A120 of ISA 315, *Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment*, states that risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

- *Greater management intervention to specify the accounting treatment.*
- *Greater manual intervention for data collection and processing.*
- *Complex calculations or accounting principles.*
- *The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.*

Rather than expanding the presumptively mandatory requirement, the Board should consider including a framework that includes factors the auditor should consider in making a determination about whether confirmations are an appropriate source of audit evidence in the circumstances. We also believe that the factors contained in paragraph A51 of ISA 330, *The Auditor's Response to Assessed Risks*, are appropriate, which are as follows:

- *The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.*
- *The ability or willingness of the intended confirming party to respond – for example, the confirming party:*
 - *May not accept responsibility for responding to a confirmation request;*
 - *May consider responding too costly or time consuming;*
 - *May have concerns about the potential legal liability resulting from responding;*
 - *May account for transactions in different currencies; or*
 - *May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.*

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.



- *The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.*

We believe that it is appropriate for auditors to use these factors, in addition to the other factors in AU 330.34 (discussed in our response to Question 7), when performing a risk assessment and evaluating whether it would be effective to use audit confirmations. Given the nature of these considerations, and the fact that the appropriate risk considerations, including the relevant factors to consider, are dependent upon the facts and circumstances, it is inappropriate to extend the presumptive requirement for confirmation of accounts receivable to other areas. However, if the Board were to create guidance, we strongly believe it should be predicated with "may" rather than "should" to allow for appropriate auditor judgment.

Question 7 - Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

Auditors currently consider each of the factors in AU 330.34 (i.e., whether accounts receivable are immaterial to the financial statements, the use of confirmations would be ineffective, and the auditor's combined assessed level of inherent and control risk in conjunction with other evidence) when designing their audit approach. We believe that adding specific procedures to evaluate the effectiveness is unnecessarily burdensome. Instead, we believe that the Board should consider including the factors in AU 330.34 and possibly adding other factors for auditors to consider, such as the items included in our response to Questions 5 and 6 from ISA 330.A51, rather than creating specific procedures for auditors to perform. Moreover, we believe that there would be greater value in focusing the auditor's attention on when confirmations can be effective and should be used, rather than directing the auditor's attention to obtaining evidence simply to verify that they are not (effective).

Question 8 - Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?

No. Attempting to define "unusual" or "complex" would not be practical given the vast array of circumstances that could fit that description. Furthermore, a prescriptive approach could result in focusing on strict compliance with standards rather than appropriately evaluating and addressing risk of material misstatement. As discussed in our response to Question 5, many factors are important to an auditor's risk assessment. We caution that what may be unusual or complex to one issuer may not be to another issuer, and that creating presumptively mandatory direction in an auditing standard could have the unintended consequences of requiring additional work to be performed that may not be commensurate with the level of risk. Additionally, creating a prescriptive approach could also have the unintended consequence of leading an auditor not to perform confirmation procedures simply because a transaction was not included within the Board's definition of unusual or complex.



Designing confirmation requests

Question 9 - Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

We believe that no significant change is required with regard to designing confirmation requests; however, the Board may consider including application guidance similar to what is included in paragraph A4 of ISA 505 and the AICPA's proposed SAS on Audit Confirmations.

Paragraph A4 of ISA 505 and paragraph A4 of the AICPA's proposed SAS on Audit Confirmations are as follows:

Factors to consider when designing confirmation requests include:

- *The assertions being addressed*
- *Specific identified risks of material misstatement, including fraud risks*
- *The layout and presentation of the confirmation request*
- *Prior experience on the audit or similar engagements*
- *The method of communication (for example, in paper form, or by electronic or other medium)*
- *Management's authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorization.*
- *The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).*

Question 10 -Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

We suggest that the Board consider including application guidance consistent with paragraph A6 of ISA 505 and the AICPA's proposed SAS on Audit Confirmations, which states that "determining that requests are properly addressed includes testing the validity of some or all of the addresses on the confirmation requests before they are sent out."

Maintaining control over confirmation requests and responses

Question 11 - What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

Question 12 - What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

In addition to the guidance contained in the Board's existing standard, the Board should consider adding guidance that maintaining control includes performing procedures to verify that the confirmation is being directed to the intended recipient, similar to that in AICPA Interpretation AU 9330. Specific to email confirmations, the auditor may decide to perform procedures to verify the email address supplied by the auditor's client for a confirmation request to be sent to that recipient's email address. If another electronic process is used, the auditor may decide to perform other procedures to determine that the request is directed to the intended recipient.



Reliability of confirmation responses

Question 13 - What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

AICPA Interpretation AU 9330 provides guidance that the Board should consider. It states that the auditor should consider the reliability of the information to be used as audit evidence in response to the risks that the confirmation might not be obtained from an authentic source, a respondent may not be knowledgeable about the information to be confirmed, and the integrity of the information might have been compromised. While AU 330.33 states that the auditor should consider the reliability of the confirmations, AU 230.12 also appropriately states that an audit conducted in accordance with generally accepted auditing standards rarely involves authentication of documentation, nor are auditors trained as or expected to be experts in such authentication.

The IAASB considered the AICPA's interpretation when recently finalizing ISA 505. ISA 505 paragraph A14 requires the auditor to obtain further evidence if the auditor identifies factors that give rise to doubts about the reliability of the response. Such factors include whether the response was received by the auditor indirectly or whether it appeared not to come from the originally intended confirming party. In these situations, the auditor is required to evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. Examples of additional procedures include calling the confirming party.

Question 14 - When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

Similar to guidance in ISA 505 and the AICPA's proposed SAS on Audit Confirmations, the Board should include guidance relating to evaluating the reliability of confirmation responses received electronically (e.g., use of a third-party service provider or direct on-line access to a third-party database provided directly by that third party). Auditors' access to a secure website through the use of a username and password that is separate from the client's is an example of direct on-line access to a third-party database. The PCAOB should consider the following guidance included in the recently issued AICPA interpretation AU 9330:

Various means might be used to validate the source of the electronic information and the respondent's knowledge about the requested information. For example, the use of encryption, electronic digital signatures, and procedures to verify Web site authenticity may improve the security of the electronic confirmation process.

If a system or process that facilitates electronic confirmation between the auditor and the confirmation respondent is in place and the auditor plans to rely on such a system or process, an assurance trust services report (for example, Systrust), or another auditor's report on that process, may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls with respect to that process. Such a report would usually address the risks described above. If these risks are not adequately addressed in the report, the auditor may perform additional procedures to address those risks.

In some cases, the auditor may determine that it is appropriate to address the risks related to the reliability of the information received electronically by directly contacting the purported sender (for



example, by telephone) rather than by using alternative means to validate the source of the electronic information. For example, if significant information is provided via an e-mail response, the auditor may perform alternative procedures, including procedures to verify the authenticity of information such as the e-mail address of the purported sender. The auditor may also contact the purported sender directly by telephone to verify that the information received by the auditor was sent by the confirming party and also that what was received by the auditor corresponds to the information transmitted by the purported sender.

As indicated in our response to Question 2, we do not believe that access should constitute "confirmation" unless the third party has knowledge of the auditor's request and intended use and unless the auditor's access is provided by the third party. Where the auditor's client has provided the auditor "access" to a bank website to view client balances without the third party's knowledge, we do not believe this should constitute a confirmation and is not the same as the electronic confirmations noted above. Accessing a bank website to review client account balances using access provided by the client provides some amount of audit evidence but less than a confirmation would provide because this process does not involve a direct response from a third party to a request for information.

Question 15 - Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

No. We believe that the factors mentioned in the Board's Concept Release are appropriate and are consistent with ISA 505, the AICPA Interpretation AU 9330 and the AICPA's proposed SAS on Audit Confirmations.

Exceptions and non-responses

Question 16 - Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

Consistent with the extant AU 330, the AICPA's proposed SAS on Audit Confirmations and ISA 505, the Board should continue to include the requirement that the auditor should perform alternative procedures to non-responses, in most circumstances, to obtain relevant and reliable audit evidence. However, similar to the concept in paragraph 31 of AU 330 and consistent with the AICPA's proposed SAS on Audit Confirmations, the omission of alternative procedures may be acceptable when testing for overstatement of amounts when: (a) the non-responses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated, and (b) the auditor has not identified unusual qualitative factors or systematic characteristics related to non-responses, such as that all non-responses pertain to year-end transactions. We believe this provision should be included in the Board's standard.

Question 17 - Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

Yes. We believe that the standard should require the auditor to investigate exceptions to determine whether or not they are indicative of misstatements. This is also consistent with ISA 505.14 and the AICPA's proposed SAS on Audit Confirmations. Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions may also indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting. The standard should of course allow for the auditor to exercise appropriate professional judgment to determine whether some exceptions do not merit follow-up based upon factors such as materiality, nature and frequency of exceptions reported.



Question 18 - Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

We believe that *guidance* (as opposed to a requirement) for auditors to consider, which is consistent with paragraph A19 of ISA 505 and the AICPA's proposed SAS on Audit Confirmations, is appropriate. These items note that non-responses to confirmation requests may indicate a previously unidentified risk of material misstatement and in such situations the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation. Similarly, exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements which may be indicative of fraud. Additionally, the Board's standard should reference AU 230, which instructs the auditor to exercise an appropriate level of professional skepticism in connection with the confirmation process. Such reference is included in AU 330.15.

Question 19 - Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

No. Auditors should exercise professional judgment when designing and performing alternative procedures for non-responses to confirmation requests of significant terms of unusual or complex agreements. Many factors are important to an auditor's decision about performing alternative procedures for non-responses including, for example, subsequent information and availability of other reliable audit evidence, among others. Given the nature of these considerations, the standard should allow for sufficient flexibility to address specific facts and circumstances.

Management requests not to confirm

Question 20 - Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Yes. We believe that the standard should include procedures for the auditor to perform to address these situations. The procedures listed in the Concept Release are appropriate, and we note that they are consistent with ISA 505, paragraph 8. They are:

- *Inquire as to management's reasons for the request and seek audit evidence as to their validity and reasonableness;*
- *Evaluate the implications of management's request on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing, and extent of other audit procedures; and*
- *Perform alternative procedures designed to obtain sufficient, appropriate audit evidence.*



Also, consistent with ISA 505, paragraph 9, if the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or cannot be supported as valid based on available audit evidence, the auditor should communicate with those charged with governance and should consider whether management's request causes a limitation on the scope of the audit.

Disclaimers and restrictive language

Question 21 - Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

We believe a requirement to evaluate the effect of disclaimer language on audit evidence is appropriate, but that the procedures to perform that evaluation should be left to the auditor's judgment based upon the facts and circumstances.

We believe that auditors should evaluate the potential impact of any language that may be included in confirmation responses, such as a disclaimer on the completeness, accuracy, or the team's ability to use/rely on the information contained in the confirmation, to determine the sufficiency of the responses in relation to the procedures being performed. Auditors should evaluate this for individual confirmation responses received, regardless of whether received electronically or in paper form. Additionally, recognition is important that even confirmations with disclaimer language provide some amount of audit evidence and in some instances, restrictions do not necessarily invalidate the reliability of the response as audit evidence to the extent that the restrictive language does not relate to the assertions being tested by the confirmation. For example, investment confirmations often include disclaimer language related to valuation, but the auditor may be using the confirmation to obtain relevant and reliable audit evidence about the existence assertion rather than the valuation assertion.

Cash confirmations frequently include the standard language agreed to between the American Bankers Association, AICPA, and the Bank Administration Institute, which notes, "The information presented above by the customer is in agreement with our records. Although we have not conducted a comprehensive, detailed search of our records, no other deposit or loan accounts have come to our attention except as noted below." This disclaimer would not impact our ability to rely on the cash confirmation; however, auditors should consider the impact when additional disclaimer type wording is included. Our viewpoint is consistent with paragraph A16 in the AICPA's proposed SAS on Audit Confirmations, which is as follows:

A response to a confirmation request may contain restrictive language regarding its use (for example, language disclaiming the responsibility of the accuracy or completeness of the information included in a response). Such restrictions do not necessarily invalidate the reliability of the response as audit evidence to the extent that the restrictive language does not relate to the assertions being tested by the confirmation. However, when the auditor has doubts as to the reliability of the response that occurs as a result of restrictive language, then in accordance with paragraph 10, the auditor is required to obtain further audit evidence to resolve those doubts. If the restrictive language precludes the auditor's use of the information provided therein as audit evidence, the auditor may conclude that it is necessary to treat such a response as a non-response and in accordance with paragraph 12, be required to perform alternative audit procedures to obtain relevant and reliable audit evidence.



Negative confirmations

Question 22 - Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

Question 23 - Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

We do not believe that the Board should eliminate the auditor's ability to use negative confirmations as a source of audit evidence. Further, we believe that the circumstances included in ISA 505.15 are appropriate, which permits the use of negative confirmations as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level only when all of the following are present:

- a) *The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;*
- b) *The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;*
- c) *A very low exception rate is expected; and*
- d) *The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.*

* * * * *

We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Vin Colman (973-236-5390), Brian Richson (973-236-5615) or Brian Croteau (973-236-4345) regarding our submission.

Sincerely,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style, with the letters 'P', 'W', and 'C' being particularly large and stylized.

***CONCEPT RELEASE ON POSSIBLE REVISIONS TO THE PCAOB'S STANDARD
ON AUDIT CONFIRMAITONS –***

Memorandum of Public Comment

To: Office of the Secretary, PCAOB

(Submitted via e-mail to comments@pcaobus.org)

**From: Frank Maguire, Vice President, Business Planning & Strategy
RPost, the Registered E-mail® Company**

Reference: PCAOB Rulemaking Docket Matter No. 028

Overview: Noting two divergent points of view contained in this release relating to the questioned **effectiveness** of Audit Confirmations due to **low response rates** and **PCAOB's desire to enhance audit quality and investor protection** by possibly “expanding the presumption to request confirmation of accounts receivable to also include confirmation of other significant terms in certain transactions and agreements” these comments attempt to reconcile and address those concerns and desires by speaking to the **mechanics of confirmations** using advanced technology.

First, to improve response rates the confirmation process must be simple to use for both sender and recipient; and reliable and trustworthy, which would promote the use of properly protected e-mail confirmations.

Second, the more “user friendly” the electronic confirmation request process the more likely a compliant response will follow thereby allowing for a broader range of information requested. Again, this would encourage the use of properly protected e-mail confirmations to insure authenticity, admissibility and enhanced accountability.

Background: E-SIGN and UETA - E-SIGN, the federal Electronic Signatures in global and National Commerce Act and UETA, the state-enacted Uniform Electronic Transactions Act were drafted with the intent of ensuring that electronic transactions would be afforded the same validity and legality as paper transactions – to accommodate and promote the efficiencies of digital information.

The foundation upon which these two laws are based can be broken down to the following rules:

- A record or signature may not be denied legal effect or enforceability solely because it is in electronic form;
- A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation;

- If a law requires a record to be in writing, an electronic record satisfies the law; and

If a law requires a signature, an electronic signature satisfies the law.

Digital Information – Burden of Proof: Permitting electronic records to substitute for writings serves little purpose if the records are not admissible as evidence in the event of a dispute. A record or signature may not be excluded from evidence solely because it is in electronic form. An electronic record also qualifies as an original, even if that record is not the original form of the document, and satisfies statutory audit and record retention requirements. Beyond that, the ordinary rules of evidence will apply.

APPENDIX QUESTIONS – Additional Background and Discussion on Possible Changes to AU Sec. 330

3) What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

Given the technology available in the market it would not be too burdensome to require that e-mail confirmations be capable of generating legal proof that the confirmation went to the correct e-mail address, was deemed delivered under electronic law and that the subsequent electronic response, including third-party service providers, originated from the proper source and was properly controlled.

- A. Delivery Proof: RPost's Registered E-mail® service provides a record of sending and receiving in accordance with UETA by recording the recipient's server's receipt thereof;
- B. Content Proof: The encryption and tamper-detectability of RPost's Registered E-mail® service preserves the contents of e-mails and their attachments so as to satisfy process requirements designed under UETA or ESIGN and evidence law and to establish evidence of content;
- C. Official Time Stamp: RPost's link to a trusted and objective time source provides essential and credible evidence in disputes in which the time an e-mail was sent or received is material to the case;
- D. Admissible Evidence: RPost's Registered E-mail® service receipts (Registered / Authentication Receipts) are admissible as to their fact of delivery, as to their legal time of delivery and as to the authenticity of their content;
- E. Functional Equivalence: RPost's Registered E-mail® service under UETA and ESIGN, can serve as the functional equivalent of paper mail, to be used in lieu of certified mail, registered mail, return receipt mail, private express mail services, fax logs and similar types of paper mail services, and
- F. Electronic Original: RPost's Registered / Authentication Receipt provides a true electronic original of the message content, message attachments, and transmittal meta-data including the delivery audit trail.

4) What procedures should the auditor be required to perform to address the risk that the information is not from source and the risk that the integrity of the data has been compromised?

Market product / service advances are such that an auditor should be held to a standard whereby he or she is capable of validating the integrity of both source and content of an e-mail confirmation response. RPost's Registered E-mail® service was carefully constructed in light of rapidly evolving electronic law, including applicable U.S. treatment of electronic message transmissions, information security and the admissibility of electronic evidence.

The ease of replication and modification of electronically stored information (ESI) and the openness and decentralization of networks, systems and the Internet pose significant challenges for rendering and keeping ESI secure against tampering after the relevant event, as well as for finding a credible custodian with firsthand knowledge of the process followed to create, execute, preserve, send and receive ESI, and to generate or recreate the ESI when it is to be proffered as evidence. ESI also presents opportunities for achieving reliable security, authentication and custodianship that paper documents do not. However, primarily due to its potential (1) for being created or securely bundled to contain its own internal controls, and (2) for instantaneous, reliable detection of tampering through comparison of ESI identifiers such as "hash" algorithms, Registered E-mail service takes advantage of both such opportunities to incorporate data-level controls and tamper-detectability that do not, like layers of information security, become more expensive and less effective over time.

Finally, RPost's use of hash values and public key infrastructure encryption to demonstrate that a proffered e-mail is the same as the original sent (as well as the reply where desired as an option feature) is very important given the potential for tampering with such content (again, greater than for paper mail).

10) Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

"Yes," given the service capabilities described above it would not be an onerous task for auditors to verify legal delivery of confirmation e-mail under terms of electronic law. Registered E-mail service is capable of capturing the e-mail confirmation receipt by the recipient's server and without any compliant action on the part of the recipient, an RPostRegistered / Authentication Receipt is automatically returned to the sender to provide legal proof of delivery to the designated e-mail address. A "Delivery Failure" notice would be generated were the e-mail confirmation was not successfully delivered.

This is very important in view of the "deemer" provision of UETA – the law in 46 states – that generally deems receipt by the server as receipt by the recipient.

12) What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

Relative to e-mail confirmations and the concerns raised with respect to possible tampering of both content and recipient identity, and proof of delivery, given the capabilities that exist in the market as described above in response to questions numbered 3, 4, 10 and 12 it would be prudent to amend the standard to require that auditors, when sending confirmations by means of e-mail should be capable of:

- Verifying correct, legal receipt by the recipient's server
- Verifying original content by use of hash values and public key infrastructure encryption to authenticate confirmation sent and response received (as well as attachments) to provide necessary tamper detection
- Verifying official time stamps to fend off possible disputes as computers can be set to read any time desired as opposed to commercial paper mail services, where neither sender nor recipient controls the time stamp.



**THE INSTITUTE
OF CHARTERED
ACCOUNTANTS**
IN ENGLAND AND WALES

29 May 2009

Our ref: ICAEW Rep 63/09

Office of the Secretary
PCAOB
1666 K Street,
N.W.
Washington
D. C. 20006-2803.

cc. Arnold Schilder, Chair, IAASB

By email: *PCAOB Rulemaking Docket Matter No. 028*

Dear Sir

PCAOB RELEASE NO. 2009 - 002: CONCEPT RELEASE ON POSSIBLE REVISIONS TO THE PCAOB'S STANDARD ON AUDIT CONFIRMATIONS

The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the PCAOB's Concept Release on possible revisions to the PCAOB's standard on audit confirmations.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

Our comments have been prepared with the help of our many members working around the world who have detailed knowledge and practical experience of US, EU and other regulatory regimes. We provide main and detailed comments resulting from our discussions as well as answers to the PCAOB's specific questions.

We welcome a revision of the confirmations guidance as it is indeed overdue given changes in technology. In many cases confirmations are still dealt with in the time-honoured manner, by post, but more use is being made of electronic confirmations. They are often a more efficient and reliable method of gathering audit evidence but they do give rise to their own set of risks and they may in some circumstances be vulnerable to greater manipulation and fraud than more traditional methods.

Our overriding concern with the Concept Release is that it should more clearly recognise that each confirmation will give rise to a unique set of risks that the auditor should be required to consider and respond to appropriately, rather than encouraging auditors to hide behind a codified set of rules that are not tailored to address the risks identified.

We welcome the issue of a Concept Release prior to any proposed revisions. This will help ensure that a good level of consensus is built prior to exposure. We also welcome the recognition of the importance of IAASB standards in this area and we urge further efforts at convergence.

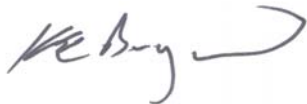


As we noted in our recent response to the PCAOB exposure of its proposed risk assessment standards dated 18 February 2009, convergence is achieved in practice by compromise in order to achieve a greater degree of consensus. While convergence that amounts to 'similarity, with add-ons' is a start, we hope that the PCAOB will seek to narrow differences between its standards and those of the IAASB. Starting with ISA 505 as a basis for the PCAOB standard would be one way to achieve this; ISA 505 covers all of the areas identified in the Concept Release including the issues associated with electronic confirmations.

Our main comments and answers to the PCAOB's detailed questions are set out below.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely



Katharine E Bagshaw FCA
Manager, Auditing Standards
ICAEW Audit and Assurance Faculty
T + 44 (0)20 7920 8708
F + 44 (0)20 7920 8754
E: kbagshaw@icaew.com

Main Comments

Risk, judgement and the mechanics of confirmations

We are particularly encouraged that the PCAOB has addressed the risk assessment standards and we urge a follow-through of the spirit of those proposals in any revisions on confirmations. We note an emphasis on the procedural aspects of confirmations in the Concept Release but we urge more focus on principles, such as the involvement of experienced staff who can exercise proper judgement in planning whether, and how, to conduct confirmations, rather than focusing on their mechanical aspects. As the PCAOB notes in the Concept Release, it is a failure to conduct confirmations at all, and failures to properly control or supervise them, or assess the significance of their outcomes that cause problems. Fine tuning of the process will not compensate for human error in sending confirmation requests out, or the carelessness, or worse, of third party respondents. We therefore urge greater emphasis on the proper use of judgement and professional skepticism in our answers to the detailed questions below. Judgement will become more important as the technology facilitating automated confirmations becomes more accessible.

Rebutting the presumption: when confirmations should not be conducted

A corollary of the risk based approach, and an important aspect of confirmations that the PCAOB has not really addressed, is the *combined* effect of the decline in use of confirmations, low response rates and respondent errors because an increasing number of entities regard them as a low priority, and the widespread increase in the use of restrictive language and disclaimers. The POB comment on Page 4 of the Concept Release to the effect that some auditors believe that confirmation is not a particularly effective audit procedure in many situations, is important. It calls into question the statement on page 5 that expanding the requirements of the standard to other areas may enhance audit quality and investor protection; it may only *appear* to do so. The IAASB has wrestled with the vexed issue of providing guidance to auditors on *when* to conduct confirmations. We do not expect that the PCAOB will withdraw from its presumptively mandatory requirement, particularly given that in some cases, such as bank confirmations, there will only be rare circumstances in which a confirmation is not appropriate. Nevertheless, it may well be prudent to emphasise that confirmations should *not* be conducted for the sake of it, particularly when the risk analysis indicates that it may not be a necessary or efficient method of obtaining audit evidence, such as confirmations of debtors many months after the period-end. A greater discussion of high quality alternative evidence would be helpful here, particularly for those assertions such as existence, for which confirmations, when they *can* be performed, are good.

Requiring the performance of specific procedures

We note that in many questions the PCAOB asks whether auditors should be required to perform specific procedures. We urge the PCAOB (and indeed other standard-setters) to consider the effects of this approach. Almost always, requiring the performance of specific procedures

- is out of line with a risk based approach;
- encourages a mechanical approach to auditing standards;

- discourages the use of professional judgement; and
- inhibits the development of judgement in more junior staff.

This is not in the long term interests of the businesses and markets that auditors serve. Requiring the performance of specific procedures is necessary in auditing standards, but it should be the exception, and not the rule.

Answers to PCAOB Questions

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

Yes, but the objective should be the objective of the auditor, and not of the standard, in line with other PCAOB standards.

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party? Why or why not?

Yes, but there should be no assumption that 'other' responses are any more inherently reliable than traditional mailed responses. They may be more unreliable, and there may be less high quality documentation to support them, depending on circumstances. This is particularly relevant to direct access where the information recorded is often transient, reflecting the position at a moment in time and where documentation such as a screen shot may be all that is available for the audit files.

Oral confirmations are acceptable, provided that there is contemporaneous documentation of the evidence obtained.

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

The control objectives relevant to electronic confirmations are the same as those relevant to more traditional methods; completeness, existence and accuracy, are sought, for example. The overarching control procedures within the control environment implemented to achieve those objectives are also similar, proper risk assessment, planning, and follow-up for example. The differences exist at a lower level. The focus should be on the higher level controls, as failures in these are where, as we note above, failures in the conduct of confirmations often occur. Direction should deal with the need for auditors to adapt processes to appropriately respond to the different risks that present themselves, and should not be detailed.

Confirmations sent to and received from third party service providers should be subject to the same standards of evidence as confirmations sent to and received from the entity itself. The risk assessment the auditor must perform before deciding to seek confirmations from such third parties needs to take account of the associated risk profile and the controls needed to reduce risk to an acceptably low level.

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

Auditors should not be required to check the authenticity of documents in this area any more than in any others, unless conditions identified during the audit cause the auditor to believe that a document may not be authentic. Professional skepticism does not extend to an assumption that documents lack authenticity. Any revision should make this clear.

Auditing guidance to date has generally either been silent on what to do when auditors' suspicions are aroused regarding the authenticity or integrity of data, or restricted to a requirement for auditors to resolve any uncertainties and inconsistencies, and failing that, to qualify their audit opinion on the basis of a limitation in the scope of the audit. In practice, while auditors may suspect, and in rare cases identify the occurrence of fraud, auditors do not make legal determinations of whether fraud has actually occurred and they can only seek additional or alternative evidence to corroborate their assessments where evidence presented is doubtful. This is a matter that is already dealt with in auditing standards on audit evidence. To require a different standard of evidence here would require consideration for the need for a different standard of evidence in many other areas.

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

No (5 and 6). *While confirming terms of revenue contracts, particularly in the software and other high technology industries is common, simply extending the presumptively mandatory requirement for confirmation to them or other items without making any reference to assessed risk, will create additional work for no benefit in the majority of industries in which contractual terms are rarely, if ever, complex or unusual. Unusual or complex transactions are not necessarily associated with heightened risk (as noted on page 11 of the Concept Release) particularly if they are immaterial. The requirement, and the work needed to document its rebuttal, is not without cost and a risk based approach, with guidance (in line with the thinking of some SAG members) rather than a presumptively mandatory requirement might make auditors think harder.*

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

No. *The auditor should be required to justify evaluation of confirmations as ineffective. Specific procedures are not necessary and are likely to enable auditors to hide behind them rather than justify their decisions.*

8. Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?

No, regardless of whether the PCAOB ultimately decides to include a risk based approach to unusual or complex agreements, or a presumptively mandatory requirement. If the PCAOB considers auditors unable to use their judgement to determine what is unusual or complex without guidance in this area, it implies that the PCAOB has no faith in the ability of auditors to use their judgement at all. If auditors require direction in this area then they have not properly understood the business they are auditing or they have been inadequately trained and it is to these areas that the PCAOB should direct its attention.

Furthermore, in many cases complexity is a consequence of the specific GAAP requirements in a particular area. Including such direction would inevitably bring GAAP into auditing standards which should be avoided where possible since PCAOB standards are often followed for audits of IFRS and local GAAP financial statements of foreign registrants filed with the Securities and Exchange Commission.

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

No. We do not believe that there are any procedural problems that need fixing here. If there are such problems, they relate to the strategic audit planning and are not mere technical issues. While standardised confirmation procedures facilitate more consistent (and to that extent reliable) responses in the case of requests to, say, banks, the benefit of such standardisation derive from requestees being a homogenous group subject to regulation. This is simply not the case with, say, recipients of requests for confirmation of accounts receivable.

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

No, simply on the basis that the proposed approach will not deter those intent on deceiving auditors. 100% testing would be extremely inefficient in the absence of some assessment of risk. Auditors might benefit from guidance suggesting that they consider such procedures as part of their risk assessment. Any presumptively mandatory requirement in this area would be better to require that confirmations are controlled by auditors, and that they should ordinarily be sent, and responses thereto received, by auditors.

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

PCAOB reports have not highlighted weaknesses in the conduct of confirmations and any additional direction should be kept to a minimum.

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

Our covering letter indicates the need for focus on the outcome of confirmations (including their reliability) and alternatives to confirmations rather than their mechanics. Auditors should be encouraged to apply professional skepticism in evaluating confirmation requests.

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third party database or provided by the third-party service provider is reliable?

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

This is a complex area in its own right and in the context of confirmations, it is a good example of circumstances in which the auditor may take the view that confirmations are not the most efficient approach to obtaining audit evidence and that alternative procedures should be considered. Direct electronic confirmation may be more efficient and reliable than manual transcription of electronic information which is then posted to the auditor but direct access to databases may equally be vulnerable to greater manipulation and fraud than more traditional methods. The databases themselves may be subject to a heightened risk of fraud or error and our answer to Q2 above notes that the information therein is often transient. Given the potentially relatively weak audit evidence provided by such databases, it is essential that the auditor either be satisfied with the controls over information delivered to the third party provider, the controls applied to the data during processing, and the control of information returned to the entity from such third parties.

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

Yes (16, 17 and 18). *Auditors should be required to perform alternative procedures to deal with non-responses (where positive confirmations are sought) and exceptions to confirmation requests. Non-responses are indicative of potential fraud or error and while alternative procedures may not provide conclusive evidence, auditors should not ignore the non-response or disregard alternative evidence. There may be a number of different reasons for non-response and the evaluation of the non-response will depend on the risk associated with the relevant item. A high number of non-*

responses may indicate that planning has not been performed properly. In all cases though, there is a need to investigate exceptions, consider the reasons for non-responses, and consider the implications for the auditors' risk assessment and audit evidence generally.

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

Yes. *Where auditors conduct such requests, they should be required to follow them through and alternative procedures should be applied for non-responses. Alternative procedures might include using the work of specialists, extending testing of revenue recognition surrounding contracts, requesting and examining copies of the contracts and amendments thereto and comparing contractual terms to industry norms.*

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Yes. *In many cases there may be valid reasons for the request not to confirm and auditors must use their judgement in determining whether that is the case. No other procedures are required in addition to the procedures listed on page A-15 of the Concept Release*

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

No. *To require auditors to effectively discount the evidence provided by confirmation requests circumscribed by disclaimers and restrictive language is to enter into a downward spiral at the end of which lies an inability to rely on any confirmation response. Such disclaimers and restrictive language are increasingly common in the UK in response to bank confirmation requests and the view taken is that of themselves, they do not significantly impair the value of such evidence. Furthermore, the practical effect of a disclaimer or restrictive language is likely to require a legal analysis that is not within the auditor's competence.*

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

Yes, *(22 and 23) but only in restricted circumstances. Negative confirmations can be useful where there are large groups of homogenous items subject to similar controls*

and a low risk of misstatement. Additional substantive procedures should be required where such items are or may be material.



May 29, 2009

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

Subject: PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2009-002,
Concept Release on Possible Revisions to PCAOB's Standard on Audit Confirmations

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) concept release on possible revisions to the auditing standard on audit confirmations.

We appreciate the PCAOB's efforts to establish auditing standards on audit confirmations for registered companies and agree that confirmation procedures can be an important means of obtaining audit evidence.

We have serious concerns about the PCAOB's proposal to retain and even expand the presumptive requirement to request confirmation of accounts receivable. International Standard on Auditing (ISA) 505, *External Confirmations*, does not require confirmation of particular accounts or transactions. Confirmation of accounts receivable has been a presumptively mandatory requirement in the U.S. since 1939 in response to a fraud case, where the auditors failed to detect misstatements due to fictitious accounts receivable. In its release, the PCAOB states; "The Board believes that it is important to retain the presumption to request confirmation of accounts receivable and to consider whether additional, similar presumptions to request confirmation of certain other accounts may be appropriate. In addition, the Board is considering whether and how improvements to the standard on confirmations could enhance the quality of audits." Yet the Board does not present any evidence or reasoning to support its belief that the presumptively mandatory requirement should not only be maintained, but possibly expanded.

As the Board examines the confirmation standard to determine if it continues to be appropriate in the current business climate, we encourage a thorough reconsideration of the benefits and drawbacks of retaining the presumption to request confirmation of accounts receivable and adding similar presumptions to request confirmation of certain other accounts. With 70 years experience implementing this Standard in the U.S., there should exist ample bodies of evidence to facilitate research in this area. The presumptive requirement, in our opinion, is problematic because it supplants auditor judgment, may result in over-reliance on confirmation procedures, and does not take into account

dramatic changes in the conduct of business since the requirement was put in place in 1939.

The presumptive requirement supplants auditor judgment by presuming that confirmation procedures are the most effective audit procedure to address the risk of material misstatement in accounts receivable, and directs the auditor to perform the audit using that assumption. Rather than requiring auditors to use judgment based on audit risk and materiality to determine the most effective procedure to obtain audit evidence supporting management's assertions related to accounts receivable, the presumptive requirement has auditors using the same procedure regardless of risk, materiality, or other relevant facts and circumstances. In addition, the presumption that requesting confirmations is always the most effective audit procedure is not entirely consistent with the PCAOB's proposed auditing standard *The Auditor's Responses to the Risks of Material Misstatement*, which states that the auditor should design and perform audit procedures the nature, timing, and extent of which are based on and address the risks of material misstatement for each relevant assertion of each significant account and disclosure.¹

The unintended consequence of the requirement is that it may encourage auditors to: (1) minimize the importance of risk and materiality assessments of accounts receivable, since the procedures to be performed on accounts receivable are predetermined; (2) spend too much time performing confirmation procedures in situations when there is a low risk of material misstatement for accounts receivable or when relevant and reliable audit evidence, such as subsequent collection, is available; and (3) spend too little time evaluating risk and performing analyses in situations when there is a risk of material misstatement for accounts receivable due to collusion between the audited entity and the customer.

Over-reliance on confirmation procedures may result from the premise that evidence is more reliable when it is obtained from independent sources outside the entity,² which is reinforced by the presumptively mandatory requirement. A key presumption is that the responding party, in addition to being knowledgeable and independent, is willing to spend the time and effort needed to provide accurate and valid information in the confirmations and submit their response to the auditors. It is often difficult for auditors to evaluate the responder's knowledge and independence and determine whether the confirmed information was actually verified by the confirming party.

Furthermore, research suggests that practitioners may place undue reliance on confirmation procedures by assuming that the confirmations are derived from independent sources.³ Studies of Accounting and Auditing Enforcement Releases issued by the Securities and Exchange Commission (SEC) have identified several confirmation pitfalls, including a significant number of cases of collusion between auditees and customers.⁴

¹ PCAOB Release No. 2008-006, October 21, 2008, page A4-4, par. 6.

² PCAOB standard AU Sec 326.21a.

³ P. Caster, R. Elder, and D. Janvrin, "Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory*, vol. 27, no. 2 (2008). Pg. 270.

⁴ *Ibid.* pg 255.

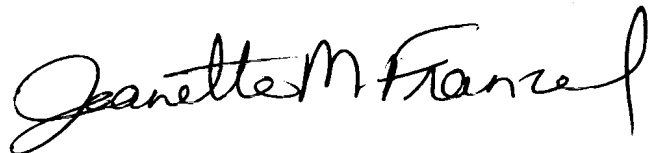
Finally, the presumptive requirement does not take into account dramatic changes that have occurred in the conduct of business since 1939. Auditors are required to direct confirmation requests to third parties whom the auditor believes are knowledgeable about the information being confirmed.⁵ This requirement appears to presume existence of a relationship between the audited entity and the responder, as may have existed 70 years ago when the presumptive requirement was adopted.⁶ Since then, however, the U.S. economy has become much more complex and decentralized, making such relationships less likely. Many vendors and suppliers now outsource their administration functions, such as bill paying and responding to confirmation requests.

We recommend that the PCAOB reconsider the appropriateness of retaining the presumptive requirement for auditors to request confirmation of accounts receivable. An effective approach to obtaining evidence to support the entity's assertions related to accounts receivable is to apply provisions of the audit risk and evidence standards to determine whether audit confirmation procedures would be most effective. These standards and the related guidance provide sufficient principles-based direction for auditors to determine when to use audit confirmation procedures.

The Board has requested comment on the specific questions noted in the Attachment to the Concept Release. We provide the requested comments in Attachment 1 to this letter. Because our responses reference paragraphs from the International Standard on Auditing (ISA) 505, *External Confirmations*, and the Proposed Statement on Auditing Standards (SAS), *External Confirmations (Redrafted)*, we have also attached copies of those documents.

We thank you for considering our comments on this very important issue.

Sincerely yours,



Jeanette M. Franzel
Managing Director
Financial Management and Assurance

Enclosures:

cc: The Honorable Mary L. Shapiro, Chairman
Securities and Exchange Commission

⁵ PCAOB standard AU Sec 330.26.

⁶ PCAOB Release No. 2009-002, April 14, 2009, page 7.

The Honorable Mark W. Olson, Chairman
Public Company Accounting Oversight Board

James L. Kroeker, Acting Chief Accountant
Securities and Exchange Commission

Mr. Harold Monk, Jr., Chair
Auditing Standards Board

Mr. Martin F. Baumann, Chief Auditor
Public Company Accounting Oversight Board

Attachment 1**GAO's Responses to Specific Questions in the
Attachment to PCAOB Concept Release****Question 1:**

1. Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

No, we believe the objective stated above would not be appropriate because it has as its basis the presumptively mandatory requirement for auditors to perform procedures to confirm accounts receivable. As noted in our letter, we have serious concerns with the presumption that auditors should always use confirmation procedures to obtain evidence supporting management's assertions related to accounts receivable. Instead, we recommend that the PCAOB adopt the following objective, which is consistent with ISA 505 and presumes that the auditor has conducted a separate evaluation to determine whether confirmations would be an effective audit procedure given the facts, circumstances, and assessed risks: *"The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence."*

Questions 2, 3 & 4:

2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party? Why or why not?

The definition of confirmation should allow for non-traditional responses such as facsimile, email, responses processed through third-party service providers, and direct online access to information held by a third party. We believe, however, that the PCAOB should not include oral statements in its definition. Oral statements may be testimonial evidence, but they are not confirmations. We recommend adopting the following definition of confirmation, which is consistent with the draft ASB standard: *"Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form, or by electronic or other medium, or through direct access by the auditor to information held by a third party."*

3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

4. What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

All confirmation responses carry some risk of interception, alteration or fraud. As noted in ISA 505, paragraph A11, such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Accordingly, the auditor should be required to develop procedures to address this risk.

Adopting provisions consistent with paragraphs A11–A17 of the draft ASB standard would provide appropriate direction applicable to the use of electronic confirmations and third-party

Attachment 1**GAO's Responses to Specific Questions in the Attachment to PCAOB Concept Release**

service providers, as well as guidance on addressing the risk that the information is not from a proper source and that the integrity of the data has been compromised.

Questions 5, 6, 7 & 8:

5. Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

7. Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

8. Should the Board include direction in the standard on what constitutes "unusual" or "complex" agreements or transactions, including revenue transactions? If so, what should that direction include?

The requirements and guidance proposed in questions 5-8 would be overly prescriptive and unnecessary if the auditor adopts a risk-based approach, as discussed in our letter. Furthermore, academic research indicates that there are several key barriers to confirmation effectiveness.¹ For these reasons and the reasons detailed in our letter, it would not be logical to expand the presumptive requirement or establish new requirements that auditors request confirmation of accounts receivable or other items.

Questions 9 & 10:

9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

10. Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

These questions address procedures that would be better suited to guidance documents.

Questions 11 & 12:

11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

¹ P. Caster, R. Elder, and D. Janvrin, "A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness," *Auditing: A Journal of Practice & Theory*, vol. 27, no. 2 (2008). Pg. 253.

Attachment 1**GAO's Responses to Specific Questions in the Attachment to PCAOB Concept Release**

12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

We agree that PCAOB standard AU 330 needs updating to address technology advances and other economic changes. For instance, the standard should discuss the importance of auditors controlling (1) the information to be confirmed, (2) the selection of the confirming parties, and (3) the design and sending of the confirmation requests. These issues would be properly addressed by adopting provisions similar to paragraphs 7 and A6 of the draft ASB standard.

Questions 13, 14 & 15:

13. What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

14. When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third party database or provided by the third-party service provider is reliable?

15. Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

The above issues would be appropriately addressed by adopting provisions consistent with ISA 505, paragraphs 10, 11, A13 and A14, which deal with auditor responsibilities in these situations.

Questions 16, 17 & 18:

16. Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

18. Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

We agree that auditors should be required to (1) perform alternative procedures for non-responses to positive confirmation requests, (2) investigate all but trivial exceptions identified in confirmations responses, and (3) consider the implications of non-responses and exceptions. These issues would be appropriately addressed by adopting provisions consistent with ISA 505 paragraphs 12, 14, A18, A19, A21 and A22.

Question 19:

19. Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

Attachment 1**GAO's Responses to Specific Questions in the
Attachment to PCAOB Concept Release**

It is not necessary for the standard to indicate the specific procedures to be used in such circumstances. The standard requires auditors to perform alternative procedures for each non-response. The appropriate procedures would depend on risks, facts, and circumstances. Specifying procedures for the auditors to perform in such situations would be overly prescriptive. Instead, these issues would be better suited to a guidance document.

Question 20:

20. Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Existing PCAOB standards include procedures for the auditor to perform in cases when management requests that the auditor not confirm certain accounts, transactions, agreements, or other items. In such situations, the auditor should communicate with those charged with governance in accordance with PCAOB standard AU Section 380.16. The auditor also should determine the implications for the audit and for the auditor's opinion in accordance with PCAOB standard AU Section 508. However, if the PCAOB believes these issues should be addressed within the confirmation standard, it should adopt provisions consistent with those of ISA 505 paragraphs 8, 9, and A8-A10.

Question 21:

21. Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

When a confirmation response contains disclaimers and restrictive language, auditors should evaluate the impact on the reliability of the response. If the restrictive language precludes the auditor's use of the information provided therein as audit evidence, the auditor would treat such a response as a non-response and perform alternative audit procedures to obtain relevant and reliable audit evidence.

Adopting provisions consistent with those of paragraph A16 of the draft ASB standard would properly address this issue.

Questions 22 & 23:

22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

Attachment 1**GAO's Responses to Specific Questions in the
Attachment to PCAOB Concept Release**

The auditor should understand the limitations of the audit evidence obtained from negative confirmation procedures and should not use negative confirmation requests as the sole substantive procedure to address an assessed risk of material misstatement at the assertion level.

Circumstances in which negative confirmations may be appropriate include when:

- (a) the auditor has assessed the risk of material misstatement as low and has obtained audit evidence to support the operating effectiveness of controls relevant to the assertion;
- (b) the population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances, transactions or conditions;
- (c) a very low exception rate is expected; and
- (d) the auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

Adopting provisions consistent with those of paragraph 15 of ISA 505 would properly address this issue.

Attachment 2

INTERNATIONAL STANDARD ON AUDITING 505
EXTERNAL CONFIRMATIONS

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

CONTENTS

	Paragraph
Introduction	
Scope of this ISA	1
External Confirmation Procedures to Obtain Audit Evidence	2-3
Effective Date	4
Objective	5
Definitions	6
Requirements	
External Confirmation Procedures	7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request	8-9
Results of the External Confirmation Procedures	10-14
Negative Confirmations	15
Evaluating the Evidence Obtained	16
Application and Other Explanatory Material	
External Confirmation Procedures	A1-A7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request	A8-A10
Results of the External Confirmation Procedures	A11-A22
Negative Confirmations	A23
Evaluating the Evidence Obtained	A24-A25

International Standard on Auditing (ISA) 505, “External Confirmations” should be read in conjunction with ISA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

UPDATED ISA 505

Introduction**Scope of this ISA**

1. This International Standard on Auditing (ISA) deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of ISA 330¹ and ISA 500.² It does not address inquiries regarding litigation and claims, which are dealt with in ISA 501³.

External Confirmation Procedures to Obtain Audit Evidence

2. ISA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.⁴ That ISA also includes the following generalizations applicable to audit evidence:⁵
 - Audit evidence is more reliable when it is obtained from independent sources outside the entity.
 - Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
 - Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This ISA is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

3. Other ISAs recognize the importance of external confirmations as audit evidence, for example:
 - ISA 330 discusses the auditor's responsibility to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, and 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 assertion level.⁶ In addition, ISA 330 requires that, irrespective of the assessed risks of material misstatement, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure. The auditor is also required to consider whether external confirmation

¹ ISA 330, "The Auditor's Responses to Assessed Risks."

² ISA 500, "Audit Evidence."

³ ISA 501, "Audit Evidence—Specific Considerations for Selected Items."

⁴ ISA 500, paragraph A5.

⁵ ISA 500, paragraph A31.

⁶ ISA 330, paragraphs 5-6.

UPDATED ISA 505

procedures are to be performed as substantive audit procedures.⁷

- ISA 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁸ 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. ISA 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 of material misstatement, whether due to fraud or error.⁹
- ISA 240 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.¹⁰
- ISA 500 indicates that corroborating information obtained from a source independent of the entity, such as external confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from representations made by management.¹¹

Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

5. The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:
 - (a) External confirmation – Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
 - (b) Positive confirmation request – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

⁷ ISA 330, paragraphs 18-19.

⁸ ISA 330, paragraph 7(b).

⁹ ISA 330, paragraph A53.

¹⁰ ISA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph A37.

¹¹ ISA 500, paragraph A8.

UPDATED ISA 505

- (c) Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
- (d) Non-response – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
- (e) Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity’s records, and information provided by the confirming party.

Requirements

External Confirmation Procedures

7. When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:
 - (a) Determining the information to be confirmed or requested; (Ref: Para. A1)
 - (b) Selecting the appropriate confirming party; (Ref: Para. A2)
 - (c) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and (Ref: Para. A3-A6)
 - (d) Sending the requests, including follow-up requests when applicable, to the confirming party. (Ref: Para. A7)

Management’s Refusal to Allow the Auditor to Send a Confirmation Request

8. If management refuses to allow the auditor to send a confirmation request, the auditor shall:
 - (a) Inquire as to management’s reasons for the refusal, and seek audit evidence as to their validity and reasonableness; (Ref: Para. A8)
 - (b) Evaluate the implications of management’s refusal on the auditor’s assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and (Ref: Para. A9)
 - (c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: Para. A10)
9. If the auditor concludes that management’s refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with ISA 260.¹² The auditor also shall determine the implications for the audit and the auditor’s opinion in accordance with ISA 705.¹³

¹² ISA 260, “Communication with Those Charged with Governance,” paragraph 16.

¹³ ISA 705, “Modifications to the Opinion in the Independent Auditor’s Report.”

UPDATED ISA 505

Results of the External Confirmation Procedures*Reliability of Responses to Confirmation Requests*

10. If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts. (Ref: Para. A11-A16)
11. If the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. (Ref: Para. A17)

Non-Responses

12. In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: Para A18-A19)

When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

13. If the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor shall determine the implications for the audit and the auditor's opinion in accordance with ISA 705 (Revised and Redrafted). (Ref: Para A20)

Exceptions

14. The auditor shall investigate exceptions to determine whether or not they are indicative of misstatements. (Ref: Para. A21-A22)

Negative Confirmations

15. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present: (Ref: Para. A23)
 - (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
 - (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
 - (c) A very low exception rate is expected; and
 - (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

UPDATED ISA 505

Evaluating the Evidence Obtained

16. The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. (Ref: Para A24-A25)

Application and Other Explanatory Material**External Confirmation Procedures***Determining the Information to Be Confirmed or Requested* (Ref: Para. 7(a))

- A1. External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement.”

Selecting the Appropriate Confirming Party (Ref: Para. 7(b))

- A2. Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

Designing Confirmation Requests (Ref: Para. 7(c))

- A3. The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.
- A4. Factors to consider when designing confirmation requests include:
- The assertions being addressed.
 - Specific identified risks of material misstatement, including fraud risks.
 - The layout and presentation of the confirmation request.
 - Prior experience on the audit or similar engagements.
 - The method of communication (for example, in paper form, or by electronic or other medium).
 - Management’s authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management’s authorization.
 - The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

UPDATED ISA 505

- A5. A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information, or by asking the confirming party to provide information. A response to a positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required of the confirming parties.
- A6. Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out.

Follow-Up on Confirmation Requests (Ref: Para. 7(d))

- A7. The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

Management's Refusal to Allow the Auditor to Send a Confirmation Request*Reasonableness of Management's Refusal* (Ref: Para. 8(a))

- A8. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Implications for the Assessment of Risks of Material Misstatement (Ref: Para. 8(b))

- A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with ISA 315.¹⁴ For example, if management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with ISA 240.¹⁵

Alternative Audit Procedures (Ref: Para. 8(c))

¹⁴ ISA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph 31.

¹⁵ ISA 240, paragraph 24.

UPDATED ISA 505

A10. The alternative audit procedures performed may be similar to those appropriate for a non-response as set out in paragraphs A18-A19 of this ISA. Such procedures also would take account of the results of the auditor's evaluation in paragraph 8(b) of this ISA.

Results of the External Confirmation Procedures*Reliability of Responses to Confirmation Requests* (Ref: Para. 10)

A11. ISA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability.¹⁶ All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include that it:

- Was received by the auditor indirectly; or
- Appeared not to come from the originally intended confirming party.

A12. Responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. A process used by the auditor and the respondent that creates a secure environment for responses received electronically may mitigate these risks. If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced. An electronic confirmation process might incorporate various techniques for validating the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify web site authenticity.

A13. If a confirming party uses a third party to coordinate and provide responses to confirmation requests, the auditor may perform procedures to address the risks that:

- (a) The response may not be from the proper source;
- (b) A respondent may not be authorized to respond; and
- (c) The integrity of the transmission may have been compromised.

A14. The auditor is required by ISA 500 to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence.¹⁷ The auditor may choose to verify the source and contents of a response to a confirmation request by contacting the confirming party. For example, when a confirming party responds by electronic mail, the auditor may telephone the confirming party to determine whether the confirming party did, in fact, send the response. When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than to the auditor), the auditor may request the confirming party to respond in writing directly to the auditor.

¹⁶ ISA 500, paragraph A31.

¹⁷ ISA 500, paragraph 11.

UPDATED ISA 505

- A15. On its own, an oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. However, upon obtaining an oral response to a confirmation request, the auditor may, depending on the circumstances, request the confirming party to respond in writing directly to the auditor. If no such response is received, in accordance with paragraph 12, the auditor seeks other audit evidence to support the information in the oral response.
- A16. A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not necessarily invalidate the reliability of the response as audit evidence.

Unreliable Responses (Ref: Para. 11)

- A17. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with ISA 315.¹⁸ For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with ISA 240.¹⁹

Non-Responses (Ref: Para. 12)

- A18. Examples of alternative audit procedures the auditor may perform include:

- For accounts receivable balances – examining specific subsequent cash receipts, shipping documentation, and sales near the period-end.
- For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes.

- A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with ISA 315.²⁰ For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with ISA 240.²¹

When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 13)

- A20. In certain circumstances, the auditor may identify an assessed risk of material misstatement at the assertion level for which a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Such circumstances may include where:

¹⁸ ISA 315, paragraph 31.

¹⁹ ISA 240, paragraph 24.

²⁰ ISA 315, paragraph 31.

²¹ ISA 240, paragraph 24.

UPDATED ISA 505

- The information available to corroborate management's assertion(s) is only available outside the entity.
- Specific fraud risk factors, such as the risk of management override of controls, or the risk of collusion which can involve employee(s) and/or management, prevent the auditor from relying on evidence from the entity.

Exceptions (Ref: Para. 14)

- A21. Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by ISA 240 to evaluate whether such misstatement is indicative of fraud.²² Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting.
- A22. Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

Negative Confirmations (Ref: Para. 15)

- A23. The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise. For example, holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request, but may be less likely to respond when they believe the balance is overstated. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated, but is unlikely to be effective if the auditor is seeking evidence regarding overstatement.

Evaluating the Evidence Obtained (Ref: Para. 16)

- A24. When evaluating the results of individual external confirmation requests, the auditor may categorize such results as follows:
- (a) A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information without exception;
 - (b) A response deemed unreliable;

²² ISA 240, paragraph 35.

UPDATED ISA 505

- (c) A non-response; or
- (d) A response indicating an exception.

A25. The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether further audit evidence is necessary, as required by ISA 330.²³

²³ ISA 330, paragraphs 28-29.

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

EXTERNAL CONFIRMATIONS

(To supersede Statement on Auditing Standards No. 67, The Confirmation Process [AICPA, Professional Standards, vol. 1, AU sec. 330])

June 1, 2009

Comments are requested by August 31, 2009

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues.

Comments should be addressed to Sherry Hazel at shazel@aicpa.org.

*Copyright © 2009 by
American Institute of Certified Public Accountants, Inc.
New York, NY 10036-8775*

Permission is granted to make copies of this work provided that such copies are for personal, intraorganizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2009 by American Institute of Certified Public Accountants, Inc. Used with permission."

CONTENTS

	Page
Explanatory Memorandum	
Introduction	4
Background.....	4
Effective Date	5
Changes From Existing Standards	5
Vote of the Auditing Standards Board.....	5
Issues for Consideration.....	5
Guide for Respondents.....	6
Supplements to the Exposure Draft	7
Comment Period	7
Auditing Standards Board Members.....	8
 Exposure Draft	
Proposed Statement on Auditing Standards <i>External Confirmations</i>	9

Explanatory Memorandum

Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *External Confirmations*. This proposed SAS would supersede SAS No. 67, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1, AU sec. 330). The accompanying proposed SAS represents the redrafting of SAS No. 67 to apply the Auditing Standards Board's (ASB's) clarity drafting conventions and to converge with International Standards on Auditing (ISAs), as discussed in the following sections.

Background

Clarity

To address concerns over the clarity, length, and complexity of its standards, the ASB is currently making a significant effort to clarify the SASs.¹ The ASB issued a discussion paper, *Improving the Clarity of ASB Standards*,² in March 2007. In response to the feedback received on the discussion paper and subsequent discussions with interested parties, the ASB has established clarity drafting conventions and has undertaken to revise all of its SASs in accordance with those conventions. The proposed SAS has been drafted in accordance with the ASB's clarity drafting conventions, which include the following:

- Establishing objectives for each of the standards
- Including a definitions section, if relevant, in each standard
- Separating requirements from application and other explanatory material
- Numbering application and other explanatory material paragraphs using an *A*-prefix and presenting them in a section following the requirements section
- Using formatting techniques, such as bulleted lists, to enhance readability
- Including, where appropriate, special considerations relevant to audits of smaller, less complex entities within the text of the standards
- Including, where appropriate, special considerations relevant to audits of governmental entities within the text of the standard

Convergence

Consistent with the ASB's strategy to converge its standards with those of the

¹ The pamphlet *Clarification and Convergence* provides information about the ASB's clarity project and can be viewed at [www.aicpa.org/download/auditstd/ASB_Clarify_%20and_Convergence_\(8.5x11\).pdf](http://www.aicpa.org/download/auditstd/ASB_Clarify_%20and_Convergence_(8.5x11).pdf).

² The discussion paper is available online at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Improving+the+Clarity+of+ASB+Standards.htm.

International Auditing and Assurance Standards Board (IAASB),³ the proposed SAS has been drafted using ISA No. 505, *External Confirmations*, as a base. There are no differences between this proposed SAS and ISA No. 505 other than those for which the ASB believes compelling reasons exist. Differences in objectives, definitions, or requirements between the proposed SAS and ISA No. 505 are identified in the exposure draft's exhibit.

The ASB has made various changes to the language of the ISA to use terms or phrases that are more common in the United States, and to tailor examples and guidance to the U.S. environment. The ASB believes that such changes will not create differences between the application of ISA No. 505 and the application of the proposed SAS.

Effective Date

The proposed SAS would be effective for audits of financial statements for periods beginning on or after December 15, 2010. This effective date is provisional but will not be earlier than December 15, 2010.

Changes From Existing Standards

The proposed SAS does not expand SAS No. 67 in any significant respect; however, there are some changes as discussed below. To reflect a more principles-based approach to standard setting, certain requirements that are duplicative of broader requirements in SAS No. 67 have been moved to application and other explanatory material, consistent with ISA No. 505. In the ASB's view, this has not changed the overall effectiveness of the proposed SAS.

The following summarize what the ASB believes would be the most significant changes to existing standards if the proposed standard was issued. The supplementary materials accompanying this exposure draft illustrate detailed changes made to SAS No. 67.

- Paragraphs 8 and 9 of the proposed SAS address the responsibilities of the auditor when management refuses to allow the auditor to send a confirmation request. These responsibilities include communicating with those charged with governance if the auditor concludes that management's refusal is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures. These procedures are not required by AU section 330.
- The ASB has added application material to the proposed SAS regarding the use of oral responses to confirmation requests as audit evidence. Paragraphs A22 and A23 clarify that the receipt of an oral response to a confirmation request does not meet the definition of an external confirmation. These paragraphs provide guidance on how the response may be considered part of alternative procedures performed to obtain sufficient appropriate audit evidence.

³ The ASB's convergence paper is available online at www.aicpa.org/download/auditstd/ASB_Convergence_Plan.pdf.

- The definition of confirmation has been changed as discussed in the ‘Issues for Consideration’ section.

Issues for Consideration

Presumptive Requirement to Confirm Receivables

The ASB has retained the presumptive requirement in the extant SAS to use external confirmation procedures for accounts receivable from paragraph .34 of the extant SAS. This requirement is an addition to the requirements ISA No. 505. As shown in the Appendix of the proposed SAS, this requirement is included as a conforming amendment to proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* because it is part of the process of determining the appropriate audit procedures to perform, which is not included in the scope of the proposed SAS. The ASB concluded that it was appropriate to retain this requirement in the U.S. environment, notwithstanding that the IAASB did not include a similar requirement in ISA No. 505. The ASB is seeking views on its decision to retain the presumptive requirement to use external confirmation procedures for accounts receivable, and on its decision to include that requirement in proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

Definition of External Confirmations

The ASB has expanded the ISA definition of an external confirmation to include direct access by the auditor to information held by a third party. Third-party involvement is increasingly common, and the ASB believes that the inclusion of direct access clarifies the definition. The ASB believes this clarification is an improvement to the ISA definition and that it is not inconsistent with the intent of the IAASB’s definition. The ASB is seeking view on its decision.

Guide for Respondents

The ASB is seeking comments specifically on changes resulting from applying the clarity drafting conventions and converging with the ISA, and their effect on the content of the proposed SAS. Respondents are asked to respond, in particular, to the following questions:

1. Are the objectives of the auditor appropriate?
2. Are the revisions made to converge the existing standard with ISA No. 505 appropriate?
3. Are the differences between the proposed SAS and ISA No. 505 identified in the exhibit, and other language changes, appropriate?

Comments are most helpful when they refer to specific paragraphs, include the reasons

for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after September 30, 2009, for one year. Responses should be sent to Sherry Hazel at shazel@aicpa.org and received by August 31, 2009.

Supplements to the Exposure Draft

To assist respondents in identifying changes and in responding to this request to comment on the proposed SAS, the Audit and Attest Standards staff has prepared the following supplementary materials:

1. A matrix document, which compares of ISA No. 505, the proposed SAS, and extant AU section 330. The schedule has four columns containing the following:
 - a. ISA No. 505
 - b. The proposed SAS, marked to show differences in language between the ISA and the proposed SAS (new and deleted material are shown in colored track changes)
 - c. The requirements and guidance in extant AU section 330, mapped against the proposed SAS, to demonstrate how the material in AU section 330 has been reflected in the proposed SAS
 - d. Comments and rationale
2. A mapping document, which maps the requirements and guidance contained within SAS No. 67 to the proposed SAS to demonstrate how the material in SAS No. 67 has been reflected in the proposed SAS.

This staff-prepared supplementary material is available on the AICPA Web site at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Improving+the+Clarity+of+ASB+Standards/default.htm. It is for informational purposes only and does not form part of the exposure draft; however, it may be useful for respondents in formulating comments.

Comment Period

The comment period for this exposure draft ends on August 31, 2009.

**Auditing Standards Board
(2008–2009)**

Harold L. Monk, Jr., *Chair*
Ernest F. Baugh, Jr.
Sheila M. Birch
Jacob J. Cohen
Walton T. Conn, Jr.
Anthony J. Costantini
Charles E. Frasier
Nicholas J. Mastracchio, Jr.
Jorge Milo
Andrew M. Mintzer

Thomas A. Ratcliffe
Randy C. Roberts
Darrel R. Schubert
Thomas M. Stemlar
Mark H. Taylor
Phil D. Wedemeyer
Stephanie A. Westington
Arthur M. Winstead, Jr.
Megan F. Zietsman

External Confirmations Task Force

Megan F. Zietsman, *Chair*
Andrew M. Mintzer

Stephanie A. Westington
Mindy K. Montgomery

AICPA Staff

Charles E. Landes
Vice President
Professional Standards and Services

PROPOSED STATEMENT ON AUDITING STANDARDS
EXTERNAL CONFIRMATIONS

CONTENTS

	Paragraph
Introduction	
Scope of This Proposed Statement on Auditing Standards	1
External Confirmation Procedures to Obtain Audit Evidence.....	2-3
Effective Date	4
Objective	5
Definitions	6
Requirements	
External Confirmation Procedures.....	7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request.....	8-9
Results of the External Confirmation Procedures.....	10-14
Negative Confirmations	15
Evaluating the Evidence Obtained.....	16
Application and Other Explanatory Material	
External Confirmation Procedures	A1-A7
Management’s Refusal to Allow the Auditor to Send a Confirmation Request.....	A8-A10
Results of the External Confirmation Procedures.....	A11-A25
Negative Confirmations	A26
Evaluating the Evidence Obtained.....	A27-A28
Appendix: Conforming Amendments to Proposed Statement on Auditing Standards, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i> (Redrafted), as a result of Proposed Statement on Auditing Standards, <i>External Confirmations</i>	A29
Exhibit: Comparison of Requirements of Proposed Statement on Auditing Standards, <i>External Confirmations</i> With Requirements of International Standard on Auditing 505, <i>External Confirmations</i>	A30

Proposed Statement on Auditing Standards *External Confirmations*

Introduction

Scope of This Proposed Statement on Auditing Standards

1. This proposed Statement on Auditing Standards (SAS) addresses the auditor’s use of external confirmation procedures to obtain audit evidence in accordance with the requirements of Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)*,¹ and Proposed SAS, *Audit Evidence (Redrafted)*.² It does not address inquiries regarding litigation, claims and assessments, which are addressed in AU Section 337³.

External Confirmation Procedures to Obtain Audit Evidence

2. Proposed SAS, *Audit Evidence (Redrafted)*, indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.⁴ That proposed SAS also includes the following generalizations applicable to audit evidence:⁵

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This SAS is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

3. Other SASs recognize the importance of external confirmations as audit evidence, for example:

¹ *Exposure Draft Proposed SAS*, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (*Redrafted*).”

² *Exposure Draft Proposed SAS*, “Audit Evidence (*Redrafted*).”

³ *AU Section 337*, “Inquiry of a Client’s Lawyer Concerning Litigation, Claims, and Assessments.”

⁴ *Exposure Draft Proposed SAS*, “Audit Evidence (*Redrafted*),” paragraph A5.

⁵ *Exposure Draft Proposed SAS*, “Audit Evidence (*Redrafted*),” paragraph A32.

- Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), discusses the auditor’s responsibility to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, and 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.⁶ In addition, Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), requires that, irrespective of the assessed risks of material misstatement, the auditor designs and performs substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure. The auditor is also required to consider whether external confirmation procedures are to be performed as substantive audit procedures.⁷
- Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), requires that the auditor obtain more persuasive audit evidence the higher the auditor’s assessment of risk.⁸ 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. Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), 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 of material misstatement, whether due to fraud or error.⁹
- Proposed SAS, *Consideration of Fraud in a Financial Statement Audit* (Redrafted), 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.¹⁰
- Proposed SAS, *Audit Evidence* (Redrafted), indicates that corroborating information obtained from a source independent of the entity, such as external

⁶ *Exposure Draft Proposed SAS, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted),” paragraphs 5 and 6.*

⁷ *Exposure Draft Proposed SAS, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)” paragraph 19 and Appendix paragraph 19A.*

⁸ *Exposure Draft Proposed SAS, “Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted),” paragraph 7(b).*

⁹ *Appendix paragraph A59.*

¹⁰ *Exposure Draft Proposed SAS, “Consideration of Fraud in a Financial Statement Audit (Redrafted),” paragraph A38.*

confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from representations made by management.¹¹

Effective Date

4. This proposed SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010.*

Objective

5. The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definitions

6. For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

External confirmation. Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form, or by electronic or other medium, or through direct access by the auditor to information held by a third party.

Positive confirmation request. A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

Negative confirmation request. A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

Non-response. A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

Exception. A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

¹¹ *Exposure Draft Proposed SAS, "Audit Evidence (Redrafted)," paragraph A8.*

* This date is provisional, but will not be earlier than December 15, 2010.

Requirements

External Confirmation Procedures

7. When using external confirmation procedures, the auditor should maintain control over external confirmation requests, including:
- (a) Determining the information to be confirmed or requested (Ref: Para. A1);
 - (b) Selecting the appropriate confirming party; (Ref: Para. A2)
 - (c) Designing the confirmation requests, including determining that requests are properly directed to the appropriate confirming party and provide for being responded to directly to the auditor; and (Ref: Para. A3-A6)
 - (d) Sending the requests, including follow-up requests when applicable, to the confirming party. (Ref: Para. A7)

Management's Refusal to Allow the Auditor to Send a Confirmation Request

8. If management refuses to allow the auditor to send a confirmation request, the auditor should:
- (a) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness; (Ref: Para. A8)
 - (b) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and (Ref: Para. A9)
 - (c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: Para. A10)
9. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor should communicate with those charged with governance in accordance with SAS, *The Auditor's Communication With Those Charged With Governance (Redrafted)*.¹² The auditor also should determine the implications for the audit and the auditor's opinion in accordance with AU Section 508.¹³

¹² *Statement on Auditing Standards, The Auditor's Communication with Those Charged with Governance (Redrafted), paragraph 12.*

¹³ *AU Section 508, "Reports on Audited Financial Statements."*

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests

10. If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor should obtain further audit evidence to resolve those doubts. (Ref: Para. A11-A16)

11. If the auditor determines that a response to a confirmation request is not reliable, the auditor should evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. (Ref: Para. A17)

Non-Responses

12. In the case of each non-response, the auditor should perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: Para A18-A20)

When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence

13. If the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor should determine the implications for the audit and the auditor's opinion in accordance with AU Section 508. (Ref: Para A21-A23)

Exceptions

14. The auditor should investigate exceptions to determine whether or not they are indicative of misstatements. (Ref: Para. A24-A25)

Negative Confirmations

15. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor should not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

- (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;

- (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
- (c) A very low exception rate is expected; and
- (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests. (Ref: Para. A26)

Evaluating the Evidence Obtained

16. The auditor should evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. (Ref: Para A27-A28)

Application and Other Explanatory Material

External Confirmation Procedures

Determining the Information to be Confirmed or Requested (Ref: Para. 7(a))

A1. External confirmation procedures frequently are performed to confirm or request information regarding account balances, elements thereof, and disclosures. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement”.

Selecting the Appropriate Confirming Party (Ref: Para. 7(b))

A2. Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

Designing Confirmation Requests (Ref: Para. 7(c))

A3. The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.

A4. Factors to consider when designing confirmation requests include:

- The assertions being addressed.
- Specific identified risks of material misstatement, including fraud risks.
- The layout and presentation of the confirmation request.
- Prior experience on the audit or similar engagements.

- The method of communication (for example, in paper form, or by electronic or other medium).
- Management’s authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management’s authorization.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

A5. A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party’s agreement with the given information, or by asking the confirming party to provide information. A response to a properly designed positive confirmation request ordinarily is expected to provide reliable audit evidence. There is a risk, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request, and ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of “blank” confirmation request may result in lower response rates because additional effort is required of the confirming parties.

A6. Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out. For example, where a confirmation request is sent by electronic mail, the auditor may perform similar procedures to verify the email address supplied by management. If another process is used, the auditor may perform other procedures to determine that the request is directed to the intended recipient. See further guidance in paragraph A12.

Follow-Up on Confirmation Requests (Ref: Para. 7(d))

A7. The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

Management’s Refusal to Allow the Auditor to Send a Confirmation Request

Reasonableness of Management’s Refusal (Ref: Para 8(a))

A8. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Implications for the Assessment of Risks of Material Misstatement (Ref: Para 8(b))

A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with Proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Redrafted).¹⁴ For example, if management’s request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with Proposed SAS, *Consideration of Fraud in a Financial Statement Audit* (Redrafted).¹⁵

Alternative Audit Procedures (Ref: Para 8(c))

A10. The alternative audit procedures performed may be similar to those appropriate for a non-response as set out in paragraphs A18-A20 of this SAS. Such procedures also would take account of the results of the auditor’s evaluation in paragraph 8(b) of this SAS.

Results of the External Confirmation Procedures*Reliability of Responses to Confirmation Requests* (Ref: Para. 10)

A11. Proposed SAS, *Audit Evidence* (Redrafted), indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability.¹⁶ All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include that it:

- Was received by the auditor indirectly; or
- Appeared not to come from the originally intended confirming party.

A12. Responses received electronically, for example by facsimile or electronic mail, involve risks relating to reliability because proof of origin and knowledge of the respondent may be difficult to establish, and alterations may be difficult to detect. An electronic confirmation process that creates a secure confirmation environment may mitigate the risks of interception or alteration. The key to creating a secure confirmation environment lies in the process or mechanism used by the auditor and the respondent to minimize the possibility that the results will be compromised because of interception or alteration of the confirmation. If the auditor is satisfied that such a process is secure and

¹⁴ *Exposure Draft Proposed SAS, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted),” paragraph 31.*

¹⁵ *Exposure Draft Proposed SAS, “Consideration of Fraud in a Financial Statement Audit (Redrafted),” paragraph 24.*

¹⁶ *Exposure Draft Proposed SAS, “Audit Evidence (Redrafted),” paragraph A32.*

properly controlled, the reliability of the related responses is enhanced. Various means might be used to validate the source of the electronic information and the respondent's knowledge about the requested information. For example, the use of encryption, electronic digital signatures, and procedures to verify Web site authenticity may improve the security of the electronic confirmation process.

A13. The auditor's consideration of the reliability of the information obtained through the confirmation process to be used as audit evidence includes consideration of the risks that:

- (a) The information obtained may not be from an authentic source;
- (b) A respondent may not be knowledgeable about the information to be confirmed; and
- (c) The integrity of the information may have been compromised.

A14. If a system or process that facilitates electronic confirmation between the auditor and the respondent is in place and the auditor plans to rely on such a system or process, an assurance trust services report (for example, Systrust), or another assurance report on that process, may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls with respect to that process. Such an assurance report may address the risks described in paragraph A13. If these risks are not adequately addressed in such a report, the auditor may perform additional procedures to address those risks.

A15. The auditor is required by Proposed SAS, *Audit Evidence* (Redrafted), to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence.¹⁷ In some cases, the auditor may determine that it is appropriate to address the risks related to the reliability of the information received electronically by directly contacting the purported sender (for example, by telephone) rather than by using alternative means to validate the source of the electronic information. For example, if significant information is provided via an e-mail response, the auditor may perform alternative procedures, including procedures to verify the authenticity of information such as the e-mail address of the purported sender. The auditor may also contact the purported sender directly by telephone to verify that the information received was sent by the confirming party and also that what was received by the auditor corresponds to the information transmitted by the purported sender. When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than to the auditor), the auditor may request the confirming party to respond in writing directly to the auditor. Confirmations obtained electronically may be considered reliable audit evidence if the auditor is satisfied that (a) the electronic confirmation process is secure and properly controlled, (b) the information

¹⁷ *Exposure Draft Proposed SAS, "Audit Evidence (Redrafted)," paragraph 9.*

obtained is a direct communication in response to a request, and (c) the information is obtained from a third party who is the intended respondent.

A16. A response to a confirmation request may contain restrictive language regarding its use (for example, language disclaiming the responsibility for the accuracy or completeness of the information included in a response). Such restrictions do not necessarily invalidate the reliability of the response as audit evidence to the extent that the restrictive language does not relate to the assertions being tested by the confirmation. However, when the auditor has doubts as to the reliability of the response that occurs as a result of restrictive language, then in accordance with paragraph 10, the auditor is required to obtain further audit evidence to resolve those doubts. If the restrictive language precludes the auditor's use of the information provided therein as audit evidence, the auditor may conclude that it is necessary to treat such a response as a non-response and in accordance with paragraph 12, be required to perform alternative audit procedures to obtain relevant and reliable audit evidence.

Unreliable Responses (Ref: Para. 11)

A17. When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with Proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Redrafted).¹⁸ For example, an unreliable response may indicate a fraud risk factor that requires evaluation in accordance with Proposed SAS, *Consideration of Fraud in a Financial Statement Audit* (Redrafted).¹⁹

Non-Responses (Ref: Para. 12)

A18. Examples of alternative audit procedures the auditor may perform include:

- For accounts receivable balances – examining specific subsequent cash receipts (including matching such receipts with the actual items being paid), shipping documentation, and other client documentation providing evidence for the existence assertion.
- For accounts payable balances – examining subsequent cash disbursements or correspondence from third parties, and other records, such as receiving reports and statements the client receives from vendors.

¹⁸ *Exposure Draft Proposed SAS, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)," paragraph 31.*

¹⁹ *Exposure Draft Proposed SAS, "Consideration of Fraud in a Financial Statement Audit (Redrafted)," paragraph 24.*

A19. The nature and extent of alternative audit procedures are affected by the account and assertion in question. The auditor may take the receipt of an oral response to a confirmation request into consideration when determining the nature and extent of alternative audit procedures. A non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures, in accordance with Proposed SAS, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)*.²⁰ For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation in accordance with Proposed SAS, *Consideration of Fraud in a Financial Statement Audit (Redrafted)*.²¹

A20. The omission of alternative procedures may be acceptable when testing for overstatement of amounts when: (a) the non-responses in the aggregate, projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated and (b) the auditor has not identified unusual qualitative factors or systematic characteristics related to the non-responses, such as that all non-responses pertain to year-end transactions.

When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence (Ref. Para. 13)

A21. In certain circumstances, the auditor may identify an assessed risk of material misstatement at the assertion level for which a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Such circumstances may include where:

- The information available to corroborate management's assertion(s) is only available outside the entity.
- Specific fraud risk factors, such as the risk of management override of controls, or the risk of collusion which can involve employee(s) and/or management, prevent the auditor from relying on evidence from the entity.

A22. An oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. Where the auditor has determined that a written response is necessary to obtain sufficient appropriate audit evidence and the auditor has obtained only an oral response to a confirmation request, the auditor may request the confirming party to respond in writing

²⁰ *Exposure Draft Proposed SAS, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)," paragraph 31.*

²¹ *Exposure Draft Proposed SAS, "Consideration of Fraud in a Financial Statement Audit (Redrafted)," paragraph 24.*

directly to the auditor. If no such response is received, in accordance with paragraph 13, alternative audit procedures will not provide the audit evidence the auditor requires and the auditor is required to determine the implications for the audit and the auditor's opinion in accordance with AU Section 508.

A23. In a situation where the auditor has concluded that a response to a positive confirmation is not necessary to obtain sufficient appropriate audit evidence and the auditor has obtained an oral response to a confirmation request, alternative audit procedures may include consideration of the oral response as audit evidence. In such a situation, the auditor may, depending on the circumstances, including for example whether the external confirmation has been requested to address a significant risk or not, determine that an appropriately documented oral response to a confirmation request (including details of the identity of the person from whom the response was received, his or her position, the date and time of the conversation) together with the evidence upon which the original confirmation request is based (e.g., statement or other correspondence received by the entity) is sufficient appropriate audit evidence. In connection with such oral response, the auditor may also consider additional precautionary measures to address the reliability of the evidence provided by such response, such as initiating the call to the respondent using a telephone number that the auditor has independently verified as being associated with the entity (e.g., the auditor might call the main telephone number obtained from the entity's website and ask to be directed to the named respondent instead of calling a direct extension provided by the client or included in the statement or other correspondence received by the entity.)

Exceptions (Ref: Para. 14)

A24. Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by Proposed SAS, *Consideration of Fraud in a Financial Statement Audit* (Redrafted) to evaluate whether such misstatement is indicative of fraud.²² Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting.

A25. Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

Negative Confirmations (Ref: Para. 15)

A26. The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a

²² *Exposure Draft Proposed SAS, "Consideration of Fraud in a Financial Statement Audit (Redrafted)", paragraph 35.*

failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise. For example, holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request, but may be less likely to respond when they believe the balance is overstated. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated, but is unlikely to be effective if the auditor is seeking evidence regarding overstatement.

Evaluating the Evidence Obtained (Ref: Para 16)

A27. When evaluating the results of individual external confirmation requests, the auditor may categorize such results as follows:

- (a) A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request, or providing requested information without exception;
- (b) A response deemed unreliable;
- (c) A non-response; or
- (d) A response indicating an exception.

A28. The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether further audit evidence is necessary, as required by Proposed SAS, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted).²³

²³ *Exposure Draft Proposed SAS, "Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)," paragraph 26 and 27.*

A29.

Appendix: Conforming Amendments to Proposed Statement on Auditing Standards, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), as a result of Proposed Statement on Auditing Standards, *External Confirmations*

19a. The auditor should consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: Para. A57a-A57d)

19b. The auditor should use external confirmation procedures for material accounts receivable except when one or more of the following is applicable: (A57e)

- (a) External confirmation procedures for accounts receivable would be ineffective. (Ref: Para.A57f)
- (b) The auditor's assessed level of risk of material misstatement is low, and the auditor plans to obtain sufficient appropriate audit evidence by performing substantive procedures. In many situations, use of external confirmation procedures for accounts receivable and the performance of other substantive tests are necessary to reduce audit risk to an acceptably low level for the relevant assertions.

The auditor should document the basis for any determination not to use external confirmation procedures for accounts receivable.

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: Para 19a-19b)

A57a. External confirmation procedures frequently may be relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no “side agreement” exists that may be relevant to an entity’s revenue cut-off assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:

- Bank balances and other information relevant to banking relationships.

- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms.

A57b. Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances, than they do of their existence.

A57c. The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures.

A57d. Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond – for example, the confirming party:
 - May not accept responsibility for responding to a confirmation request;
 - May consider responding too costly or time consuming;
 - May have concerns about the potential legal liability resulting from responding;
 - May account for transactions in different currencies; or
 - May operate in an environment where responding to confirmation requests

is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response

- The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.
- Information from prior years' audits or audits of similar entities. This information includes response rates, knowledge of misstatements identified during prior years' audits, and any knowledge of inaccurate information on returned confirmations. For example, if the auditor has experienced poor response rates to properly designed confirmation requests in prior audits, the auditor may instead consider obtaining audit evidence from other sources.

A57e. For the purpose of this SAS, *accounts receivable* means—

- a. The entity's claims against customers that have arisen from the sale of goods or services in the normal course of business, and
- b. A financial institution's loans.

A57f. Confirmations may be considered ineffective if, based on prior years' audit experience or on experience with similar engagements, the auditor concludes that response rates to properly designed confirmation requests will be inadequate, or if responses are known or expected to be unreliable, the auditor may determine that the use of external confirmation procedures for accounts receivable would be ineffective.

Substantive Procedures Responsive to Significant Risks (Ref: Para. 21)

A59. Paragraph 21 of this SAS requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a risk that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmations procedures not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor may find it effective to supplement such external confirmations procedures with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms. ~~Substantive procedures related to significant risks are most often designed to obtain audit evidence with high reliability.~~

A30.

Exhibit: Comparison of Requirements of Proposed Statement on Auditing Standards *External Confirmations* With Requirements of International Standard on Auditing 505, *External Confirmations*

This analysis was prepared by the Audit and Attest Standards staff to highlight substantive differences between the proposed Statement on Auditing Standards *External Confirmations* with International Standard on Auditing No. 505, *External Confirmations*, and the rationale therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on or reviewed by the Auditing Standards Board.

Presumptive Requirement to Confirm Accounts Receivable

Paragraph .34 of SAS 67 contains a presumptive requirement to perform external confirmation procedures for accounts receivable. ISA No. 505 does not include a similar requirement. The ASB concluded that this requirement is appropriate in the U.S. environment. As shown in the Appendix of the proposed SAS, this requirement is included as a conforming amendment to Proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, because it is part of the process of determining the appropriate audit procedures to perform, which is not included in the scope of the proposed SAS (that is, ISA No. 505 and the proposed SAS presume that the auditor has already determined an external confirmation is the appropriate audit procedure.)



Exhibit 2(a)(F)

Alphabetical List of Commenters on the Proposal in PCAOB Release No. 2010-003
--

1	American Accounting Association
2	American Bankers Association
3	AuditConfirmations, LLC
4	BDO USA, LLP
5	California Society of Certified Public Accountants
6	Capital Confirmation, Inc.
7	Center for Audit Quality
8	Crowe Horwath LLP
9	Deloitte & Touche LLP
10	Ernst & Young LLP
11	Federation of European Accountants
12	Grant Thornton LLP
13	Illinois CPA Society
14	Institut der Wirtschaftsprüfer
15	Institute of Internal Auditors
16	KPMG LLP
17	Joseph A. Maffia, CPA (2 Letters)
18	Mayer Hoffman McCann P.C.
19	Mazars
20	McGladrey & Pullen, LLP
21	New York State Society of Certified Public Accountants
22	Piercy Bowler Taylor & Kern, Certified Public Accountants
23	PricewaterhouseCoopers LLP
24	Texas Society of Certified Public Accountants

Alphabetical List of Commenters on the Proposal in PCAOB Release No. 2010-003	
25	The Institute of Chartered Accountants in England and Wales
26	U.S. Chamber of Commerce, Center for Capital Markets Competitiveness
27	United States Government Accountability Office

September 10, 2010

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

Via email to comments@pcaobus.org

**RE: PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2010-003
Proposed Auditing Standard Related to Confirmation and Related Amendments to
PCAOB Standards**

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the *PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2010-003 Proposed Auditing Standard Related to Confirmations and Related Amendments to PCAOB Standards*.

The views expressed in this letter and attachments are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member. We also note that three Committee members performed research that is cited in Release No. 2010-003, and these individuals were significantly involved in the drafting of this comment letter. However, we do not believe this affected the objective nature of our comments.

We hope that our attached comments and suggestions are helpful and will assist in the revisions to the proposed standard on audit confirmations. If the Board has any questions about our input, please feel free to contact our committee chair for any follow-up.
Respectfully submitted,

Auditing Standards Committee
Auditing Section - American Accounting Association

Committee Members:

Chair – Joe Brazel, North Carolina State University
Past Chair – James Bierstaker, Villanova University
Larry Abbott, University of Memphis
Paul Caster, Fairfield University
Randal Elder, Syracuse University
Steven Firer, Monash University – South Africa
Diane Janvrin, Iowa State University (ad hoc member)
Ed O'Donnell, Southern Illinois University
Susan Parker, Santa Clara University
Brad Reed, Southern Illinois University
Sandra Shelton, DePaul University

Auditing Standards Committee
Auditing Section – American Accounting Association

General Comments

The Committee commends the PCAOB (“the Board”) for addressing the use of confirmations, including electronic confirmations, and confirmations of other accounts and special terms. We believe the proposed standard significantly improves the confirmation process. We also believe that issuance of the Concept Release (PCAOB Release No. 2009-002) significantly improved the proposed standard, and that use of concept releases is beneficial if a proposed standard significantly changes existing standards. However, use of a concept release may not be more efficient or effective than re-exposing a proposed standard after initial comments are received.

The following section presents a number of specific comments or suggestions, organized along the lines of the questions posed by the Board in the release of the proposed standard.

1. Are the definitions included in the proposed standard clear and appropriate? If not, what changes should the board make to the definitions?

The Board has done a good job of defining a confirmation to incorporate electronic responses, and the reference to “other medium” allows for flexibility in interpreting the nature of a confirmation for changes in technology. The Committee agrees with definition A4 that an oral response is not a confirmation, and the description in paragraph 35 of the conditions under which direct access constitutes a confirmation response.

2. Is the objective of the standard clear and appropriate? If not, what changes should the board make to the objective?

3. What other matters, if any, should the objective include?

The Committee believes that the objective is too generic to be useful. Indeed, the objective of many standards could be “to obtain relevant and reliable audit evidence.” The objective in the proposed Auditing Standards Board standard includes the term “when using confirmation procedures,” but this also does not capture the depth of the standard in providing guidance on the use of confirmations. We provide suggested wording below:

“The objective of the auditor is to perform confirmation procedures, including designing confirmation requests and evaluating confirmation responses, when required or appropriate to obtain relevant and reliable audit evidence.”

Auditing Standards Committee
Auditing Section – American Accounting Association

4. *Is the description of “receivables that arise from credit sales, loans, or other transactions” sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee believes that the description is clear and appropriate. However, the Committee believes that the elimination of the exceptions for confirming receivables in AU sec. 330 needs further clarification. The Committee agrees with the elimination of the exception related to immaterial receivables. The Committee agrees with elimination of the exception related to situations where risk is low and other evidence is available to obtain sufficient appropriate evidence, because of risks related to revenue recognition, and because of the quality of evidence provided by confirmations. However, it may be helpful to footnote why this exception is not appropriate.

The exception related to ineffectiveness of confirmations is more challenging. The release indicates (p. 13) that “...if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures.” The release then indicates “Accordingly, pursuant to Auditing Standard No. 3, the auditor should document in the audit work papers his or her rationale for not performing confirmation procedures for receivables that arise from credit sales, loans, or other transactions.”

This leaves auditors unclear as to whether ineffectiveness can be used as a basis for not sending confirmations. While the need to document the decision not to send confirmations can be inferred from Auditing Standard No. 3, it is not explicit. Further, it may not be beneficial to force auditors to send confirmations in all circumstances. For example, one Committee member conducted research involving confirmation decisions. On one audit, 114 invoice confirmations were sent, and only three responses were received.

We believe it is appropriate to send confirmations, even when response rates are low. A response to a positive confirmation is highly effective evidence as to the existence assertion. Even a non-response to a positive confirmation provides limited evidence as to the existence assertion to the extent the U.S. postal service can be relied on and the confirmations are not returned as undeliverable (Ashton and Hylas 1980). We suggest wording such as the following:

“Confirmations may be ineffective due to low response rates, or unreliable responses. Auditors should first evaluate whether the confirmations can be redesigned to improve response rates, and whether ineffectiveness relates to all receivables or only certain customers or types of receivables. Even when response rates are low, positive confirmations help provide evidence as to the existence assertion. In rare circumstances where the decision is made not to send confirmations because of their ineffectiveness based on the auditor’s current or prior experience, the rationale for the decision should be documented in the work papers.”

Auditing Standards Committee
Auditing Section – American Accounting Association

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

We agree with the requirement to confirm cash and other financial relationships with financial institutions. The guidance to not base the confirmation decision on the reported cash balance, and the need to understand the treasury function and assess the risk of material misstatement in determining which accounts and relationships to confirm is particularly helpful.

6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

We believe the guidance is unclear. Based on the example, it can be inferred that if the auditor has identified a significant risk, the auditor should confirm the amounts and terms of significant transactions, including whether there are any other undisclosed oral or undisclosed written modifications to those agreements. Paragraph 10 indicates confirmations should also be used for other significant risks, however, the note indicates that confirmations might not be specifically responsive to every significant risk. Should an auditor send confirmations if they are responsive to a significant risk, even if another form of evidence is more responsive or more efficient in addressing that risk?

We recommend making the guidance more explicit that the auditor must confirm the amounts and terms of significant transactions, including whether there are any other undisclosed oral or undisclosed written modifications to those agreements, when a significant risk is identified. We believe this is appropriate because of concerns about revenue recognition. For other significant risks, we recommend that the standard require auditors to assess whether confirmations would address that risk. In such circumstances, the auditor should perform confirmation procedures, or document why they were not performed.

We expect that many auditors might find such a requirement burdensome. However, we do not know how many significant risks are identified on an average audit. We believe this approach is clearer than indicating that the auditor should perform confirmation procedures whenever there is a significant risk that can be addressed by confirmation procedures, since it allows the auditor to select procedures that may be more effective than confirmations, even if confirmations address the assertion affected by the significant risk.

Auditing Standards Committee
Auditing Section – American Accounting Association

8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

We believe that paragraph 11 needs further clarification. It consists of one sentence, and is designed to indicate that confirmations may be appropriate in other circumstances. These circumstances may involve situations that involve a risk that is not significant, or situations where no risk has been identified. We recommend changing the heading from “Other Risks” to “Use of Confirmations in Other Circumstances.” We would change the text to terminology such as:

“Use of confirmation procedures may be an appropriate response to address other risks that are not considered significant risks. Even in circumstances where no specific risk has been identified, confirmation procedures may be an appropriate form of evidence for certain relevant assertions regarding a particular account, balance, transaction, agreement, or other item.”

9. Are the requirements in the proposed confirmation for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

We believe the requirements are clear and appropriate. The guidance addresses electronic confirmations, and we found the guidance on determining the validity of addresses particularly helpful.

10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The proposed standard does not provide guidance on the use of internal auditors, and primarily relies on the guidance in AU sec. 322. The guidance found on page 20 of the Release is clear, and we believe some of this should be moved into the proposed standard. We recommend a paragraph with the heading “Use of Internal Auditors.” This paragraph should indicate:

“The auditor cannot use internal auditors to send confirmation requests, receive confirmation responses, or evaluate the audit evidence from using confirmation procedures. Internal auditors may assist in other ways, such as testing whether confirmations are properly addressed or assembling information necessary for the auditor to resolve exceptions in confirmation responses, provided the auditor has assessed the internal auditors’ competence and objectivity, and the auditor supervises, reviews, evaluates, and tests the work performed by internal auditors.”

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

*Auditing Standards Committee
Auditing Section – American Accounting Association*

The factors identified are clear and appropriate. We believe that paragraph 16 on designing the confirmation requests should follow paragraph 17 on determining the type of confirmation requests to send. We believe the factors to consider should include addressing whether risks have been identified related to side agreements. A footnote or other information on balance, invoice, and blank form confirmations would also be beneficial.

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

The guidance is clear and appropriate. We appreciate the suggestion that negative confirmations may be used in combination with positive confirmation requests. We also believe the guidance that the auditor must perform other substantive procedures when negative confirmations are used, without specifying the nature of the substantive procedures, is appropriate.

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

14. Are the procedures the auditor should perform to when he or she determine that the confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

The guidance is clear and appropriate. We appreciate the guidance that the procedures should depend on risk and materiality, and that the testing of validity of addresses could be based on substantive procedures or tests of controls.

15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements.?

We believe the guidance is sufficiently clear and appropriate, especially the need to evaluate the implications of the request on the auditor's assessment of relevant risks. We also agree with the note in 24.b. that the auditor should obtain more persuasive evidence when performing alternative procedures when management has requested that the balance or item not be confirmed, but believe an example or footnote guidance would be helpful to illustrate this. For example, in addition to examining subsequent cash receipts, the auditor may also examine the customer order and evidence of shipment to verify the validity of the sale.

16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?

Auditing Standards Committee
Auditing Section – American Accounting Association

We do not believe there are circumstances when it would not be necessary to perform alternative procedures for non-responses to positive confirmation requests. Even if an individual request is not material, even when projected to the population items not tested, it was still part of the sample selected for testing, and the alternative procedures are necessary to obtain evidence regarding the existence assertion.

17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

We believe the additional procedures are appropriate.

18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

We did not identify additional circumstances beyond those identified in paragraph 29.

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

We believe the requirement is clear and appropriate. However, we note that in some cases it may not be necessary to determine the exact cause of an exception, especially when the difference is immaterial, but it would be sufficient to perform procedures to assess whether the difference is due to fraud or a systematic cause. An overly restrictive requirement to investigate all exceptions may cause auditors to use invoice confirmations, even when balance confirmations are preferred, because invoice confirmations are likely to result in fewer exceptions.

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

The requirement is sufficiently clear and appropriate. We especially appreciate the requirement in paragraph 32 that the auditor assess any indication that the third party has questionable motives or is not free from bias, given the number of situations in which third parties have colluded with the company under audit in providing confirmation responses.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

Auditing Standards Committee
Auditing Section – American Accounting Association

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.

Paragraph 35 indicates that “The auditor should perform procedures to determine whether the auditor can use the intermediary’s process.” Because the auditor is relying on controls at the intermediary, the requirements should be similar to relying on controls at service organizations that process transactions for the client.

24. Are there risks related to the auditor’s use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

We are not aware of risks related to direct access that have not been identified. We do not believe that direct access should be limited to financial institutions. The auditor should evaluate the reliability of direct access similar to the evaluation of the reliability of a confirmation response.

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements related to disclaimers and restrictive language are clear and appropriate. We note that the example in paragraph 36 as to the accuracy of the confirmation response primarily affects the use of the confirmation response to address the valuation assertion. The confirmation response may still provide appropriate evidence for the existence assertion.

27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

We believe the requirements are sufficiently clear and appropriate.

Reference

Ashton, R., and R. Hylas. 1980. The return of problem confirmation requests by the U.S. Postal Service. *The Accounting Review* 55 (October): 649-657.



Donna J. Fisher
Senior Vice President
Tax, Accounting & Financial Management
202-663-5318
dfisher@aba.com

August 17, 2010

Jennifer Rand
Deputy Chief Auditor
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Dee Mirando-Gould
Associate Chief Auditor
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Christopher David
Assistant Chief Auditor
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 028
Proposal Relating to New Auditing Standard on Confirmation

Ladies and Gentleman:


The American Bankers Association (ABA) would like to request a meeting with the Public Company Accounting Oversight Board ("PCAOB") staff responsible for the Board's proposed auditing standard released on July 13, 2010. According to the release, the Board is proposing an auditing standard, *Confirmation*, which would supersede the Board's current standard, AU section 330, *The Confirmation Process*, and related amendments to the Board's auditing standards. The audit confirmation process is important to ABA member banks who, due to their relationship with their clients, are obligated to participate in the audit confirmation process. Hence, the ABA would like to clearly understand any changes that are contemplated under this proposal and, if necessary, provide necessary comments on behalf of ABA member banks.

On April 14, 2009, the Board issued *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* and requested public comments. It is our understanding that the PCAOB is basing the proposed auditing standard, which has an impact on both auditors and financial institutions involved in the audit confirmation process, on the following: (i) comments received, (ii) input from the Board's Standing Advisory Group, (iii) the Board's inspection activities and academic research, and (iv) the actions of other standard setters.

The ABA has spent a significant amount of time in the past coordinating with the American Institute of Certified Public Accountants on both the confirmation processes and the forms. It is important to point out the fact that financial institutions currently expend a significant amount of time and effort in order to timely and correctly address audit confirmation requests. Thus, we believe that any contemplated changes in the audit confirmation standards or processes should take this fact into account and ensure that the possibility for additional burdens or increased liabilities for banks are effectively minimized, while also ensuring a high quality confirmation process.

We will contact the PCAOB staff to establish a meeting date on this important issue. In the meantime, please feel free to contact me at 202-663-5318 or dfisher@aba.com.

Sincerely,

A handwritten signature in cursive script that reads "Donna J. Fisher". The signature is written in black ink and is positioned above the printed name.

Donna J. Fisher



▪ AuditConfirmations, LLC
10955 Westmoor Dr., Suite 400
Westminster, CO 80021

▪ Phone: (800) 788-1051
Fax: (303) 468-1989
AuditConfirmations.com

September 13, 2010

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

Re: PCAOB Rulemaking Docket Matter No. 028

Dear Board Members and Staff:

AuditConfirmations, LLC appreciates the opportunity to provide an updated comment letter on the PCAOB's proposed rule, *PROPOSED AUDITING STANDARD RELATED TO CONFIRMATION AND RELATED AMENDMENTS TO PCAOB STANDARDS*. AuditConfirmations, LLC is a service provider that owns and operates a web based application for processing electronic audit confirmations for use by public accounting firms.

We welcome the Board's efforts to broaden the existing confirmation standard and provide guidance on the use of electronic confirmations. Our comments to certain technology specific questions are noted below.

QUESTIONS & RESPONSES

23. *The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.*

AuditConfirmations LLC is an intermediary that facilitates the confirmation process through electronic methods. We take our responsibilities to the profession seriously and seek to improve both audit efficiency and audit integrity. We feel that the following is a listing of some of our responsibilities and obligations:

Between the Auditor and Intermediary

- ✓ Maintain the security, control, and confidentiality of information submitted by the auditor.
- ✓ Transmit electronic confirmations only to the recipients specified by the auditor.
- ✓ Maintain effective internal controls and electronic evidence that could be reasonably expected to prevent, identify, and/or document attempts to provide fraudulent responses to confirmation requests.
- ✓ Transmit results directly to (and only to) the auditor to ensure all confirmation information is directly communicated between the auditor and the third party.



-
- ✓ Only permit data to be entered and displayed using encrypted methods (e-mail is used to notify parties of confirmation requests, never to provide a confirmation response or otherwise complete confirmations).
 - ✓ Host data on secure servers in data centers that have undergone a Type II SAS 70 audit, undergo regular audits and testing of system security, and provide transparency to auditors of internal controls in place to control confirmation-related data.
 - ✓ Provide real-time status tracking of outstanding electronic confirmation.
 - ✓ Provide an electronic audit trail with Internet Protocol (IP) address stamps, time & date stamps, detailed user information, and other relevant routing information useful in assisting auditors with evaluating and understanding the integrity of the transmission process.
 - ✓ When providing confirmations through direct access methods, do so in a manner that supports the audit process through producing reliable and familiar audit evidence free of terms of use that conflict with confirmation guidance.
 - ✓ When providing confirmations through direct access methods, producing information that was obtained directly and independently from the third-party's records.
 - ✓ Perform direct access confirmations in a manner that searches for other information relevant to the audit procedures in accordance with applicable confirmation guidance (e.g., when providing direct access confirmations of cash, executing a reasonable search of the entity's loan and credit systems to identify otherwise undisclosed liabilities held at the same financial institution).
 - ✓ Maintain and document independence, in accordance with all applicable professional audit standards, from any entities for which we are providing a service of confirming assets or liabilities.
 - ✓ Maintain and document independence, in accordance with all applicable professional audit standards, from any confirming entities as those entities may have motives that conflict with the objectives of the confirmation process.

Between the Intermediary and Confirming Party

- ✓ Maintain the security, control, and confidentiality of information submitted by the confirming party.
- ✓ Transmit completed electronic confirmations *only* to the auditor that originally initiated the confirmation under the authorization to do so provided by the confirming party's customer.
- ✓ Only permit data to be entered and displayed using encrypted methods (e-mail is used only to notify parties of confirmation requests, not to complete confirmations).
- ✓ Host data on secure servers in data centers that have undergone a Type II SAS 70 audit, undergo regular audits and testing of system security, and provide transparency to auditors of internal controls in place to control confirmation-related data.



24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

There is a comment within the release that states “Direct access might pose additional risks because the information might not be in a form that is readily understandable or the Web site might contain disclaimers or restrictions as to use.” We believe this is a true statement; however, we also would like the PCAOB to consider that direct access, when executed properly and in accordance with the audit guidance, might also *significantly* reduce many risks in cases where the confirming party is a financial institution. Direct access can be used in an electronic confirmation to systematically access historical data at a financial institution without manual intervention by the financial institution. Most financial institutions within the United States and many abroad already have mechanisms in place to allow direct access using certain software tools created by these same financial institutions. These tools allow historical account balance information to be collected in a matter of seconds and in a secure manner. By using direct access methods developed specifically for the purpose of confirmation procedures, the following risks can be addressed:

- The risk of unintentional mistakes or errors made by the confirming financial institutions employees. Also, direct access can eliminate the risk of collusion with financial institution insiders.
- By utilizing appropriate methods of direct access, auditors are able to complete the confirmation with a higher level of independence as it relates to the financial institution avoiding concerns mentioned other places in the proposed rule such as inappropriate motives, lack of independence from the audit client, etc.
- Direct access methods, when properly executed, may provide a more thorough search for unrecorded liabilities or other relationships between the financial institution and the audit client that were previously undisclosed. Often, a financial institution will assign the responsibility of confirmation responses to lower level employees that may not have a comprehensive view of the organization and its relationship with that customer. Direct access methods, such as that provided by AuditConfirmations, provide a programmatic search across institution systems/departments to identify such relationships which may have gone undetected by the financial institution employee.

There is also a comment that “If access codes or information necessary to access data held by a confirming party are provided to the auditor by management of the company and not by the confirming party, evidence obtained by the auditor from access to such information does not meet the definition of a confirmation response. Rather that information constitutes other audit evidence.” In certain cases, it is necessary that management of the company provide access codes (e.g., read-only account user names and passwords) to the auditor so that the auditor in turn may enter the direct access codes into the intermediary’s system to complete the electronic audit confirmation. With AuditConfirmation’s system, the auditor *may choose*, with the cooperation of company management, to use access codes to complete the entire



confirmation with the confirming financial institution. However, since AuditConfirmations and other vendors offer an intermediary system that has verified direct access to the financial institution's systems, there is not an opportunity to for management to interfere with the data exchanged between the systems, despite having provided the access codes. Additionally, using this method the confirmation can be completed with a financial institution in ten minutes or less. This process is fast, secure, and virtually eliminates error and fraud risk since it relies on application controls to directly access financial institution data as noted in the paragraph above. Given this particular set of facts and circumstances in this situation, we believe that this and similar direct access systems meets the current definition of a confirmation response and, in fact, dramatically improves upon any other methods of obtaining confirmation than is otherwise currently available, whether electronic or manual.

25. *Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?*

As noted above, financial institutions within the United States have created and utilize tools to permit direct access to historical financial information that can be used to securely provide authentic information about assets liabilities to auditors in the form of a confirmation. We are not aware of other types of institutions that can provide reliable historical financial information in a systematic and controlled way across an industry a similar manner as the financial institution industry. Therefore, we believe at the present time, direct access should be limited to confirming parties that are financial institutions. However, should this change, it should be the responsibility of the auditor to evaluate the direct access methods in other institutions and determine they are adequate to provide reliable confirmation or the responsibility of an intermediary service (should that access be provided through an intermediary service) to provide evidence of such to that auditor.

* * * * *

Similar to the American Bankers Association (ABA), AuditConfirmations LLC would like to request a meeting with the Public Company Accounting Oversight Board ("PCAOB") staff responsible for this proposed auditing standard. The audit confirmation process, specifically electronic audit confirmations, has a direct and significant impact on the rules contemplated under this proposal and there are many rapidly advancing technologies that provide extraordinarily effective methods for protecting the integrity and reliability of the process. We will contact the PCAOB to establish a meeting date.

In the interim, we would be pleased to discuss our comments with members of the PCAOB or a member of its staff. Please feel free to contact either Newel C. Linford at (720) 330-7202 or newel@auditconfirmations.com or Daniel R. Zitting at (212) 202-2183 or dan@auditconfirmations.com. We thank you for your consideration in this matter.

Very truly yours,
/s/ AuditConfirmations, LLC



Tel: 212-885-8000
Fax: 212-697-5076
www.bdo.com

100 Park Avenue
New York, NY 10017

September 13, 2010

Via E-mail: comments@pcaobus.org

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

Re: **PCAOB Release No. 2010-003, Rulemaking Docket Matter No. 028,**
*Proposed Auditing Standard Related to Confirmation And Related Amendments to
PCAOB Auditing Standards*

Dear Members and Staff of the Public Company Accounting Oversight Board:

BDO USA, LLP welcomes this opportunity to comment on the Public Company Accounting and Oversight Board's (PCAOB or the Board) Proposed Auditing Standard, *Confirmation* (the proposed standard). Overall, we support the Board's objective in addressing this topic, as there have been significant changes in the confirmation process, largely due to technological advances and the increase in the use of disclaimers and restrictive language in confirmation responses, which present unique challenges to auditors in assessing the reliability of such responses.

We note that, consistent with previously proposed standards, the Board has provided a comparison of the proposed standard with the related standards of the International Auditing and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB). We support the Board's consideration of the work of these other standard setters and recognize that certain differences are necessary to reflect the U.S. public company environment; however, we also note that many of the differences between the respective standards relate to the prescriptive nature of this proposed standard when compared against either the IAASB or ASB standard. As such, we are concerned that this proposed standard may lead to a "check the box" mentality that could result in ineffective audit procedures. Rather than prescribing audit procedures in all cases, regardless of the auditor's risk assessment, we would support the application of professional judgment in evaluating the risks of material misstatement and in determining the appropriate audit approach. We encourage the Board to reconsider the impact that such a prescriptive approach may have on audit quality and cost.

Furthermore, we believe that the Board may not have fully considered the responsibility that this standard has seemingly imposed upon responding parties, over which the Board has no authority and the auditor has no influence. In that regard, we are concerned that the expanded requirements have not considered the operational challenges auditors will face in obtaining appropriate responses to the expanded confirmation requests. Accordingly, we encourage the Board to discuss this proposed standard with other organizations whose members will be expected to respond to auditor's confirmation requests, to understand how their members would be affected by the proposed standard.



Office of the Secretary
Public Company Accounting Oversight Board
Page 2 of 9

A. Definitions

1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

Overall, we believe the definitions are sufficiently clear and appropriate; however, we are concerned that the proposal has expanded the definition of receivables beyond that included in extant AU sec. 330, by eliminating the exception provided in paragraph 34 of AU sec. 330, to requesting confirmation of accounts receivable when certain conditions are met. While we agree that confirmation procedures may provide an effective and efficient means of obtaining appropriate audit evidence in many circumstances, we do not believe that this is always the case, and recommend retaining the guidance from paragraph 34 of the extant standard to allow auditors to use professional judgment in determining the most appropriate audit approach. (See also our response to question 4 below.)

Additionally, we believe the term “financial institution,” as it relates to employee benefit plans, should be clarified by including the following within the definition: “insurance companies and 401(k) recordkeeping service entities that are affiliated with or acting as an agent for such financial institutions.”

B. Objective

2. Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?

We believe that the objective is appropriate as it relates to the design and performance of confirmation procedures; however, the proposed standard also addresses the auditor’s response to significant and other risks, using confirmation procedures. For this reason, we recommend revising the objective as follows (additions are in bold italics and deletions in strikethrough text):

The objective of the auditor ~~is~~ *is to determine when to use and how to design* and performing confirmation procedures to obtain relevant and reliable audit evidence.

3. What other matters, if any, should the objective include?

We have no additional comments.

C. Confirmation of Specific Accounts

4. Is the description of “receivables that arise from credit sales, loans, or other transactions” sufficiently clear and appropriate? If not, what changes should the Board make?

While we believe the description of “receivables that arise from credit sales, loans, or other transactions” is generally clear (see our comment relating to employee benefit plans below), we believe that the requirement to confirm receivables that arise not only from credit sales



Office of the Secretary
Public Company Accounting Oversight Board
Page 3 of 9

of goods and services in the normal course of business but also from loans and “other transactions” is overly prescriptive. We agree that the requirement to confirm receivables from credit sales is appropriate (and consistent with extant AU sec. 330, *The Confirmation Process*); however, we do not believe it is appropriate to expand the requirement to areas other than accounts receivable. The recently adopted risk assessment standards, specifically, Auditing Standard No. 13, *The Auditor’s Responses to the Risks of Material Misstatement*, discusses the auditor’s responsibility to design and implement appropriate responses to the risk of material misstatement, which include procedures that are responsive to risks that are assessed as significant. Such procedures include confirmation procedures - if the auditor determines that such procedures effectively address the assessed risk [emphasis added].

Further, we are concerned that the guidance in extant AU sec. 330, paragraph 34, has not been carried forward to the proposed standard, such that the presumption to confirm accounts receivable would not be required if one of the following circumstances exist: (1) accounts receivable are immaterial to the financial statements, (2) the use of confirmations would be ineffective, or (3) the auditor’s combined assessed level of inherent and control risk is low, and the assessed level, 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 note that Appendix 3 states that this guidance has not been carried forward because “if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures.” However, it may not always be possible to improve the effectiveness of confirmation procedures, and it also may not be efficient to look for ways to improve such effectiveness when there may be other procedures that provide sufficient appropriate audit evidence. Accordingly, we recommend retaining the extant guidance in the proposed standard.

With respect to employee benefit plans required to file audited financial statements using Form 11-K, it is not clear whether the term receivables applies to participant loans and, as such, whether confirmation of these accounts is required by the proposed standard. Based upon the low-risk nature of these loans (i.e., fully secured by the remaining vested balance in the participants accounts, and generally repaid through payroll withholding), we recommend the Board consider specifically excluding participant loans from the confirmation requirement, and clarifying the standard as it relates to employee benefit plan registrants.

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

We are concerned that the proposed standard is too prescriptive in requiring confirmation of cash with financial institutions and believe confirmation procedures should be based on the auditor’s assessment of whether such a procedure is the best way to address the assessed risk of material misstatement. Often, confirmation of cash and other relationships with financial institutions will be the most effective way to address the assessed risk; however, we do not believe it is appropriate to prescribe such a procedure. For example, a multi-location entity may have bank accounts at numerous locations - some of which are immaterial individually but in the aggregate may be material. In such circumstances, we



Office of the Secretary
Public Company Accounting Oversight Board
Page 4 of 9

believe the strength of entity level controls, supplemented by analytical procedures, may sufficiently address any assessed risks without the need to perform confirmation procedures.

- 6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?**

We do not believe the proposed standard appropriately addresses the risk of material misstatement in response to significant risks. The requirement in paragraph 10, to perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures, seems to be contrary to the guidance set out in the recently adopted risk assessment standards that provide for performing risk assessment procedures to identify and assess the risks of material misstatement (Auditing Standard No. 12, paragraph 4) and then based on that assessment, design and implement overall responses to address such risks (Auditing Standard No. 13, paragraph 5). Our concern with the structure of the proposed standard is that it seems to require the performance of confirmation procedures in all circumstances in which confirmation procedures could possibly be applied, regardless of the level of risk or the practicality of such an approach.

We believe a better approach would be to align this proposed standard with the concepts set out in the newly adopted risk assessment standards, which emphasize the use of professional judgment in assessing risks and responding to those assessed risks with a focused approach that considers the relevance and reliability of audit evidence to be obtained.

Further, we are concerned that given the prescriptive nature of this proposed standard and its focus on confirmations to address significant risks, auditors may over-rely on confirmations by not adequately considering certain limitations that may impact the reliability of confirmation responses, such as the confirming party's knowledge of the subject matter, the ability or willingness of the intended confirming party to respond, or the objectivity of the responding party.

- 7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?**

See our response to question 6 above.

- 8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?**

While we believe the description of other risks is not inappropriate within this proposed standard, Auditing Standard No. 13, paragraph 3, already explains that the auditor must design and implement audit responses (which include confirmation procedures) that address the risks of material misstatement that are identified and assessed in accordance with the



Office of the Secretary
Public Company Accounting Oversight Board
Page 5 of 9

provisions set out in Auditing Standard No. 12. As such, we believe the description of other risks is unnecessary within this standard.

D. Confirmation Procedures

9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

We do not think the requirements for maintaining control over the confirmation process are appropriate. While we agree that the auditor should maintain control over the confirmation process, we have concerns about certain of the requirements that may be outside the control of the auditor. For example, paragraph 16 explains that the auditor should design confirmation requests to obtain relevant and reliable audit evidence and provides a list of factors to consider. While we agree that most of these factors are appropriate, we believe that one of the factors listed, that directs the auditor to assess the local customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information, may be beyond the ability of the auditor to assess. We believe that a more appropriate factor would be for the auditor to *consider the ability* (rather than the competence or intentions) of the intended confirming party to confirm or provide the requested information (for example, by requesting confirmation of individual invoice amount versus total balance), which is consistent with International Standard on Auditing (ISA) 505, *External Confirmations*. For this reason, we recommend that the Board replace the proposed language with the language from ISA 505.

Further, we note that the second factor listed under paragraph 16, refers to “the specific risks of material misstatement;” however, to clarify that the risk being referred to is an “identified” risk, we recommend adding the word “identified” before the phrase “specific risks.”

See also our response to question 10.

10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

We do not agree that an auditor should not be permitted to use internal audit or others within the company to assist in performing certain confirmation procedures. We note that the proposed standard prohibits the use of internal audit or others within the company from sending confirmation requests, receiving responses, or evaluating evidence; however, we believe that in areas of low risk, for which the use of confirmations may be an effective source of evidence, the use of sufficiently competent and objective internal auditors to perform these procedures, if properly supervised, should be permitted.



Office of the Secretary
Public Company Accounting Oversight Board
Page 6 of 9

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

See our response to question 9.

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

The requirement in paragraph 17, that directs the auditor not to use negative confirmation requests as the only form of confirmation request to address the assessed risk of material misstatement at the assertion level unless certain factors are present, is unclear. This requirement seems to direct the auditor to supplement negative confirmation requests with another form of confirmation request when the listed factors are not present. However, we note that a similar requirement in ISA 505 explains that negative confirmations should be supplemented with *substantive audit procedures*, not necessarily other confirmation procedures, when the listed factors are not present. We support the ISA 505 wording for reasons described previously in this letter.

Additionally, the last factor listed in paragraph 17 states that negative confirmation requests should not be used as the only form of confirmation request, unless the auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration. It is unclear how an auditor would be able to determine whether recipients of negative confirmation would give such requests adequate consideration. We believe a better formulation is provided in ISA 505, which instead asks if the auditor is aware of circumstances or conditions that would cause recipients to disregard such requests. The application guidance to this requirement explains that confirming parties may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise.

Further, we note that negative confirmation procedures are often used to address the risks associated with deposit or other liability accounts, when inherent and control risks are assessed as low. We believe that in such circumstances, negative confirmations may provide sufficient appropriate audit evidence.

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

For the most part, we agree that the procedures are sufficiently clear and appropriate; however, we recommend expanding the guidance to include a discussion about how the risks associated with a particular type of confirmation or address on a confirmation request may impact the auditor's procedures. For example, the use of electronic confirmations may require the auditor to perform different or more extensive procedures to determine a request has been directed appropriately than for a written confirmation request to an entity that is well known to the entity and the auditor.



Office of the Secretary
Public Company Accounting Oversight Board
Page 7 of 9

14. Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

Yes, the procedures are clear and appropriate.

15. Are the procedures the auditor should perform when management requests the auditor not confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

We do not believe certain of the procedures included within paragraph 24 of the proposed standard are appropriate. Specifically, we do not believe that communication to the audit committee regarding management's request not to perform confirmation procedures is necessary in all circumstances; instead, we believe that a more effective requirement would be to communicate those instances where management refuses to authorize the confirmation procedure where the auditor deems the confirmation to be the most effective audit procedure. Further, we believe this approach would support the Board's efforts to strengthen communication with audit committees by focusing the communication on those matters that have a significant impact on the financial statement audit.

E. Evaluation

16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?

We agree that in the case of each non-response, the auditor should perform alternative audit procedures to obtain relevant and reliable audit evidence; however, we do not believe that it is appropriate in all cases to send or consider sending second and third requests. We believe the nature of the alternative audit procedures should be left to the judgment of the auditor in deciding which procedures would provide sufficient appropriate evidence to address the assessed risk.

17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not what changes should the Board make?

The additional procedures seem appropriate.

18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

We are not aware of any additional circumstances.



Office of the Secretary
Public Company Accounting Oversight Board
Page 8 of 9

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

We do not believe the requirement in the proposed standard that directs the auditor to investigate all exceptions is sufficiently clear. While we agree that the auditor should evaluate the results of confirmation procedures to determine whether such exceptions represent misstatements or potential misstatements, we believe that the decision about whether an exception represents a risk of material misstatement that requires the performance of additional procedures should be left to the judgment of the auditor, since some exceptions do not represent misstatements, but instead represent timing differences, or measurement or clerical errors.

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

The requirements seem sufficiently clear and appropriate.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

Yes, the proposed standard provides adequate requirements regarding electronic confirmation procedures.

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

We believe additional guidance is necessary to address the electronic confirmation process to ensure that where an intermediary is used, such intermediary employs a system that is suitably designed and operating effectively to preserve accuracy of data transmitted. As such, we recommend adding guidance that directs the auditor to obtain an assurance trust services report or a report similar to a SAS 70 report on such a process to assist the auditor in assessing not only the design, but also the operating effectiveness of the relevant controls. If such a report is not available, additional procedures should be described that could assist the auditor in addressing these risks.

23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.

We have no comments.



Office of the Secretary
Public Company Accounting Oversight Board
Page 9 of 9

24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

We are not aware of any other risks.

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

We are not aware of any reasons why direct access should be limited to responses from a financial institution, as long as the risks relating to the reliability of the confirmation responses were appropriately addressed.

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

We believe additional guidance is needed with respect to disclaimers and restrictive language that is used in confirmation responses, as they are becoming increasingly common in the confirmation process. While we recognize that a response that contains disclaimers or restrictions may not in all circumstances invalidate the reliability of the audit evidence for all assertions, we believe additional guidance, including examples that illustrate when such language would not impact the reliability of the confirmation response, would be helpful.

27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

We believe the requirements are sufficiently clear and appropriate.

We appreciate your consideration of our comments and suggestions, and would be pleased to discuss these with you at your convenience. Please direct any questions to Wayne Kolins, National Director of Assurance at 212-885-8595 (wkolins@bdo.com) or Susan Lister, National Director of Auditing at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP



1235 Radio Road
Redwood City CA 94065
(800) 922-5272
www.calcpa.org

September 8, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington D.C. 20006-2803

Re: Comments Regarding PCAOB Rulemaking Docket Matter No. 028
Proposed Auditing Standard Related to Confirmation

Board Members:

The Accounting Principles and Auditing Standards Committee (the AP&AS “Committee”) of the California Society of Certified Public Accountants (“CalCPA”) is pleased to provide our comments to the PCAOB on the proposed auditing standard.

The AP&AS Committee is the senior technical committee of CalCPA. CalCPA has approximately 32,000 members. The Committee is composed of 50 members, of whom 67 percent are from local or regional firms, 23 percent are sole practitioners in public practice, 5 percent are in industry and 5 percent are in academia.

The Committee’s responses are organized to follow the questions set forth by the PCAOB in the proposed auditing standard.

Question 1: Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

A. The definition of “confirmation” ought to include the concept of direct access, by acknowledging that obtaining direct access to a confirming party’s electronic records constitutes an acceptable form of confirmation.

B. The definition of “non-response” ought to be expanded to include the obvious case where no response from the confirming party constitutes a non-response. As currently drafted, the definition at Appendix A8 implies that some form of communication, be it incomplete, must exist before the response can be considered a non-response. In practice, many confirming parties have established as a clear business policy, their unwillingness to respond to written confirmations, and will not respond at all, or will not submit a partial response.

Question 2: Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?

The stated objective is clear, appropriate and consistent with the ISA 505 definition.

Question 3: What other matters, if any, should the objectives include?

None.

Question 4: Is the description of “receivables that arise from credit sales, loans, or other transactions” sufficiently clear and appropriate? If not, what changes should the Board make?

The current audit requirement to confirm receivables has been limited to receivables arising from credit sales, subject to the auditor’s ability to support the ineffectiveness of past attempts to confirm such receivables. The Committee does not support the Board’s expansion of required confirmations absent this exclusion on practical grounds. While the Committee believes the confirmation process represents a highly effective means of gathering audit evidence, the Board as well as the registered public accounting firms under its jurisdiction cannot force the recipient of the confirmation to return it. If the Board ultimately expands the required applicability of sending confirmations, we suggest the Board provide additional examples of the types of “other transactions” contemplated. For example, transactions with related parties often result in loans, advances, etc. Does the Board contemplate requiring written confirmation for such related party transactions?

Question 5: Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

The Board should be aware that confirming cash account balances, as a standard audit procedure, has, in many instances, been dropped in favor of direct access to period end bank statements, or other means to validate period end cash account balances. The Committee supports the affirmation that obtaining direct confirmation of relevant bank account cash balances represents a means of obtaining highly effective audit evidence at a reasonable cost.

The Board might consider providing additional guidance regarding the process of obtaining confirmation of other relationships from financial institutions (as set forth in paragraph 9 of the proposed standard). It is common practice for financial institutions to refrain from responding to blank requests regarding other relationships, unless the client specifically identifies the existences of such other relationships on the standard bank account confirmation form.

Question 6: Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

The Board's proposed standard contains a potentially material change in practice by suggesting that confirmation of the terms of agreements or transactions be considered in response to significant audit risk. The majority of the Committee members strongly believe this requirement ought to be removed in its entirety and left to the professional judgment of the auditor. The Board should limit the expansion of the confirmation process and instead adopt the provisions set forth in ISA 505.

Question 7: Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

Please refer to our response to Question 6. above.

Question 8: Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

The Committee does not consider the discussion of "other risks" in paragraph 11 of the proposed standard sufficiently clear; in light of the Board's intent to require the expanded use of the confirmation process from current practice. Otherwise, an indication that consideration of confirmation procedures in situations not required by the proposed standard be left to the professional judgment of the auditor might be added.

Question 9: Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements are clear in the proposed standard.

Question 10: Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The Board states on page 20 of the Release that "The Board is not retaining the reference to the use of internal auditors in the proposed standard because the requirements for considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor are included in AU Sec. 322..." The discussion of the use of internal auditors on pages 20 and 21 of the Release is confusing. On page 20 the Release says "...the auditor cannot use internal auditors to send confirmation requests, receive confirmation responses..." This would be a significant change from current practice.

But then on page 21, the Release says: “..., consistent with AU sec. 322... if the internal auditors, as part of their work, confirm certain receivables, the auditor may consider the internal auditor’s work and change the timing of his or her confirmation procedures or the number of receivables to confirm.” By reducing the number of receivables to confirm, the auditor is relying on the internal auditor to mail confirmations and receive responses on receivables that the auditor otherwise would confirm. This reflects current practice, but is contradictory to what is on page 20. While use of internal auditors is not covered in the proposed standard, the discussion should be amended to clarify whether any change in practice is being proposed. Therefore, use of a client’s internal auditors is not sufficiently clear in the proposed standard as drafted, and ought to be expanded to identify in what circumstances the auditor can consider using internal auditors in the confirmation process.

Question 11: Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

The stated factors are sufficiently clear and appropriate.

Question 12: Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

The Committee suggests that, in addition to the other constraints, that negative confirmations be used only for numeric balances (e.g., the amount owing) and not other information.

Question 13: Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

The stated procedures are sufficiently clear and appropriate.

Question 14: Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the board make to the proposed procedures?

the stated procedures are sufficiently clear and appropriate.

Question 15: Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the board make to the proposed requirements?

The stated procedures are sufficiently clear and appropriate.

Question 16: Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?

There may be situations where it would not be necessary to perform alternative procedures for non-responses to positive confirmation requests. For example, the auditor may send out confirmation requests on a large proportion of accounts, anticipating a low response rate, in order to get a sampling of responses to a question on the confirmation about credit terms. Other procedures are used to audit the receivables. Alternative procedures on non-responses would serve little, if any, purpose. Some room should be left to the auditor's judgment in following up on non-responses.

Question 17: Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

Please refer to our response to Question 6 above regarding the Committee's recommendation to not require the use of confirmations regarding the terms of significant transactions or agreements, follow ISA 505 and leave to the professional judgment of the auditor.

Question 18: Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

The proposed standard is sufficiently clear regarding the need to receive a confirmation response to a positive confirmation request.

Question 19: Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

The proposed standard is sufficiently clear regarding the need to investigate all exceptions. However, the Board might wish to clarify the use of the client's internal auditors with respect to assistance in resolving any numeric differences which might arise from commonly encountered timing differences in the posting of cash receipts, credit memorandums, etc.

Question 20: Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

The proposed standard is sufficiently clear regarding addressing the reliability of confirmation responses.

Question 21: Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

The Committee believes the overall guidance on pages 37 through 40 of the Release is good, but the conclusions ultimately reflected in the proposed standard are too rigid, and are in danger of becoming obsolete by technology changes. We are in a world of increasing automation, and automated access to specific portions of an entity's records by authorized parties has arrived. A logical next step is to expand access to auditors, either directly or through intermediaries. This authorized access may happen

without the entity's direct knowledge. The only written representation from the confirming party would be an electronic receipt that can be printed or stored electronically in the audit work papers. A written representation from the confirming party may not be feasible. It should be left to the auditor to take steps to become satisfied as to the authenticity of the information received.

Question 22: Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

The risks associated with the use of an intermediary should be correlated to the risk the elements confirmed cannot be validated through other means. End of period bank balances can be traced to a bank statement as a means of validating the bank confirmation received from the intermediary.

Therefore, the requirements set forth in the third bullet in paragraph 35 of the proposed standard regarding acceptance of the intermediary's processes, may be difficult or impossible to satisfy unless the intermediary were to provide a service organization report prepared in conformity with AU sec. 324. We recommend the Board reduce the extent of required procedures to be performed when an intermediary is used to allow for the application of the auditor's judgment.

Question 23: the Board is interested in information about the services that an intermediary provides, specifically information about responsibilities and obligations between the auditor and the intermediary and the confirming party.

The Committee is not in a position to comment on this question.

Question 24: Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

Please refer to our response to Question 21 above.

Question 25: Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

Direct access should be permitted in any case where the requirements set forth in the definition of “direct access” at A5 of Appendix A are met. Direct access is particularly useful when the entity has online access to a vendor’s order entry/accounts receivable system, or the underlying detail accounts of a factor or asset based lender who manages the entity’s accounts receivable activities.

Question 26: Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the board make?

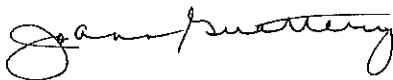
The proposed standard is sufficiently clear regarding disclaimers and restrictive language.

Question 27: Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements set forth in paragraph 39 of the proposed standard are sufficiently clear and appropriate. However, as discussed in several of the Committee’s responses to the questions above, the more detailed requirements set forth in paragraph 26 “Evaluation” ought to be modified regarding the requirement to perform an alternative procedures for “each” non-response and the application of professional judgment in assessing the reliability of electronic confirmation responses.

We thank the Board for the opportunity to comment on the proposed standard. We would be glad to discuss our opinions with the Board should they have any questions or require any additional information.

Very truly yours,



JoAnn Guattery, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants



September 13, 2010

Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006
USA

By E-mail: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 028

To the PCAOB Board:

We would like to thank you for the opportunity to provide the Public Company Accounting Oversight Board (PCAOB) with our comments on the Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards (hereinafter referred to as "the Standard").

We believe that the updated Standard will provide a useful basis for improving the effectiveness and the efficiency of audits and more specifically will improve the audit confirmation process. We support the revised Standard.

The Proposed Standard asked for answers to a list of questions and we have weighed in on all the questions we thought would be most beneficial to the PCAOB.

Questions raised by the PCAOB

1. Are the definitions included in the proposed standard sufficiently clear and appropriate?

Yes, the definitions in the proposed standard are clear and appropriate.

2. Is the objective of the proposed standard clear and appropriate?

Yes, the objective is clear and we agree with the objective as stated in the proposed standard as it is written.

5. Is the requirement in the proposed standard to confirmation cash and other relationships with financial institutions sufficiently clear and appropriate?

The requirement to confirm cash and other relationships with financial institutions is clear and appropriate. The Board should maintain this requirement in the final version. Auditors, in performing their risk evaluation, must assume a risk of fraud within the revenue recognition area. Because the



September 13, 2010

offsetting journal entries to Revenue are either Accounts Receivable or Cash, it is appropriate to require confirmations of cash which complements the requirement to confirm accounts receivable. Doing so targets a fraud risk area that fraudsters might otherwise continue to take advantage of. Over the last several years there seems to have been more confirmation frauds involving cash, like Parmalat and HealthSouth, and it leaves one to ask if the fraudsters saw the lack of a requirement to send cash confirmations as an easier target for fraud as opposed to booking the offsetting journal entry to accounts receivable where confirmations are required and more scrutiny is therefore given.

10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate?

We agree with the Board that Internal auditors should not be used during the confirmation process to send or receive confirmations. In line with that, we also believe that Internal auditors should not be allowed to participate in the testing of confirmation addresses. There is a presumption that the Internal auditor can use their position to help management misdirect or circumvent the auditor's confirmation procedures which is why Internal auditors should not participate in either the sending or the receiving of confirmations. In line with that same reasoning, the auditor will also lose control of the confirmation process if the Internal auditor "validates" a falsified mailing address and the auditor in turn relies on the Internal auditor's work and sends the confirmation to the fraudulent address. Management in the ZZZZ Best fraud provided the auditors with a friend's residential mailing address and management told the auditors that the address was the address of a valid customer. Parmalat's auditors also sent a confirmation to an incorrect location at the direction of management. Had Internal auditors been relied on by the auditors auditing either ZZZZ Best or Parmalat, the Internal auditors – with management's direction and/or coercion – could have simply "validated" the incorrect address as a valid address and the auditor's confirmation procedures would still have been circumvented no differently than if the Internal auditor had interfered with the sending or receiving of the confirmation letters. To strengthen the auditor's procedures and to reduce the opportunity for fraud, we recommend that Internal auditors be specifically excluded from testing the validity of addresses.

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate?

Yes, the auditor should be required to test all of the addresses (or other relevant contact information depending on the confirmation process used) for all of the auditor's confirmations. Independently validating all of the mailing addresses and contact information is part of performing the confirmation process correctly.

Validating the mailing address is part of the auditor's responsibility to Control the confirmation process. If the auditor has a statement provided by the client, why send the confirmation at all if the auditor isn't going to validate the location for where the confirmation is sent? It is impossible for the auditor to place



September 13, 2010

any reliance on the information provided in a confirmation response if the auditor can give no assurance as to the location of where the confirmation was sent.

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate?

Yes, the proposed standard is clear and appropriate as to the auditor's need to investigate all exceptions in the confirmation process.

20 Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate?

Yes, the requirements related to addressing the reliability of confirmation responses is clear and appropriate.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures?

Both the IAASB and the ASB state that auditors can use a service auditor's report and SysTrust reports to evaluate the three risks identified in Section 34 of the proposed standard and we believe that it would be helpful to auditors for the PCAOB's standard to provide that same level of guidance in assisting auditors in the evaluation of any electronic confirmation process.

Additionally, under Section 35 of the proposed standard, the third bullet point, we have two suggestions. The first suggestion has to do with the third sentence in that bullet point. That sentence reiterates the three risks auditors must consider when using electronic confirmations; however, these three risks are already appropriately including in Section 34 because these risks apply to all forms of electronic confirmations, intermediaries included. Because Section 34 already lists the three risks that are relisted in Section 35, and because the three risks apply to all forms of electronic confirmations and not just to intermediaries, we recommend that the third sentence in Section 35 be stricken.

The second suggestion related to Section 35 of the proposed standard under the third bullet point is that not all intermediary electronic confirmation services are the same. For example, at Confirmation.com we do not respond to the confirmation requests on behalf of the responding parties, instead, we provide the secure clearing-house for confirmations where the auditors still make the confirmation request and the companies that respond to those requests on paper are still the ones to respond electronically through Confirmation.com. We believe that what the Board is trying to address with the fourth sentence is that the auditors need to verify that the responding party has authorized the use of the intermediary for electronic confirmation and we agree with that intention. As such, we recommend that the fourth sentence read as follows:



September 13, 2010

“In addition, the auditor should determine whether the intermediary is an authorized service provider for the intended confirming party.”

We also recommend that the Board consider providing auditors with additional supplementary material to help auditors effectively evaluate any electronic confirmation process. A sample Electronic Confirmation Security Assessment is enclosed as Attachment 1 to this document.

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed?

With the two changes to the third bullet point in Section 35 that we presented above in response to Question #21 we believe the risks related to intermediaries have been properly addressed.

23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party?

Today there are over 7,000 CPA firms in more than 90 countries that use Confirmation.com for electronic confirmations and Confirmation.com is the only electronic confirmation service endorsed by the American Bankers Association (ABA) and the only one that has both a SAS 70 Type II and a SysTrust certification – which Confirmation.com has performed twice a year for both the SAS 70 Type II and SysTrust. While every third-party – other than the auditor, the client and the responder - that is involved in the confirmation process is defined as an intermediary in the confirmation process, at Confirmation.com we only have specific knowledge as to the responsibilities and obligations that we provide to both auditors and responding parties. We do have extensive knowledge about electronic confirmation risks and the fraud risks associated with various types of electronic confirmation processes from our research and sole focus on electronic audit confirmations for more than 10 years. We would be happy to meet with the Board and answer any questions that you may have regarding our patented Confirmation.com clearing-house or the research that we have on the risks related to various electronic confirmation methods.

Based on the *Guide to Electronic Confirmations* written by Gary Boomer and Brian Fox, there are principally two types of electronic confirmations provided by intermediaries: In-Network confirmations and Out-of-Network confirmations. Taken from the *Guide to Electronic Confirmations*, here are the definitions:

In-Network – Electronic confirmation service where responding companies have proactively signed up for a confirmation service where the confirmation service guarantees the Authentication of the responding party and has verified the Authorization of the responding



September 13, 2010

individual ensuring they are knowledgeable, free from bias and authorized to respond on behalf of the responding entity.

Out-of-Network – Electronic confirmation service where the auditor Authenticates the responding party and determines the Authorization of the responding individual ensuring they are knowledgeable, free from bias and authorized to respond on behalf of the responding entity.

24. Are there risks related to the auditor’s use of direct access that the proposed standard has not adequately addressed?

We agree with how the Board addressed the risks associated with direct access. In the numerous CPE classes we teach on confirmation fraud and electronic confirmations, we teach auditors how easy it is to set up a fake website and emails that look legitimate for under \$500, and we believe that auditors should take extreme caution in using direct access and email for confirmations. Our research suggests that it will only be a matter of time – if it hasn’t already happened – where a company being audited sets up a fake website and related fake email accounts to pose as a legitimate responding company in order to provide auditors with fraudulent confirmation responses. A website address and related emails are simply virtual real-estate that are easier and less expensive to fake and make to appear as legitimate businesses entities than doing so with real mailing addresses.

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution?

Because financial institutions have a greater fiduciary responsibility to their account holders and because it is so easy to set up fake websites and make them appear to be legitimate business entities, we do agree with the Board’s suggestion that direct access be permitted as a confirmation response only for financial institutions.

Thank you for the opportunity to provide input into the standard setting process and we hope that our views will be helpful to the PCAOB as it deliberates on the final version of this proposed standard. If you have any questions relating to our comments in this letter, we would be pleased to discuss them with you.

Sincerely,

C. Brian Fox

C. Brian Fox, CPA
Founder & Chief Marketing Officer



September 13, 2010

ATTACHMENT 1 Electronic Confirmation Security Assessment

	Required for		Reviewed, Appropriate & In Place			
	In-Network	Out-of-Network	Yes	No	Notes	Reviewer
1. SAS 70 Type II						
1.01	Performed every 6 months	√	√			
1.02	Controls for Organization & Administration	√	√			
1.03	Controls for Systems Development & Change Management	√	√			
1.04	Controls for Computer Operations	√	√			
1.05	Controls for Physical Access & Environmental Controls	√	√			
1.06	Controls for Authenticated Proper Source	√	N/A			
1.07	Controls for Authorized Users	√	N/A			
1.08	Controls for Proper Client Authorization	√	√			
1.09	Controls for Data Integrity & System Transmission Integrity	√	√			
1.10	Controls for Electronic Signatures	√	√			
1.11	Controls for Backup & Recovery/Data Retention	√	√			
2. SysTrust Certification						
2.01	Performed every 6 months	√	√			
2.02	Includes Principle of Availability	√	√			
2.03	Includes Principle of Confidentiality	√	√			
2.04	Includes Principle of Processing Integrity	√	√			
2.05	Includes Principle of Security	√	√			
2.06	Includes Principle of Privacy	√	√			
3. Privacy Policy						
3.01	Certified by recognized 3rd Party (e.g. TRUSTe)	√	√			
3.02	Includes EU Safe Harbor Certification (highest available)	√	√			
4. Website Authentication						
4.01	Extended Validation SSL Certification by recognized 3rd Party (e.g. VeriSign)	√	√			
5. Disaster Recovery Plan						
5.01	Tested at least Quarterly	√	√			
6. Hosting Facilities						
6.01	Primary Hosting Facility with SAS 70 Type II or ISO Certification, minimum Tier 4 facility	√	√			
6.02	Separate Backup Hosting Facility with SAS 70 Type II or ISO Certification, minimum Tier 4 facility	√	√			
7. Insurances						
7.01	Rating A+ or better in the current Best's Insurance Reports published by A. M. Best Company	√	√			
7.02	E-commerce Technology Liability	√	√			
7.03	User Privacy Protection to cover 1 year worth of Consumer Credit Monitoring in the event of a Security Breach	√	√			
7.04	Commercial General Liability	√	√			
7.05	Professional Practice	√	√			
7.06	Umbrella Coverage	√	√			
8. Security						
8.01	Compliant with ISO 27001 Control Objectives					
8.02	All IT infrastructure & access limited to only company employees (e.g. including System Administration/Root Access)	√	√			
8.03	Physical and logical access control is a managed process (e.g. access control lists, change management, monitoring & logging)	√	√			
8.04	Only dedicated servers are utilized (e.g. no shared computing environments)	√	√			
8.05	All company employees have Federal & State background checks, annual drug testing, and are fingerprinted	√	√			
8.06	Sensitive confirmation data stored using cryptographic algorithms minimum key length 192-bit (e.g. Triple DES)	√	√			
8.07	Confirmation Data is transmitted with a minimum of 128-bit SSL using recognized 3rd Party encryption certificate (e.g. Verisign)	√	√			
8.08	Intrusion Presentation System (IPS) and Intrusion Detection System (IDS) are both deployed for security	√	√			
8.09	Web Application Firewall for HTTPS traffic inspection	√	√			
8.10	Defense in Depth strategy deployed	√	√			
8.11	External Vulnerability & Penetration Testing performed by recognized 3rd Party (e.g. McAfee Secure)	√	√			
8.12	Internal Vulnerability & Penetration Testing performed using industry standard tools (e.g. AppScan, Websinspect)	√	√			
8.13	Virus protection runs on all servers	√	√			
9. Electronic Confirmation Process						
9.01	A user cannot electronically sign someone else's name on the confirmation	√	√			
9.02	User activity is logged	√	√			
10. Additional Items						
10.01	Defined Service Level Agreement with Escalation Procedures	√	√			
10.02	Review Service Agreement	√	√			
10.03	Review Privacy Policy	√	√			



September 13, 2010

EXECUTIVE DIRECTOR

Cynthia M. Fornelli

GOVERNING BOARD

Chairman

James S. Turley, Chairman and CEO
Ernst & Young LLP

Vice Chair

Michele J. Hooper, President and CEO
The Directors' Council

Vice Chair

Barry C. Melancon, President and CEO
AICPA

Charles M. Allen, CEO
Crowe Horwath LLP

Stephen Chipman, CEO and Executive Partner
Grant Thornton LLP

Harvey J. Goldschmid, Dwight Professor of Law
Columbia University

Robert E. Moritz, Chairman and Senior Partner
PricewaterhouseCoopers LLP

Lynn S. Paine, Professor of Business
Administration and Senior Associate Dean,
Director of Faculty Development
Harvard Business School

Barry Salzberg, CEO
Deloitte LLP

Dave Scudder, Managing Partner
McGladrey & Pullen, LLP

John B. Veihmeyer, U.S. Chairman and CEO
KPMG LLP

Jack Weisbaum, CEO
BDO USA, LLP

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

Re: Request for Public Comment: *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*, PCAOB Rulemaking Docket Matter No. 028

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA). The CAQ appreciates the opportunity to respond to the Public Company Accounting Oversight Board's (PCAOB or the Board) *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (the proposal or proposed standard). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member.

As we noted in our comment letter to the PCAOB's *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (the concept release), we support the PCAOB's standard-setting project to amend AU Section 330, *The Confirmation Process* (AU 330). We support the Board's objective of updating its interim standards related to the confirmation process. AU 330 was written over 15 years ago and the confirmation process has undergone a number of changes over that period. For example, advances in information technology and the use of the internet have had a significant impact on the confirmation process. We believe the guidance in the proposal to address the use of electronic confirmations is generally appropriate. In addition, counterparties to a company have increasingly included disclaimers or other limiting language in their responses to confirmations. We commend the PCAOB for considering input received on the concept release in developing the proposal.

We fully support the Board's consideration of the work of other standard setters, such as the International Auditing and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB), in the development of the proposal. We recognize that the Board may decide that different procedures are appropriate in the U.S. public company audit environment. However, we are concerned that the Board has included more prescriptive requirements in the proposal than those of the IAASB and ASB, but has not provided sufficient rationale as to why these additional prescriptive requirements are necessary to result in a more effective audit. Further, as we have commented previously, we are supportive of the PCAOB's efforts to provide a comparison of its standards to those of the IAASB and the ASB. Such comparisons facilitate the identification of differences between the various standards as well as provide additional perspective of the PCAOB's intended changes to practice. However, we note the comparison provided in the proposal indicates that several areas of the analogous IAASB and ASB standards "do not include similar requirements" to those being proposed by the Board. Although the proposed requirements may not be included as requirements in the respective IAASB and ASB standards, we note the other standard setters require the auditor to use judgment in determining the appropriate audit procedures to be performed and supplement that requirement to use judgment with additional application guidance similar to the PCAOB's requirements. To avoid a potentially misleading comparison, we recommend the PCAOB acknowledge the additional application guidance and further clarify why establishing requirements where other standard setters have required auditors to use judgment in determining the appropriate audit procedures (supplemented by application guidance) will result in a more effective audit, rather than simply indicating in the comparison provided that the proposed requirements are not required by the other standard setters.

We have certain overall observations that we believe will enhance the PCAOB's proposal and have organized these observations and comments as follows:

- Overarching Concerns
- Principles-based Standards
- Risk Assessment
- Operational Challenges of Certain Aspects of the Proposal
- Use of Internal Audit in the Confirmation Process
- Drafting Conventions

In addition, we have other specific comments, which we have included as an Attachment to this letter.

Overarching Concerns

While we support the Board's efforts to improve the existing confirmation standard, we are concerned that the proposal is overly prescriptive (see Principles-based Standards below) and may result in a significant increase in the use of confirmation requests (i.e. paragraph 8 includes a new and expanded definition of receivables for which there is a presumptive requirement to use confirmation procedures, and eliminates the exception that was provided in AU 330 which allowed an auditor to not confirm receivables if certain conditions were met, paragraph 10 includes a presumptive requirement for auditors to use confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures) and require additional audit procedures regarding the design and evaluation of confirmations, without a corresponding increase in audit quality or effectiveness. The use of confirmations in the appropriate circumstances can provide an effective and efficient means for obtaining audit evidence. However, as discussed in Principles-based Standards below, we are concerned that the proposal does not adequately recognize that confirmations may not always be the most effective means of gathering evidence and, as a result, limits the auditor's ability to use judgment in determining the audit procedures that are appropriate based on the assessed level of risk at the assertion level (see Risk Assessment below).

We believe the proposal will result in a significant increase in not only the auditor's use of confirmation requests but also for a concomitant increase in the effort by responding parties. Consistent with our response to the Board's concept release, we are concerned that the expanded requirements imposed solely on auditors without consideration of the increased obligation being requested of third parties from whom confirmations are sought, presents operational challenges. We strongly recommend that the PCAOB consider the practical implications of the proposed standard and liaise with other organizations, such as the American Bankers Association and Financial Executives International, to understand the impact of the proposal on these organizations' members. The Board should discuss with these organizations whether their members will be willing and able to respond timely to an increase in confirmation requests.

We share the PCAOB's concern regarding the growing prevalence of restrictive language in confirmation responses. However, the fact that some respondents use disclaimers and other restrictive language highlights a fundamental flaw of imposing unilateral requirements on auditors without also addressing the fact that respondents have a variety of reasons for including such language – and can do so regardless of the impact on the audit. In order to reduce the use of such language we believe this issue should be addressed at its root cause rather than including additional prescriptive requirements (i.e., paragraphs 37-38) on the auditors; an approach that only places additional requirements on auditors when confirmations are received with disclaimers and restrictive language does not address the increasing trend for third parties to include restrictive language and does not appear to be in the public interest. To the extent the PCAOB continues to emphasize and expand the use of confirmations, we encourage the Board to work with other organizations, as discussed above, to identify the cause of such restrictive language (i.e., liability concerns) and work to clarify and / or minimize the use of restrictive language in order to enhance the evidence provided.

Principles-based Standards

As mentioned above, while we support the Board's efforts to improve the existing confirmation standard, we are concerned that the proposal is overly prescriptive. We believe a high quality audit is not a predefined set of steps that are applied to each and every engagement, but instead includes a customized set of procedures designed to be responsive to the risks identified. Accordingly, standards should not represent a checklist of requirements, but a collection of guiding principles for the auditor to apply to the particular facts and circumstances of a given audit.

One source of concern relates to the aspects of the proposal related to the presumption that the auditor will request confirmation of accounts receivable. While the PCAOB's interim standards (paragraph 34 of AU 330) includes a presumption that the auditor will request the confirmation of accounts receivable during an audit, the extant standard allows the auditor to exercise professional judgment in determining whether the use of confirmations would be effective. In situations, for example, where an auditor determines that confirmations would not be effective or the auditor's combined level of control and inherent risk are at a sufficiently low level (combined with other evidence obtained as part of the audit), existing PCAOB standards do not require the auditor to request confirmations. We believe that the proposed standard, which eliminates these exceptions, combined with the Board's rationale contained in the accompanying release, as described in the following paragraph, will significantly reduce the auditor's ability to use his or her judgment in determining whether confirmations are an appropriate procedure based on the assessed level of risk.

In addition, because the proposal significantly broadens the requirement of when confirmations are to be used (i.e., paragraph 10 includes a presumptive requirement that the auditor will perform confirmation procedures in response to significant risks that relate to the assertions that can be adequately addressed by confirmation procedures, paragraph 11 includes a statement that "the performance of confirmation procedures still might be an appropriate response to obtain audit evidence" for other risks) we believe this will, at a minimum, result in an increased documentation burden in situations where an auditor determines that confirmation procedures

would not be appropriate. This could also have the unintended result of shifting the auditor's focus from obtaining sufficient appropriate audit evidence to support his or her conclusions to justifying a decision not to send confirmations and/or whether the confirmations were used in an appropriate manner. Ultimately, this may result in an increase in the performance of confirmation procedures in order to satisfy the "checklist" requirement, regardless of whether the audit procedure provides the most effective or efficient means of obtaining sufficiently persuasive audit evidence.

Further, we note the accompanying release currently states, "if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures." However, the Board fails to acknowledge that in certain situations the auditor cannot improve the effectiveness of confirmation procedures. For example, the healthcare industry traditionally experiences low response rates to confirmation requests. Under the extant standard the auditor would have the discretion to determine whether alternate procedures would be a more effective and efficient means for obtaining audit evidence. However, the proposed standard would significantly limit the auditor's ability to use judgment in determining the appropriate audit procedures for obtaining sufficient audit evidence. As a result, we believe that auditors may expend significant efforts performing confirmation procedures in situations where they are neither the most effective nor efficient means of gathering sufficiently persuasive audit evidence.

Any of these outcomes would not enhance the persuasiveness of audit evidence obtained by the auditor. Therefore, we encourage the PCAOB to reconsider these provisions and allow the auditor to use his or her judgment in determining whether confirmations procedures are appropriate in the circumstances to address the identified risks.

Risk Assessment

We note that in an audit performed in accordance with PCAOB recently issued risk standards, risk assessment and response underlies the entire audit process. However, we are concerned that the proposal removes the auditor's judgment to assess and respond to risk and instead includes prescriptive requirements for the confirmation process, regardless of the assessed level of risk. For example:

- Paragraph 10 states that "[t]he auditor should perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures." Does the Board intend for this to be a requirement for the auditor to perform confirmation procedures in response to significant risks in every circumstance where an auditor *can* perform them? We believe the Board should allow the auditor to determine the most effective audit response that would provide sufficiently persuasive audit evidence to address the identified risk.
- Paragraph 15 requires an auditor to select the confirming party, even if the company provides the auditor with the name, regardless of the assessed level of risk. We recommend that the Board allow the auditor to use judgment, based on risk, in determining the nature and extent of verification procedures necessary to identify the confirming party. For example, sending a deposit account confirmation to a bank generally would be considered lower risk than confirming for the possibility of side agreements on revenue contracts. Given the assessed level of risk, it may be appropriate for the auditor to use the names and addresses provided by the bank when sending deposit account confirmations but an auditor may want to perform additional procedures to select and/or verify the confirming party relative to a side agreement risk, given the higher risk.

Given these concerns, we recommend the Board align the procedures in the proposed standard to the assessed level of risk so the auditor may apply his or her time and attention to the specific area that would have the greatest effect on improving audit quality.

Operational Concerns of Certain Aspects of the Proposal

The proposal includes requirements for auditors to perform additional procedures to address possible inherent risks that are beyond the scope of the audit and outside an auditor's control as well as to consider or assess certain risk factors based upon information we believe an auditor should not be reasonably expected to know. For example:

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

Given these concerns we urge the Board to consider the practical implications of these requirements.

Use of Internal Audit in the Confirmation Process

In the proposed standard and accompanying release, the PCAOB notes that the auditor cannot use internal audit to send confirmation requests, receive confirmation responses or evaluate the evidence obtained from performing confirmation procedures. Further, the proposed standard significantly reduces the auditor's ability to use judgment in determining the extent to which the work of internal auditors can be used in confirmation procedures. The Board's rationale for restricting the role of the internal audit function as well as the auditor's ability to use judgment in the confirmation process is unclear. We believe that internal audit can assist in many aspects of an auditor's confirmation process and that such assistance, appropriately supervised, increases audit quality by allowing the auditor to focus his or her efforts on the areas of higher risk, which is consistent with extant PCAOB guidance (e.g., PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*), and the risk standards recently approved by the Board. While we believe the standard should emphasize the auditor's responsibility to maintain control over the confirmation process (as defined in AU 330.28) as well as to evaluate the responses, we believe that the auditor should be able to use his or her assessment of risk and the framework provided in AU Section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, in determining the appropriate manner to use the work of internal auditors.

Drafting Conventions

We appreciate the Board’s inclusion of a number of examples to illustrate requirements in the standard. However, we note the examples included in the proposal state that an auditor “should” perform certain auditing procedures. Consistent with the Board’s drafting conventions, the word “should” is used to identify procedures that the auditor is required to perform. We do not believe examples should be determinative of required audit procedures. We urge the Board to replace the term “should” with “may” in each of the illustrative examples. To the extent the PCAOB intends to communicate requirements in certain examples, we encourage the Board to develop the appropriate principle or provide guidance within such standards, as it may be difficult for auditors to apply such guidance broadly when it is contained only within a narrow example. The following instances illustrate this observation:

- Paragraph 14 states, “when an auditor performs confirmation procedures for receivables at an interim date, the auditor *should* perform sales cutoff testing at the balance sheet date to reduce audit risk to an appropriately low level for the existence and completeness assertions.” We recommend the Board change the “should” to “may” as this procedure is only one example of an audit procedure the auditor may perform to obtain relevant and reliable audit evidence. Rarely is there only one audit procedure that would be acceptable to reduce the risk of misstatement to an appropriately low level. In addition, the Board should consider whether this is the most appropriate example given (1) it does not relate specifically to the use of confirmations, but rather provides guidance regarding an auditor’s consideration of obtaining evidence at an interim date (AU Section 313, *Substantive Tests Prior to the Balance Sheet Date*), and (2) it could be misleading as there may be other procedures, in addition to sales cutoff procedures, that would be necessary in order to fully address the completeness and existence assertions.
- The examples included in paragraph 28 (Note) are intended to illustrate audit procedures that could be performed in order to satisfy an auditor’s responsibilities related to performance of alternative procedures for non-responses. However, the examples are narrowly focused and include a number of “should” requirements specific to confirmation of terms of transactions or agreements. We recommend the Board replace the term “should” with “may”. Further, to supplement these examples, the Board should consider including general principles or considerations for alternative procedures, which would enhance an auditor’s understanding of the Board’s view of the nature and extent of alternative procedures to be performed.

In addition, we are concerned with the inconsistent requirements in the accompanying release of the proposal versus the proposed standard and vice versa. For example, page 33 of the accompanying release requires an auditor to consider whether an exception to a confirmation indicated a previously unidentified risk of material misstatement due to error or fraud or deficiencies in the company’s internal control over financial reporting. The notion of the impact of confirmation procedures on the auditor’s consideration of the company’s internal control over financial reporting is not included within the proposed standard, thus we recommend such guidance specifically be incorporated into paragraph 30 as opposed to only in the accompanying release. In order to avoid possible confusion, we recommend the Board ensure these inconsistencies are reconciled before finalizing the standard.

We appreciate the opportunity to comment on the proposed standard and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

Enclosure

cc: PCAOB

Daniel L. Goelzer, Acting Chairman

Willis D. Gradison, Member

Steven B. Harris, Member

Charles D. Niemeier, Member

Martin Baumann, Chief Auditor and Director of Professional Standards

SEC

Chairman Mary Schapiro

Commissioner Luis Aguilar

Commissioner Kathleen L. Casey

Commissioner Troy Paredes

Commissioner Elise B. Walter

James L. Kroeker, Chief Accountant

ATTACHMENT

#	COMMENT
<i>Relationship of Confirmation to the Auditor's Assessment of Audit Risk</i>	
1	Paragraph 4 reiterates a portion of the guidance provided in the Board's recently adopted risk assessments standards, Auditing Standard No. 13, <i>The Auditor's Responses to the Risks of Material Misstatement</i> and Auditing Standard No. 15, <i>Audit Evidence</i> . We recommend that the standard instead refer back to these standards to 1) reduce redundancy and 2) encourage auditors to consider these standards in their entirety when considering the relationship of confirmations to the auditor's assessment of audit risk.
2	Paragraph 5 states that "[a]udit evidence in the form of a confirmation response, because it is received directly by the auditor from a confirming party, <i>generally is</i> more reliable than audit evidence generated internally by the company or provided directly by the company." However, given certain circumstances exist where confirmation responses do not yield more reliable audit evidence, we believe that this sentence should be revised as follows: <i>Audit evidence in the form of a confirmation response, because it is received directly by the auditor from a confirming party, generally is may be more reliable than audit evidence generated internally by the company or provided directly by the company.</i>
<i>Confirmation of Specific Accounts</i>	
3	The first sentences of paragraphs 6 and 7 state "[c]onfirmation requests address one or more of the assertions of specific accounts and disclosures" and "[c]onfirmation requests do not address all assertions equally well" respectively. A confirmation <i>request</i> does not address assertions. We recommend the Board consider whether articulating as "confirmation requests could be designed to address..." and "confirmation procedures do not address..." would better express the Board's point.
<i>Cash with Financial Institutions</i>	
4	Paragraph 9 states that "[the] auditor should perform confirmation procedures for cash with financial institutions" and other relationships, such as lines of credit, as well as whether any additional information about other deposit or loan accounts that have come to the attention of the financial institution. We recommend the Board expand the description of cash to include both cash and cash equivalents.
<i>Other Risks</i>	
5	Paragraph 11 states that the performance of confirmation procedures might be an appropriate response to obtain audit evidence for certain items even when a significant risk does not exist. This does not appear to be an incremental requirement and therefore we recommend the Board delete the paragraph. Further, determination of the appropriate audit procedures to be performed to address a specific assertion is already part of the auditor's responsibility when planning and performing the audit.
<i>Determining the Type of Confirmation Requests to Send</i>	
6	Paragraph 17 provides guidance regarding the use of negative confirmations. We recommend the Board clarify these requirements. For example, it would be helpful for the Board to clarify whether it intends to require an auditor to supplement negative confirmations with positive confirmations if certain factors stated in the proposal are not present. Given that negative confirmations provide some audit evidence, we believe the

	auditor should consider the amount of incremental evidence necessary to support his/her conclusions on the basis of risk – which may or may not include the use of positive confirmations.
7	Paragraph 17 states, in part, “negative confirmation requests provide limited audit evidence...the auditor should perform other substantive procedures to supplement the use of negative confirmation requests.” Based on the proposed requirement, it appears that the use of negative confirmations will no longer be sufficient without supplemental audit procedures. We encourage the Board to reconsider this requirement given, for example, negative confirmations are typically used for deposit liability accounts, particularly when the inherent risk of such accounts is assessed as low and the internal control risk is assessed as very low. We believe in these situations, negative confirmations may provide sufficiently persuasive audit evidence.
8	The second sentence of paragraph 17 states that “a positive confirmation request provides audit evidence only when a response is received directly by the auditor from the confirming party.” However, in assessing the reliability of confirmation responses, the first two factors in paragraph 31 refer to indirectly received responses. We recommend the Board modify paragraph 17 to indicate that, based on an auditor’s risk assessment, obtaining indirectly received responses provides a form of audit evidence with the acknowledgement that the auditor will need to consider the persuasiveness of the evidence obtained and determine if additional procedures should be performed.
9	The fourth bullet of paragraph 17 states that the auditor “reasonably believes that recipients of negative confirmation requests will give such requests consideration.” We note that the extant AU 330 utilizes the term “the auditor has no reason to believe.” As such, we recommend the PCAOB clarify whether or not they intend for a change in an auditor’s evaluation based on the change included in the proposal. We believe that any such clarification should consider that the auditor will not have a direct relationship with the confirming party.
<i>Determining That Confirmation Requests Are Properly Addressed</i>	
10	Paragraph 18 states “[t]he auditor should design confirmation requests to establish direct communication between the confirming party and the auditor to minimize the possibility that the audit evidence resulting from the confirmation procedures might not be reliable as a result of interception, alteration, or fraud.” We acknowledge that the auditor should control the confirmation process and send confirmation requests and receive responses directly (in accordance with guidance in paragraph 28 of extant AU 330). We request the PCAOB clarify and/or provide examples to illustrate what additional procedures the PCAOB envisions in “designing” confirmation requests to facilitate this process given this proposed change to the existing requirement.
11	Paragraph 19 includes the use of post office boxes as a factor in determining the nature and extent of procedures to perform to validate addresses on confirmation requests. We request the Board clarify its views on the level of risk associated with a post office box. Given the prevalence of their use, particularly in areas such as trade receivables, this may be the only address on file with the company. Without further guidance, we are concerned that auditors may perform significant verification procedures related to post office box addresses without a significant increase in the quality of audit evidence obtained.

12	<p>We request the PCAOB clarify what is meant in paragraph 19, which states that “the auditor should perform procedures to determine the validity of the addresses on the confirmation requests, including substantive procedures or tests of controls.” Further, we are concerned with how to operationalize this requirement. Specifically, since an auditor is simply verifying the address, what constitutes “tests of controls” versus “substantive procedures?” For example, with regard to trade accounts receivable confirmations, would tests of controls represent, for instance, procedures an auditor may perform on a company’s controls regarding establishing and maintaining customer information as part of its revenue billing and collection process? Would these procedures not be adequate to address the risk of invalid addresses for significant risks? What other types of substantive verification procedures does the Board believe would be appropriate? The PCAOB should provide additional guidance in this area in order to clarify the Board’s expectations.</p>
<i>Directly Sending the Confirmation Requests</i>	
13	<p>In a footnote to paragraph 21 the proposed standard defines the term “Intended Intermediary.” We recommend the Board include this term in Appendix A - <i>Definitions</i>, to maintain consistency with the rest of the proposed standard.</p>
<i>Management Requests Not to Confirm</i>	
14	<p>The Note accompanying paragraph 24b. states that in the situation where management requests the auditor not confirm certain accounts, balances, or other items, “[t]he auditor should perform procedures to obtain more persuasive audit evidence than he or she would have obtained had there been no responses to a confirmation request or had the auditor made a decision not to perform confirmation procedures.” We are unclear as to the Board’s rationale in requiring the auditor to obtain “more persuasive” evidence in this situation rather than a situation where there was no response to a confirmation request or had the auditor chosen not to confirm. Is the concern that where management requests the auditor not confirm a certain item, the auditor should consider an increased fraud risk and exercise a heightened level of skepticism in performing alternative procedures? We recommend that the Board clarify its rationale.</p> <p>In addition, we recommend the Board provide further clarification as to what an auditor should do if “more persuasive” evidence is not available. For example, if alternative procedures for a non-response on an installment loan confirmation are to audit subsequent cash receipts and read/agree the balance back to the loan agreement, the Board should clarify what procedures could be performed that would be “more persuasive.”</p>
15	<p>Paragraph 24c. requires that the auditor communicate all management requests not to confirm to the audit committee. It is unclear whether the Board intends to require notification of each individual account to the audit committee. If so, we are concerned that such a requirement may not result in the most useful information being provided to the audit committee. For example, many financial institutions maintain no-mail accounts as a regular business practice. Is it the Board’s intention to require notification of each individual account to the audit committee?</p> <p>We believe a more appropriate trigger for communicating management’s request for the auditor not to confirm certain accounts, balances or other items is whether the request has a significant impact on the audit or the financial statements and whether the auditor <u>does not agree</u> to the request and management refuses to authorize the confirmation request (paragraph 25).</p>

	<p>In addition, we question the Board’s rationale underlying this new requirement. Is the purpose of the requirement simply to inform the audit committee of management’s request not to confirm? Does the Board intend for the audit committee to provide some additional assurance to the auditor as to the appropriateness of management’s request not to confirm? We recommend the Board discuss these issues with audit committee representatives or organizations (i.e. National Association of Corporate Directors, Association of Audit Committee Members, Inc.) to gain their perspective before finalizing this guidance.</p>
<i>Non-Responses</i>	
16	<p>Paragraph 27 states, “[w]hen using positive confirmation requests and a response from a confirming party has not been received, the auditor should follow up with a second request and should consider following up with a third request.” We are concerned that the mandate of a second request and consideration of a third request for positive confirmations may not be appropriate requirements for all situations where confirmation procedures are being performed and may not result in a commensurate increase in audit quality. For example, if the auditor has no expectation of receiving responses to specific confirmation requests, it would seem more appropriate to plan and perform alternative audit procedures rather than sending out second or third requests. We recommend that the Board consider allowing the auditor to exercise professional judgment when determining whether it is appropriate to send follow-up confirmation requests, rather than including a requirement.</p>
17	<p>We note that in the Appendix A – <i>Definitions</i>, the Board has defined a confirmation response as “audit evidence obtained as a direct communication to the auditor from a third party.” Further, the definition states that “[a]n oral response to a confirmation request is audit evidence, but it does not meet the definition of a confirmation response.” We recommend the Board modify paragraph 27 to indicate that, based on an auditor’s risk assessment, obtaining an oral response in follow-up to a non-response provides a form of audit evidence with the acknowledgement that the auditor will need to consider whether and the extent of supplemental procedures required.</p>
<i>When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence</i>	
18	<p>Paragraph 29 should be clarified to provide for auditor judgment in determining when a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Accordingly, we recommend the first sentence of paragraph 29 be revised as follows:</p> <p style="padding-left: 40px;">“When the auditor determines that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence”</p>
<i>Reliability of Confirmation Responses</i>	
19	<p>When assessing the reliability of confirmation responses we agree there is a need for auditors to exercise the appropriate level of skepticism. However, we believe that the prescriptive requirements in paragraph 31 would be more appropriate as factors the auditor should consider if they have identified concerns as to the reliability of the confirmation response. We recommend the guidance in this paragraph be conformed with paragraph 10 of ISA 505, <i>External Confirmations</i>, which includes a requirement for the auditor to obtain further audit evidence only “if the auditor identifies factors that give rise to the doubt about the reliability of the response to a confirmation request.”</p>



20	<p>Extant AU 330.33 states that an auditor should consider the combined evidence provided by the confirmations and the alternative procedures to determine whether sufficient audit evidence has been obtained. The extant standards states that in performing the evaluation the auditor should consider the reliability of a confirmation response and alternative procedures, nature of any exceptions, evidence provided by other procedures and whether additional evidence is required. If the combined evidence is not sufficient, the auditor is required to obtain additional evidence. Paragraph 33of the proposal requires an auditor to obtain additional audit evidence if a confirmation response is deemed not to be reliable, regardless of whether the combined evidence provided by the audit procedures provides sufficiently persuasive audit evidence. In accordance with extant AU 330, when a confirmation response is deemed not to be reliable, we believe an auditor should be required to use his/her professional judgment to determine whether the auditor has obtained sufficiently persuasive audit evidence or whether additional audit evidence is necessary. Therefore, we believe this paragraph should be modified to require the auditor to focus on the impact of the reliability of the confirmation on the combined audit evidence obtained and the assessed level of risk to determine whether additional evidence is necessary.</p>
----	---



Crowe Horwath LLP
Independent Member Crowe Horwath International

330 East Jefferson Boulevard
Post Office Box 7
South Bend, Indiana 46624-0007
Tel 574.232.3992
Fax 574.236.8692
www.crowehorwath.com

September 13, 2010

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

RE: PCAOB Rulemaking Docket Matter No. 028, Proposed Auditing Standard Related To Confirmation and Related Amendments to PCAOB Standards, PCAOB Release No. 2010-03

Office of the Secretary:

Crowe Horwath LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Proposed Auditing Standard, (the "Proposed Standard"). This letter contains our general comments on certain matters contained in the Proposed Standard.

We support the Board's objective to improve audit quality by updating interim standards and providing new standards that provide clarity. We support the Board's consideration of the work of other standard setters, such as the International Auditing and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB), in the development of new standards. We understand the Board may decide that different procedures are appropriate in the U.S. public company audit environment; however, we strongly encourage the Board to consider the need for such differences in an area such as confirmations. We fully support convergence of the auditing standards and encourage the Board to work with the other standard setters to achieve an appropriate level of convergence.

We believe there are several matters that should be addressed before the Proposed Standard is adopted. We have provided specific observations and comments on the Proposed Standard in the body of this letter which we believe will assist the Board in achieving its goals for this Proposed Standard. The matters are organized by paragraph number to expedite consideration.

Paragraph 8

This paragraph states: *"The auditor should perform confirmation procedures for receivables that arise from credit sales, loans, or other transaction."* The Board has included the presumptively mandatory requirement to confirm credit sales, loans and other transactions without the exception for ineffectiveness of the confirmation as provided by AU section 330 *"The Confirmation Process"*. In the release on pages 12-13, the Board indicates that ineffectiveness is not an appropriate exception to the confirmation process because the auditor should determine why confirmations are ineffective and look for ways to improve the effectiveness of the confirmation procedures. The release continues with the example of confirming specific transactions that make up an account balance versus confirming the account balance. Auditors have utilized the transaction confirmation process for years, and in certain situations this process is no more effective than account balance confirmations. Companies, including

Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 2

financial institutions, large multinational companies and many others, have adopted policies of not responding to confirmations. Some of these policies are based on their cost cutting measures and some are based on their own risk assessment processes – but as an auditor, we would not know the specific reasons. The auditor does not control the responding entity's process and by not including the ineffective exception in the standard, auditors will spend time and effort sending confirmations that past experience has proven to be ineffective. We suggest that the Board consider including language in the standard that indicates that in situations where the confirmation process has been proven to be ineffective, the presumption of confirming receivables that arise from credit sales, loans, other transactions or cash has been overcome.

The third exception to sending confirmations within AU 330 is when the combined assessed level of inherent and control risk is low, and the assessed level, in conjunction with the evidence expected to be provided by analytical procedures and other substantive procedures of details, is sufficient to reduce audit risk to an acceptably low level for the applicable assertion. Appendix 3, page A3 states that AU section 316, "Consideration of Fraud in a Financial Statement Audit requires the auditor to presume there is a risk of material misstatement due to fraud related to revenue recognition and receivables often are related to revenue recognition". As noted here, the Board notes "receivables often are related to revenue recognition". This implies that receivables are not always related to revenue recognition. In addition, some receivables are dollar for dollar related to revenue recognition, such would be the case of a manufacturer selling inventory, while other receivables are only a percentage, such as the case for a financial institution recognizing interest income on a loan. We suggest the Board consider language that the presumption of confirmation may be overcome, through documentation of the risk based standards where the auditor has concluded the assessment of risk is sufficiently low.

The above suggested changes would also move the standard closer to that adopted by other standard setters.

Paragraph 9

The first sentence of this paragraph states: "*The auditor should perform confirmation procedures for cash with financial institutions.*" This provides a presumption that confirmations are required for all cash accounts with financial institution. However, the paragraph further expands the requirement by having the auditor consider the company's cash management and treasury function as well as the assessment of risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which cash accounts and other relationships to confirm. We agree with the risk assessment process as defined in the paragraph for selecting cash accounts and relationships to be confirmed. The first sentence should be removed as it is contradictory to the rest of the guidance since it implies all cash accounts with financial institutions should be confirmed.

The sentence "*The auditor should obtain an understanding of the company's cash management and treasury function to determine which cash accounts and other relationships with financial institutions to confirm*" represents a requirement of a risk assessment process that should be in the risk assessment standards and not in the confirmation standard. We encourage the Board to revise this statement to refer to the risk assessment process associated with the company's cash management and treasury function in identifying the appropriate cash accounts and relationships to confirm.

Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 3

Paragraph 12

This paragraph states that *“the auditor should maintain control over the confirmation process”* and control is defined in paragraphs 13-22. Paragraph 21 indicates that the auditor should send the confirmation requests directly to the intended confirming parties and should not permit the company or any other party to send the confirmation requests. This is different than the existing standard which allows the auditor to maintain control while utilizing internal auditors in the confirmation process. We generally agree with the Board’s description of control as presented in paragraphs 13-22 except that we suggest the Board consider the utilization of internal audit for part of the confirmation process. The auditor should control the variable inputs to the confirmation process through the determination and selection process. However, the Board should recognize the use of internal audit to control a portion of the mailing of confirmations. The lack of consideration of internal audit in this process appears to indicate that the Board does not believe internal audit can function with competence and objectivity which, if that were true, would also impact the use of internal audit for other functions during the audit. This is in contrast of PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, paragraphs 16-19 and encouragement of auditors to use the work of others, as well as AU Section 322, *The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements* paragraph 21 which indicates consideration of internal audit alone cannot reduce audit risk to an acceptable level, but does not restrict the use of internal audit. We would encourage the Board to reconcile paragraph 12 of this proposed standard to other auditing standards that allow use of internal audit.

Paragraph 26

As noted above in the discussion of paragraph 12, the Proposed Standard indicates that *“the auditor should evaluate the audit evidence obtained from performing confirmation procedures and should not rely on the company or any other party for this evaluation”* which precludes the auditors from utilizing the work of internal audit. This statement appears to alter the guidance in Auditing Standard No. 5 paragraphs 16-19 and the encouragement of auditors to use the work of others and AU Section 322, paragraph 21 as noted above. We would encourage the Board to reconcile paragraph 26 of this proposed standard to other auditing standards that allow use of internal audit in the conduct of an audit.

Paragraph 27

The Proposed Standard requires the auditor to send second requests for confirmations not returned and mandates that they should consider following up with a third request. By this, the Board has moved from a principles based approach to a rules based approach. The objective of the audit is to gain sufficient appropriate audit evidence to support the conclusions and the opinion rendered. The Board should allow the auditor to use their judgment to determine if second and or third confirmation requests will be sent in order to gather sufficient audit evidence, or to simply move to alternate procedures to gather the appropriate evidence.

Paragraph 30

This paragraph states: *“The auditor should investigate all exceptions in confirmation responses to determine why each exception occurred and whether any exceptions, individually or in the aggregate, are indicative of a misstatement or of a previously unidentified risk of material misstatement.”* The use of “all” in this requirement suggests that there should be no materiality

Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 4

consideration. For example, a \$.50 error on a confirmation for \$100,000 must be investigated based on this paragraph. Auditors should be allowed to utilize their judgment in evaluating results which may mean passing on differences because they are small enough that when projected over the population is immaterial or, conversely, pursuing a difference because it appears to be a control issue or a potential material fraud risk. As in the risk based standards, we suggest the Board allow the auditor to exercise professional judgment to appropriately mitigate the risk on the engagement, without such specific rules.

Paragraph 31

The Board has proposed that the auditor should assess the reliability of the confirmation responses and has also provided some factors to consider in the auditor's assessment process. While we generally agree with the factors noted, we are unsure how an auditor is to have knowledge of local customs that may affect the confirmation process. We encourage the Board to clarify various customs they are aware of to help the auditor with this assessment. Alternatively, the Board should consider changing the requirement to assess responses to the auditor should consider the reliability of the confirmation responses as part of their evaluation process. This would remove the mandatory requirement which will be confusing and allows the auditor to utilize professional judgment in the confirmation evaluation process.

* * * * *

Crowe Horwath LLP supports the Board's efforts to improve its auditing standards with the objective of furthering the public interest. We hope our comments and observations will assist the Board in its consideration of the Proposed Standard. We would be pleased to discuss our comments with members of the Board or its staff. If you would like to discuss with us any of our observations, please contact Wes Williams (wes.williams@crowehorwath.com) or Mike Yates (mike.yates@crowehorwath.com).

Cordially,



Crowe Horwath LLP



Deloitte & Touche LLP
Ten Westport Road
P.O. Box 820
Wilton, CT 06897-0820
USA

www.deloitte.com

September 13, 2010

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

Re: *Request for Public Comment on Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards (PCAOB Release No. 2010-003, July 13, 2010, Rulemaking Docket Matter No. 028)*

Deloitte & Touche LLP appreciates the opportunity to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (PCAOB Release No. 2010-003 (the "Release"), July 13, 2010, Rulemaking Docket Matter No. 028) (the "Proposed Standard").

Improving the Effectiveness of the Confirmation Process

We are supportive of efforts to improve the effectiveness of the confirmation process as we believe that, in appropriate circumstances, confirmation procedures are appropriate and effective in addressing identified risks of material misstatement. We also acknowledge that the extant standard (PCAOB AU 330 *The Confirmation Process*) needs to be updated, in particular to recognize increasing and evolving use of technology in performing confirmations.

We believe, however, that the effectiveness of the confirmation process in its entirety needs to be improved, and revisions to the extant auditing standard are only part of what should be a much broader initiative. For the effectiveness of the confirmation process to be improved, confirming parties (1) should be more accountable for responding promptly, accurately, and completely to confirmation requests and (2) should respond without using unnecessary restrictive language. In recent years, auditors have experienced declining response rates to confirmation requests and increasing use of disclaimer or restrictive language in confirmation responses. We believe that, if adopted, the Proposed Standard, in calling for significantly more confirmation requests, will serve to exacerbate these issues.

We realize that addressing respondents' obligations and the mechanisms that might be put in place to reinforce their responsibilities is a broad and complex undertaking. However, given the direction of the Proposed Standard, which is calling for significantly more effort on the part of the auditor in the confirmation process, we believe that it is now more imperative than ever that there be a corresponding (if not greater) effort to address the obligations and responsibilities of confirming parties. We believe that it is not in the public interest for an auditing standard addressing the confirmation process to impose significant incremental requirements on auditors without an effort to similarly address the obligations of the parties that will be responding to the increased level of confirmation requests that will result from the Proposed Standard.

To that end, we strongly recommend that prior to the finalization of the Proposed Standard, the PCAOB should take the lead in an effort to improve the effectiveness of the confirmation process, working with the Securities and Exchange Commission, issuers, banking and other regulators, auditors, investors, and others. The objective of

such effort should be to (1) surface and understand the issues related to the confirmation process, including liability concerns that are driving the increasing use of restrictive language, and (2) work collaboratively to develop appropriate solutions. Without such an effort, we are very concerned about the ability of the auditor to be successful in implementing the Proposed Standard, and we believe that it will result in little, if any, improvement in audit quality. Rather, it will create effort without the concomitant benefits.

We also believe the Proposed Standard's requirements are unnecessarily expansive when compared to the extant standard, unduly onerous and too prescriptive. We believe that the requirements in the Proposed Standard will result in an inordinate increase in the number of confirmation requests that the auditor will be required to send, regardless of whether the auditor believes that confirmations are actually likely to be effective in addressing identified risks. The prescriptive direction regarding the use of confirmations in the Proposed Standard is inconsistent with the direction of the Board's recently finalized risk assessment standards, which are premised on the planning and performance of audit procedures that the auditor believes will be most effective in addressing the identified risks.

We do not believe that creating additional requirements to use confirmations will necessarily result in improved audit quality. Prescriptive requirements, by their nature, can never be comprehensive in addressing any and all facts and circumstances of a particular situation. Such requirements detract from the ability of the auditor to exercise professional judgment in determining and performing those procedures that are likely to be most effective in addressing identified risks of misstatement.

Establishing detailed requirements to always obtain confirmations in a wide variety of situations also conveys the notion that confirmations are therefore always more reliable or effective than other forms of audit evidence. Confirmations, however, have limitations and other audit procedures may be more effective in addressing particular risks of misstatements.

Consideration of the Work of Other Standard Setters

As we have remarked in previous comment letters on the Board's proposed standards, we support and encourage the Board's ongoing consideration of the work of other standard setters. As such, we support the inclusion of appendices such as Appendix 3, *Comparison of the Objectives and Requirements of the Proposed Auditing Standard and the Analogous Standards of the International Auditing and Assurance Standards Board [(IAASB)] and the Auditing Standards Board [(ASB)] of the American Institute of Certified Public Accountants*, as an appendix to the Proposed Standard, and as a similar appendix to future exposure drafts and final auditing standards. Appendices such as these provide an opportunity for the Board to clearly describe the rationale for the structure and content of its proposed standards. Providing such information is an important step for the Board in meeting its 2009 – 2013 Strategic Plan objectives for transparency.

The discussion in Appendix 3 compares each PCAOB requirement with the equivalent requirement (if any) in the corresponding International Standard on Auditing (ISAs) of the IAASB and Statement on Auditing Standards (SASs) of the ASB, and provides an opportunity for the Board to explain its rationale in establishing different or incremental requirements. Many of the requirements in the Proposed Standard are incremental to, or more prescriptive than, the requirements in the ISAs or the SASs. We are concerned that the Board has not provided sufficient or compelling rationale as to how these incremental and very prescriptive additional requirements will drive an improvement in overall audit quality that is commensurate with the additional and substantial effort that will be required.

We also note that the comparison in Appendix 3 is misleading because some of the instances identified therein as requirements in the Proposed Standard that are incremental to the ISAs or the SASs are actually encompassed in the standards of the IAASB or the ASB in the form of application material or guidance that is attached to more overarching requirements in those standards. The existence of this application material is not called out in

Appendix 3. By failing to identify the existence of such application material in the ISAs or the SASs, the Appendix incorrectly implies that the ISAs or SASs fail to address the issues that are being covered by the PCAOB requirements identified as incremental. The Appendix does not identify those situations in which the ISAs or SASs are more principles-based and support the exercise of auditor judgment in determining how to address the requirements.

We understand that the Board may conclude that it is appropriate for its standards to contain incremental requirements, or to elevate guidance from the ISAs or the SASs to requirements. However, in order to improve the transparency of its standard-setting process, and the usefulness of Appendix 3, we believe that the Board should clearly highlight those instances in which the subject matter of a particular requirement is addressed as application material or guidance in the ISAs or the SASs, instead of only stating that those standards “do not include similar requirements.”

In addition to the overarching concerns discussed above, we have more specific concerns regarding the Proposed Standard. These concerns are presented in two sections in the attachment to this letter. The first section, entitled Overall Comments, sets forth those comments that are pervasive in nature (and in some cases those comments expand upon the points addressed in this cover letter), while the second section, entitled Detailed Comments and Other Observations, sets forth paragraph-specific comments and other observations.

We welcome an opportunity to further discuss these matters with the Board and the staff. Dialogue with commenters as the Proposed Standard is evaluated and changes are considered will facilitate a more complete understanding of the comments, full consideration of the related implications, and, we believe, will ultimately improve the final standard and the auditor’s ability to implement it effectively and with the desired effect of improving audit quality.

If you have any questions or would like to discuss these matters further, please do not hesitate to contact John Fogarty at (203) 761-3227 or Megan Zietsman at (203) 761-3142. We thank you for your consideration of these matters.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Daniel L. Goelzer, Acting PCAOB Chairman
Bill Gradison, PCAOB Member
Steven B. Harris, PCAOB Member
Charles D. Niemeier, PCAOB Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

Mary L. Schapiro, SEC Chairman
Luis A. Aguilar, SEC Commissioner
Kathleen L. Casey, SEC Commissioner
Troy A. Paredes, SEC Commissioner
Elisse B. Walter, SEC Commissioner
James L. Kroeker, SEC Chief Accountant
Brian T. Croteau, SEC Deputy Chief Accountant

I. Overall Comments

Our overall comments are organized as follows:

- A. Expanded Scope of Required Confirmations
- B. Prescriptive Nature of the Proposed Standard and Implementation Challenges
- C. Inconsistencies with Other PCAOB Auditing Standards
- D. Drafting Conventions
 - 1. Use of Present Tense
 - 2. Requirements Embedded in Examples
 - 3. “Requirements” Presented Outside of the Proposed Standard

A. Expanded Scope of Required Confirmations

Overall Observations

The Proposed Standard significantly expands the scope of required confirmation procedures and now includes confirmation (a) of receivables that arise from credit sales, loans, or other transactions, (b) of cash and other relationships with financial institutions, and (c) in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures. The expanded requirements appear premised on the belief that confirmation procedures “can provide audit evidence to address the risk of material misstatement due to fraud.”¹ However, alleged audit failures and enforcement actions seem to have been more often linked to fraudulent or unreliable confirmations than to auditor failure to request a confirmation or to perform alternative procedures.

As noted in our cover letter, the expanded requirements in the Proposed Standard addressing when confirmations are required to be performed give the investing public, other interested parties, and auditors the impression that confirmations are a superior form of audit evidence and the most appropriate procedure to perform in all instances. We do not believe that this is supported by the academic studies cited on page 2 of the Release which provide evidence of challenges in the confirmation process that affect the reliability of the audit evidence that confirmation responses might provide. Specifically, one of the studies involved reviewing Security and Exchange Commission Accounting and Auditing Enforcement Releases (AAERs) to highlight weaknesses in current audit practice. The number of enforcement actions supporting the observations regarding the issue of evaluating reliability of evidence from confirmations was overwhelming.² For example, a table in the study summarizing confirmation problems reported in AAERs shows that the greatest problem area in current audit practice is evaluating the reliability of confirmations. Of the 30 reported cases, 25 involved collusion between the audited party and a third party to deceive the auditor. The other academic study cited in the Release³ specifically stated that “academic studies have questioned the reliability of confirmations” and that “a review of AAERs found a

¹ Page 3 of PCAOB Release No. 2010-003.

² See Diane Janvrin, Paul Caster, and Randy Elder, “Enforcement Release Evidence on the Audit Confirmation Process: Implications for Standard Setters,” *Research in Accounting Regulation* 22 (April 2010).

³ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, “A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness,” *Auditing: A Journal of Practice & Theory* 27, no.2 (November 2008).

significant number of cases involving collusion and also forged and false confirmations, suggesting that confirmation evidence may not be as persuasive as it is generally perceived.”

It is not clear to us why, despite the questions surrounding the reliability of evidence provided by confirmations and the lack of compelling evidence linking alleged or actual audit failures to an auditor’s decision to not perform confirmation procedures, the Board, through the Release and the Proposed Standard, is placing such significant importance on this type of evidence and requiring significantly more confirmation procedures.

The Board’s recently finalized risk assessment standards provide an appropriate framework to guide the auditor’s judgment regarding the nature, timing, and extent of audit procedures necessary to obtain sufficient appropriate audit evidence. It is therefore not necessary for the Board to establish prescriptive requirements in the Proposed Standard as to the types of procedures that auditors should perform. The establishment of such requirements is inconsistent with the risk assessment standards which call for the planning and performance of procedures that are most responsive to identified risks. Instead of imposing prescriptive requirements for confirmations, the PCAOB should consider adding guidance that illustrates how the auditor can use confirmations to address the risk of material misstatement in areas other than accounts receivable. This would enhance the Proposed Standard and demonstrate how the framework in the risk assessment standards is intended to be applied to the confirmation process.

We also encourage the Board to more specifically acknowledge in the Proposed Standard that the effectiveness of confirmations may be compromised by management override, collusion or by other factors, and that responses may not, therefore, be reliable.

Requirement to Confirm Receivables

The requirement to confirm accounts receivable in the Proposed Standard represents a significant scope expansion from what is included in the PCAOB’s extant standard. The extant standard contains a rebuttable presumption that auditors confirm only certain receivables (including the entity’s claims against customers that have arisen from the sale of goods or services in the normal course of business, and a financial institution’s loans). However, it allows auditors to apply professional judgment in evaluating whether there is a basis to overcome that presumption, including making a determination as to whether the use of confirmations would be effective in a particular situation.

We are concerned with the expansion of the nature and scope of the requirement to confirm accounts receivable to now include all receivables. Combined with the absence of the ability to appropriately exercise judgment regarding when confirmation procedures are not likely to be effective, this expansion will place the auditor in the position of needing to send confirmation requests even when the auditor knows that the confirmation requests are unlikely to be effective in addressing the identified risks of material misstatement.

We note that page 13 of the Release currently states, “if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures.” This statement does not acknowledge that, in many cases, auditors will not be able to meaningfully improve the effectiveness of the confirmation procedures on their own. For example, the auditor cannot control what disclaimers or restrictive language respondents might choose to use in responding to the confirmation requests. Additionally, the auditor has no way of compelling respondents to reply to confirmation requests if they choose not to respond. As explained in our cover letter, we believe the only way to improve the confirmation process is through an undertaking that brings all relevant parties, including regulatory leadership, together with a clear mandate to collectively develop ways to improve the confirmation process. Improvements to the auditing standard are only one part of how this might be accomplished.

In certain industries, response rates are traditionally very low and, therefore, subject to appropriate consideration of the factors in extant PCAOB AU 330 (paragraph 34). Under the extant standard, it is not common practice to send receivables confirmations when they would not be effective. The healthcare industry provides a relevant example of an industry in which accounts receivable confirmations not only are ineffective, but potentially problematic. Due to the complex nature of accounts receivable associated with delivering health care services, for instance, in the hospital setting, the inability to get responses from third party payers and the difficulty patients would have in verifying amounts owed (e.g., the patient may not be aware of the amounts not covered by insurance plans), it is ineffective and inefficient for auditors to send confirmation requests when performing audits of health care providers. Patients may become confused and concerned upon receipt of such requests. Additionally, use of patient information to send the requests and the risk of unauthorized disclosure of that information if the requests are misdelivered raises legal issues under federal and state privacy and security laws. Under the Proposed Standard, the auditor will now be required to send the confirmation requests regardless, follow up with second requests, consider third requests, and then perform alternative procedures. Additionally, the auditor will likely have to devote significant attention to following up on responses that are actually received which likely will contain exceptions because many patients will not understand the basis for the charges reflected on the invoices that comprise the balances being confirmed and will reflect that in their responses. Currently, auditors use other appropriate procedures to obtain more reliable audit evidence supporting the existence of receivables in the healthcare industry while protecting the privacy and security of patient information. It will be ineffective and inefficient, if not legally problematic, for the auditor to use patient information to send confirmation requests for which they may well not receive a response.

Another example of an industry in which confirmation requests are unlikely to be effective is provided by the utilities industry where confirmations for gas, electric and water bills are highly unlikely to be as effective as substantive analytical procedures. We do not believe that all of this incremental audit effort to perform confirmation procedures where they will be ineffective will result in the desired improvement in audit quality.

Requirement to Use Confirmations in Response to Significant Risks

Paragraph 10 of the Proposed Standard indicates that the “auditor should perform confirmation procedures in response to significant risks that relate to relevant assertions that can be adequately addressed by confirmation procedures.” We are concerned about a requirement that mandates the use of confirmations when they may be adequate, but are not necessarily the best or most effective procedure, to address a risk that the auditor has identified. Moreover, the Proposed Standard does not provide guidance for the auditor to apply in determining whether confirmations can “adequately address” a significant risk. We believe the Proposed Standard fails to make the point that when evidence from a third party is key to addressing a significant risk, the confirmation is likely to be the most effective way for the auditor to address such a risk. There are many significant risks where third party involvement is very limited or not relevant at all. In such circumstances, the use of confirmations would clearly not be appropriate or effective. The Proposed Standard will now drive the need for additional audit documentation as to why confirmations were not used to respond to those significant risks.

Summary

For the foregoing reasons, we believe that implementation of the expanded requirements to perform confirmation procedures and elimination of the ability to use professional judgment in determining when confirmation requests do not need to be sent, will result in more widespread use of a procedure that:

- Might not provide reliable evidence
- Might not be the most effective procedure
- Might not be practicable in the circumstances.

The expansion of required confirmation procedures, detached from the risk assessment process, may have the effect of creating more of a mechanical process in which the auditor “checks off” the procedures stated in the requirements as opposed to evaluating whether confirmation procedures are, in fact, the most appropriate procedures to perform, given the circumstances. The unintended consequence may be that audits will be less effective because by requiring confirmation procedures, the perception is created by the Proposed Standard that confirmation is, and always will be, sufficient. Consequently auditors will be less inclined to consider whether additional procedures are necessary to supplement the required procedures or whether other procedures may be more effective in addressing identified risks. Additionally, auditors will need to devote time and effort to complying with the Proposed Standard and the documentation requirements that it triggers and will be left with less time to devote to other audit procedures that are more appropriate for addressing the identified risks of material misstatement.

We urge the Board to reconsider the expansion of the requirements to perform confirmations in the Proposed Standard, and instead allow for the auditor to use his or her judgment in determining whether confirmation procedures are appropriate in the circumstances to address the identified risks. If the Board still concludes that these requirements should be retained, we recommend, similar to the extant standard, that the Board establish requirements to perform confirmation procedures as rebuttable presumptions that provide for the auditor to use appropriate professional judgment in determining when confirmation requests will not be sent.

B. Prescriptive Nature of the Proposed Standard and Implementation Challenges

The Proposed Standard also adds a significant number of required procedures making it significantly more prescriptive than the extant standard. Absent a preponderance of evidence demonstrating that a general practice issue exists among registered firms regarding the confirmation process or, as noted above, evidence that an increase in confirmation requests has led to an increase in the detection of fraud, we believe that the expanded scope and prescriptive nature of the requirements in the Proposed Standard are inconsistent with the risk-based approach that the PCAOB adopted in the risk assessment standards, and are not necessarily in the public interest, as they are unlikely to result in a commensurate increase in audit quality.

We are also concerned that a number of the required procedures that the auditor is expected to perform under the Proposed Standard are, in fact, beyond the auditor’s control, or relate to matters that we believe the auditor cannot be reasonably expected to know or to be able to find out. For example:

- Paragraph 16 requires the auditor to consider, when designing confirmation requests, “[l]ocal customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information.” Similarly, paragraph 31 requires the auditor, when assessing the reliability of confirmation responses, to take into account whether confirmation responses reflect “[l]ocal customs that may affect the confirmation responses, such as customs that create an environment in which confirmation responses are inherently unreliable.” It is not clear to us what is meant or intended by the use of the term “local customs,” and we question how the auditor might be expected to have this knowledge, or what is expected in terms of making efforts to obtain it. Additionally, to the extent the auditor has knowledge of local customs or practices whereby respondents reply to requests without verifying information or where customs create an environment in which confirmation responses are inherently unreliable, it seems illogical that the auditor would try to perform confirmation procedures. However the Proposed Standard would nevertheless require that confirmations be performed in those circumstances.
- Paragraph 32 requires the auditor to assess any indication that the confirming party is not competent or objective, has questionable motives, or is not free from bias with respect to the company, when evaluating the reliability of the response received. The auditor has limited

interaction with a confirming party; therefore we are not sure how the auditor might be expected to have this knowledge, or what would be expected of the auditor in making efforts to obtain it.

We therefore request the Board to revisit the requirements in the Proposed Standard, particularly those cited above, and specifically challenge their practicability, including whether they are reasonably expected to be matters that the auditor can control, have knowledge about, or make reasonable efforts to obtain such knowledge.

C. Inconsistencies with Other PCAOB Auditing Standards

Use of Internal Auditors

The Proposed Standard restricts the role that the internal audit function may have in the confirmation process and therefore limits the auditor's ability to use judgment in determining the extent to which the work of others can be used in the confirmation process. Specifically, the auditor is precluded from using the work of internal auditors or others within the company to send confirmation requests, receive confirmation responses or evaluate the evidence obtained from performing confirmation procedures.

We are not aware of widespread support for the notion that the use of internal auditors in performing confirmation procedures has been shown to have contributed to audit failure. There are only two situations referred to in one of the academic studies cited in the Release where it appears that the use of third parties to send confirmations was related to an SEC enforcement action, one involving an internal auditor in 1999 and the other not involving an internal auditor at all, but rather a secretary of a related party in 1987.⁴

We do not believe that the one case involving the use of an internal auditor in the confirmation process alone creates a compelling rationale for this new limitation on the ability to use the work of internal auditors. We are concerned that the new limitation will drive an unnecessary change in current practice without a corresponding improvement in audit quality. We believe that there are times when appropriately objective and competent internal auditors might be used to assist the auditor in the confirmation process, particularly in areas where the risk of material misstatement has not been assessed as high. We also believe that appropriate use of internal auditors may also allow the auditor to focus more effort on areas that are more complex and where the risk of material misstatement is higher.

We therefore believe that the Proposed Standard should emphasize the auditor's responsibility to direct and control the entire confirmation process, and that it be modified to provide for the auditor's ability to use the work of others based on the application of the framework in PCAOB AU 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, and the auditor's risk assessment.

We note that modifying the Proposed Standard along these lines would achieve more consistency with the approach that is included in PCAOB Auditing Standard ("AS") No. 5, *An Audit of Internal Control over Financial Reporting That Is Integrated with an Audit of Financial Statements*, and the risk assessment framework in the Board's recently approved risk assessment standards. The framework for the use of internal auditors provided by PCAOB AU 322 is acknowledged in the release to AS No. 5. The effect of a risk-based approach on the auditor's use of internal audit and others in an audit of internal control over financial reporting was discussed on page 14 of the release to AS No. 5⁵. The Board stated that, "[i]n line with the overall risk-based approach to the audit of internal control over financial reporting, the extent to which the auditor may use the work of others

⁴ See Diane Janvrin, Paul Caster, and Randy Elder, "Enforcement Release Evidence on the Audit Confirmation Process: Implications for Standard Setters," *Research in Accounting Regulation* 22 (April 2010).

⁵ See PCAOB Release 2007-005A, *An Audit of Internal Control over Financial Reporting That Is Integrated with an Audit of Financial Statements and Related Independence Rule and Conforming Amendments*, June 12, 2007, Rulemaking Docket Matter No. 021.

depends, in part, on the risk associated with the control being tested.” It further stated that “...the final standard allows the auditor to use the work of these sufficiently competent and objective others — not just internal auditors — to obtain evidence supporting the auditor's assessment of control risk for purposes of the audit of financial statements.... The Board believes that this provision will promote better integration of the audit of internal control with the audit of financial statements.”

It is unclear why, despite allowing the auditor to use internal auditors and others in an audit of internal control over financial reporting, the Proposed Standard prohibits such use for confirmation procedures, which are performed as part of a risk-based audit.

We also note that the use of the term “rely” in paragraph 26 of the Proposed Standard is inappropriate because the concept of “shared responsibility” that the word implies is prohibited in paragraph PCAOB AU 322.⁶

D. Drafting Conventions

1. Use of Present Tense

We continue to have concerns about the use of the present tense in PCAOB Proposed Standards. The use of the present tense in the Board’s standards creates ambiguity and confusion as to what is required of the auditor pursuant to such statements. To the extent such statements describe auditor actions, it is not clear where they fit within the framework of Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*.

As we have indicated in prior comment letters to the Board on its Proposed Standards, we believe that the Board should develop and publish guidelines for use of the present tense in the Board’s auditing standards. We believe that the use of present tense should be reserved for providing or describing statements of fact and not for when describing auditor actions. We have concerns that the lack of clarity and transparency as to the Board’s intent when using the present tense to describe auditor actions will lead to inconsistency in the application by auditors of the Board’s standards. In many cases in the Proposed Standard, we believe it would be more appropriate to replace present tense statements that describe auditor actions with conditional statements, for example, “lists of factors that may be considered” instead of statements that “factors to be considered are...”

Examples that support this observation are as follows:

- Paragraph 16: This paragraph includes a present tense statement that “[f]actors to consider when designing confirmation requests include:” which is followed by a list of eight bulleted items. It is not clear whether the auditor needs to consider each and every item (and document the results of such consideration as to each) or whether the auditor might exercise judgment in considering which factors might be relevant to the requirement to “design confirmation requests to obtain relevant and reliable audit evidence,” and include in the audit documentation a more general description as to how the requirement was addressed overall. We recommend revising the lead-in to the bulleted items to be “[f]actors **that the auditor may** consider when designing confirmation requests include:”
- Paragraph 19: The last sentence of the paragraph before the bulleted list includes a present tense statement that “[o]ther factors to consider in determining the nature and extent of procedures to perform to validate addresses on confirmation requests include the following...” Similar to our observations on paragraph 16, it is not clear whether the auditor needs to separately consider each bullet (and document such consideration) or whether a more overall consideration would be acceptable. We recommend revising the

⁶ See paragraph 19 of PCAOB AU 322, *The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements*.

lead-in to the bullet points to be “...factors *that the auditor may* consider in determining the nature and extent...”

The uncertainty as to the intent of the Board in using present tense statements is a source for concern as to how they will be interpreted when audit work is subsequently evaluated by the PCAOB (through its inspection process or through enforcement) or addressed by others (e.g., in the context of litigation).

2. *Requirements Embedded in Examples*

We are supportive of the inclusion of examples in the Proposed Standard as we believe they are helpful in providing additional guidance and in demonstrating how requirements might be addressed. However, there are a number of instances in the Proposed Standard where requirements (i.e., “should” statements) are embedded within the examples. We do not believe that this practice is appropriate because examples are meant to illustrate the potential application of a requirement to a particular situation and what is described in an example may not be relevant in all instances. The inclusion of requirements in examples will cause the auditor to have to evaluate and document why that requirement does not apply to a particular engagement, and we do not believe this incremental effort will have a commensurate improvement in audit quality.

We therefore recommend replacing all requirements (“should’s”) embedded in the examples with “may’s.” If the Board intends any requirements currently stated in examples to be applicable more broadly, we encourage the Board to draft such requirements as separate paragraphs in the Proposed Standard and not embed them as part of specific examples. Doing so will assist the auditor in being able to better understand the Board’s intent, and will allow the auditor to exercise professional judgment in determining how the requirement might be addressed in situations that are not identical to those described in the example.

Examples that support this observation are as follows:

- Paragraph 14: The “should” embedded in the example in this paragraph might be misconstrued as meaning that sales cutoff testing is the only procedure the auditor needs to perform at year end to update accounts receivable confirmation procedures performed during interim. While sales cutoff testing may be an appropriate test to be performed, it is likely that such testing would need to be combined with other procedures in order to provide sufficient appropriate audit evidence for the existence and completeness assertions. We therefore suggest redrafting the example to indicate that cutoff testing *may* be performed, and that such testing *may* need to be combined with other procedures, as appropriate. We also question whether this is the most appropriate example to use to illustrate the point in the first sentence of paragraph 14 as it appears to be more focused on the auditor’s consideration of evidence obtained as of an interim date as opposed to the use of confirmation procedures.
- Paragraph 19: It is not clear how the apparent requirement embedded in the example and the requirement in the first sentence are intended to be applied, or when the Board believes that tests of controls might be appropriate. The first sentence includes a requirement “to perform procedures to determine the validity of the addresses on the confirmation requests, including substantive procedures or tests of controls.” This requirement therefore allows for the option of using only tests of controls to validate addresses. However, the example in paragraph 19 indicates that “the auditor should perform substantive procedures to determine the validity of addresses on the confirmation requests for transactions or accounts that involve significant risks or are material to the financial statements.” This example therefore seems to eliminate the availability of the option for testing the validity of addresses using tests of controls, in the situations described therein. Furthermore, in referring to “transactions or accounts that involve significant risks or are material to the financial statements,” the example seems to encompass

virtually all situations where confirmations might be used. It is not apparent to us why the auditor would need to perform any procedures, including confirmations, for accounts or transactions that are not material to the financial statements or that do not involve significant risks.

- Paragraph 28: The use of “should” in the examples in the note to this paragraph results in very granular and specific requirements for the auditor’s alternative procedures to address non-responses. The first sentence of the paragraph establishes the requirement to perform alternative procedures for all non-responses to positive confirmation requests and therefore it would be much more appropriate for the examples to be illustrations of the actual alternative procedures the auditor may perform in particular situations. Certain of the procedures included in the examples may not always be appropriate in a particular situation, and the auditor should be allowed to exercise professional judgment in determining the appropriate procedures to address the requirement. We therefore recommend that the detailed examples be redrafted to indicate that they are procedures that the auditor “may” perform, and that they may need to be combined with other procedures, as appropriate.

3. *“Requirements” Presented Outside of the Proposed Standard*

We noted that the Release contains sentences describing certain actions of the auditor in terms of “should.” That term is defined in Rule 3101 and is one of the terms used to “describe the degree of responsibility that the standards impose on auditors.” However, the references in the Release do not consistently appear in, or correspond to requirements in the Proposed Standard. Because the actions characterized as requirements in the Release do not appear within the Proposed Standard, they may not be the focus of comment by the investing public and other interested parties. Additionally, the SEC’s approval of the final standard will not extend to those apparent requirements. We believe this will cause significant confusion and uncertainty regarding the requirements of the final standard.

We do not believe that is appropriate to use “should” statements in the Release that do not fully reconcile with an existing requirement in the Board’s standards or proposed requirement within the Proposed Standard. Such use (a) bypasses the approved standard-setting process to establish what some will (presumably) incorrectly believe to be additional requirements, (b) does not serve the public interest, and (c) broadens the expectations gap. We therefore recommend deletion of the “should” statements from the Release unless they are quoting a specific requirement in the Proposed Standard or an existing standard. The following are examples of the problematic use of such terms in the Release:

- “... if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures.”⁷
- “Consequently, when using an electronic environment, such as direct access, the auditor should include sufficient detail in the audit documentation to demonstrate that the auditor complied with the requirements of the proposed confirmation standard.”⁸

⁷ Page 13 of PCAOB Release No. 2010-003.

⁸ Page 39 of PCAOB Release No. 2010-003.

II. Detailed Comments and Other Observations

Detailed Comments on PCAOB Proposed Confirmation Standard — By Paragraph

Paragraph 4

Paragraph 4 contains requirements that are identical to requirements in PCAOB Auditing Standards (AS) No. 13, *The Auditor’s Responses to the Risks of Material Misstatement* and No. 15, *Audit Evidence*. Although these requirements are cross-referenced to the requirements in PCAOB AS No.13 and No. 15, it appears that they are potentially incremental requirements to those within paragraph 4 itself. In order to address this potential confusion, eliminate redundancy, and encourage auditors to read and apply the risk assessment standards in their entirety, we recommend clarifying that these are references to requirements in other standards rather than incremental requirements within paragraph 4.

Paragraph 5

Paragraph 5 states that “[a]udit evidence in the form of a confirmation response...generally is more reliable than audit evidence generated internally by the company or provided directly by the company.” We believe that there are circumstances in which confirmation responses may not be more reliable than other audit evidence and we therefore believe that this sentence should be revised to read that “[a]udit evidence in the form of confirmation response is **may be** more reliable...”

Paragraphs 6 and 7

Paragraphs 6 and 7 make reference to the concept of “confirmation requests” in the first sentences of each paragraph as addressing relevant assertions. The requests themselves do not however provide audit evidence. In the case of positive confirmations, it is not the requests themselves that address the relevant assertions, but rather the procedures or the responses received pursuant to the requests that will actually provide the evidence to address the relevant assertions. In the case of negative confirmations, it is the absence of a response that provides the evidence, not the request itself. We therefore believe that it would be more appropriate to refer to “confirmations” (which is defined in Appendix A, *Definitions*) instead of “confirmation requests.” We also believe that these sentences should not be absolute statements as they are currently drafted, because they may not be true in all cases, particularly if confirmation responses are not received by the auditor. We therefore suggest rewording the introductory phrases of the first sentence of paragraph 6 to read “Confirmations ~~requests~~ **may** address...” and the first sentence of paragraph 7 to read “Confirmations ~~requests~~ **may** not address...”

Paragraphs 8 and 9

It is not clear how the risk assessment described in the last sentence of paragraph 8 (“The auditor should assess the risk of material misstatement... when selecting which receivables to confirm”) and the fourth sentence of paragraph 9 (“The auditor also should assess the risk of material misstatement... when selecting which cash accounts and other relationships to confirm”) interact with the requirements in PCAOB AS No. 12, *Identifying and Assessing Risks of Material Misstatement*, paragraph 59, to identify and assess the risks of material misstatement at the financial statement level and assertion level. Additionally these sentences appear contradictory with the first sentences in each paragraph which appear to indicate that confirmation procedures should be performed for all receivables and all cash with financial institutions. We therefore recommend that these paragraphs be redrafted to clarify the references to, and interactions with, the risk assessment process and also the manner in which auditors might appropriately make selections of individual items to confirm.

Paragraph 11

We do not believe that paragraph 11 provides useful incremental guidance (i.e., that confirmation procedures might be an appropriate response to obtain audit evidence for certain relevant assertions) as the same might be said for any other audit procedure. The determination of the nature, timing, and extent of further audit procedures to be performed to address identified risks at the relevant assertion level (including confirmation procedures, if appropriate) is comprehensively dealt with in PCAOB AS No. 13. We therefore do not believe that paragraph 11 is necessary and recommend its deletion.

Paragraph 12e and Paragraph 22

Item *e* of paragraph 12 appears to set up paragraph 22 and states that maintaining control over the confirmation process includes “requesting responses directly from the confirming parties.” Paragraph 12e is not currently consistent with paragraph 22. We suggest revising item *e* in paragraph 12 to be consistent (subject to our comment below on paragraph 22) as follows “Requesting ***that the confirming parties*** responses ***directly to the auditor and not to the company or any other party*** ~~from the confirming parties~~”

Paragraph 22 also indicates that the “auditor should request that the confirming parties or intended intermediaries respond directly...” We believe that this is incorrect because the intended intermediary is not responsible for responding; rather it is the confirming party that should respond. The confirming party may respond directly or by using an intended intermediary, but the response is still that of the confirming party. Consequently, we recommend that the phrase “or intended intermediaries” be deleted from the first sentence in paragraph 22.

Paragraph 17

Use of Negative Confirmations

Paragraph 17 addresses the use of negative confirmations. We agree that positive confirmations provide better audit evidence than negative confirmations; however we acknowledge that there are situations when the auditor might conclude that negative confirmations are sufficient as the only substantive procedure to be performed to address certain risks (e.g., based on the auditor’s assessment of the risk of material misstatement as low and based upon having successfully tested relevant controls that address the identified risks). We are therefore supportive of retaining the framework in the extant standard for the appropriate use of negative confirmations. We note however that paragraph 17 in the proposed standard includes some differences from the extant standard (PCAOB AU 330, *The Confirmation Process*). It is not clear to us why these changes have been made and what changes are expected in terms of auditor performance. In particular:

- The fourth bullet of paragraph 17 indicates that one of the factors that needs to be present if negative confirmations are to be used is that the “auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration.” In the extant standard, paragraph 20 indicates that the use of negative confirmations is appropriate when (among other factors) “the auditor has no reason to believe that the recipients of the requests are unlikely to give them consideration.” We believe that the requirement in the Proposed Standard will be read as requiring a higher level of performance/evidence than the extant standard. Additionally, the Proposed Standard does not take into account that the auditor will not have a direct relationship with the confirming party. We therefore request that the PCAOB indicate whether this revision is intended to change current practice, and if so, provide a clear description of the nature of the expected change in the auditor’s procedures to address consideration of this factor. If this revision is not intended to change current practice, the language in the Proposed Standard should be revised accordingly to be consistent with the extant standard. If the revision is intended to change current practice, the language in the Proposed Standard should be revised to make the Board’s intent more apparent and a rationale should be provided for the desired change in practice.

- The last sentence of paragraph 17 contains a new requirement that other substantive procedures be performed to supplement negative confirmations in all cases, even when the factors described in the paragraph are present. Paragraph 20 of the extant standard indicates that the “auditor should consider performing other substantive procedures to supplement the use of negative confirmations.” It is not clear to us why the ability of the auditor to apply judgment in selecting the most appropriate procedures or combination of procedures would now be limited in the Proposed Standard through the introduction of the requirement to perform other substantive procedures in combination with negative confirmations in all cases. In some circumstances when negative confirmations have been appropriately used, it may be difficult, if not impossible, for the auditor to develop and perform other substantive procedures at reasonable cost and with a commensurate increase in audit quality. For example, when negative confirmations are used in connection with customer deposits in a financial institution, it is unclear what an appropriate (and cost-effective) additional substantive procedure would be. We question whether the incremental audit effort that might be expended in addressing this new requirement might be better directed towards more risky areas of the audit. We recommend that the Board revise the last sentence of paragraph 17 to make it consistent with the extant standard and to indicate that the auditor “should *consider whether to* perform additional substantive procedures...” It may also be helpful to provide examples of other substantive procedures that might be considered and performed. If the requirement is not changed as we have suggested above, we encourage the PCAOB to provide such examples to assist auditors in complying with the new requirement.

Direct Receipt of Confirmation Responses

The second sentence of paragraph 17 indicates that a “positive confirmation request provides audit evidence *only when a* response is received directly by the auditor from the confirming party.” It is not clear to us how this is intended to relate to the factors described in paragraph 31 that should be taken into account by the auditor in assessing the reliability of confirmation responses. Certain factors address situations when the response is received indirectly and the statement in paragraph 17 appears to preclude the auditor from considering such responses as audit evidence. This is not consistent with paragraph 31 where it appears that the auditor has some ability to exercise judgment in evaluating the reliability of the confirmation responses, including consideration of whether additional procedures are necessary. This apparent inconsistency needs to be resolved.

Paragraph 18

It is not clear to us what incremental procedures with respect to the design of confirmation requests the Board expects the auditor to perform to satisfy this requirement (other than those already expected to address the other requirements in the Proposed Standard). We recommend that additional clarification be provided, including examples of what such procedures might be.

Paragraph 19

Many companies use post office addresses for certain types of correspondence, including confirmation requests. It is unclear why, absent any indications of impropriety, a post office address is a factor that requires consideration by the auditor when determining the nature and extent of procedures to perform to validate addresses on confirmation requests. We recommend that the Board clarify the risks associated with using a post office address for confirmations with which it is concerned, and revise that bullet to more appropriately describe the circumstances in which such validation is advisable.

Paragraph 21

We recommend defining the phrase “Intended Intermediary” in Appendix A, *Definitions*, instead of in a footnote.

Paragraphs 23, 24, and 25

These paragraphs address situations in which management requests the auditor not to confirm certain accounts, balances, or other items. It is not clear from the Proposed Standard how these requirements are to be applied when the confirmation requests relate to accounts that are otherwise required to be subjected to confirmation procedures (e.g., receivables, cash, accounts where significant risks have been identified). For example, it is unclear whether it is acceptable for the auditor to agree to a request from management not to confirm such accounts, if the auditor determines that management's request is appropriate. Additionally, the last part of the note in paragraph 24 implies that there are situations in which the auditor would decide to not perform confirmation procedures ("had the auditor made a decision not to perform confirmation procedures"). The Proposed Standard does not make clear whether an auditor may make such a decision for balances that are required to be confirmed by the Proposed Standard.

Paragraph 24

As currently drafted paragraph 24 does not make it clear that the basis for the auditor agreeing to management's request should be based on the auditor's determination of whether management's request is appropriate. We recommend that the sentence be revised as follows "If the auditor agrees to management's request, ***based on the auditor's determination that the request is appropriate***, and does not...."

We also do not understand why the note to paragraph 24b requires the auditor to perform procedures to obtain "more persuasive audit evidence than he or she would have obtained had there been no response to a confirmation request or had the auditor made a decision not to perform confirmation procedures." We recommend that the Board clarify its rationale with respect to this note and what is expected of the auditor, including in situations when more persuasive evidence does not exist.

Paragraph 27

This paragraph requires that the auditor follow up non-responses to initial confirmation requests with second requests and to consider following up with a *third* request. If the auditor decides to not send the third request, he or she will need to document the reason for not doing so, as well as perform *and* document alternative procedures.

It is not clear how a requirement to send second and third requests in all cases is appropriate and likely to enhance audit quality. In those situations when the auditor already expects that response rates will be low, we expect that practice will evolve in these situations such that the auditor will commence immediately with performing alternative procedures. The sending of follow-up requests will be merely a perfunctory exercise, but one that is necessary in order to comply with the requirements of this Standard. We therefore believe that this requirement is overly prescriptive and recommend that it be deleted or replaced with guidance that indicates that the auditor may use professional judgment in determining whether to send follow-up requests or commence directly with performing alternative procedures.

Paragraphs 27 and 28

Paragraphs 27 and 28 do not address how the auditor might consider an oral response to a confirmation request. The definition of "confirmation response" indicates that an "oral response to a confirmation request is audit evidence, but it does not meet the definition of a confirmation response," and as such an oral response would be a non-response. Paragraph 28 requires the auditor to perform alternative procedures for all non-responses to positive confirmation requests. Paragraph 28 does not discuss how receipt of an oral response affects the nature, timing, and extent of alternative procedures. We suggest that Board provide guidance in paragraph 28 on how an oral response to a confirmation might be considered.

Paragraph 28

Paragraph 28 requires the auditor to obtain written representations from management regarding the *terms* of significant transactions or agreements in addition to other alternative procedures when confirmation requests are not responded to. We believe that the auditor’s working papers will contain documentation/agreements that set forth those terms, and therefore we believe that it may be more appropriate to consider requesting the following representations:

- That the agreement provided to the auditor is the complete agreement and the one currently in effect.
- That there have been no modifications to the terms of the agreement or transaction, or side agreements that have not been communicated to the auditor.

Additionally, it may be appropriate to request representation regarding management’s intent and/or interpretation of the more significant and relevant provisions of the agreement. Consistent with our commentary in our overall comments section about the inclusion of requirements in examples, we also recommend that the Board redraft this example such that it provides guidance about the procedures that the auditor may consider, as opposed to establishing a number of incremental requirements in an example that might not be applicable in all circumstances.

Paragraph 29

Paragraph 29 requires the auditor to consider the implications for the audit and the audit report when (1) there is no response to a positive confirmation request *and* (2) alternative audit procedures will not provide the necessary audit evidence that the auditor requires. We recommend that the requirement be revised to make it clear that the determination as to whether a response to a confirmation request is necessary is a matter of auditor judgment.

We also note that one of the circumstances cited for when alternative audit procedures will not provide the necessary audit evidence is where there is a risk of collusion, which can involve outside parties according to paragraph 29. We believe that any confirmation procedure is potentially subject to this risk and that the inclusion of this circumstance as a bullet in paragraph 29 may therefore lead to the auditor concluding that responses to positive confirmation requests are always necessary, thereby undermining requirements in other parts of the Proposed Standard, such as paragraph 28. We believe the auditor should have the ability to appropriately exercise his or her professional judgment in determining whether alternative procedures might be effective. We therefore recommend that the Board revisit the second bullet of paragraph 29 and clarify how it is intended to be considered and applied by the auditor.

Paragraph 31

Paragraph 31 includes an overall requirement for the auditor to assess the reliability of confirmation responses and then continues with a detailed requirement that the auditor take into account each of the factors listed in paragraph 31, presumably for *each* confirmation response. We believe this to be overly prescriptive. We also believe that it imposes an unduly burdensome obligation for the auditor to document the consideration of each and every factor on the list for every confirmation received, particularly as the number of confirmation responses increases. We assume that this is not what the Board intends, and therefore believe additional clarification is necessary.

Alternatively if the Board really intends for each and every factor to be specifically and individually considered, then we believe that point should be clarified too. If that is the case, we are concerned that the incremental effort that will be required will not necessarily result in a corresponding increase in audit quality. It is also not clear to us how the auditor might demonstrate how some of the factors have been “taken into account”, in the absence of

some indication of a problem. For example, it is unclear how the auditor might demonstrate how he or she has “taken into account” that the response does not appear to have come from the originally intended confirming parties. The evaluation of the reliability of confirmation responses is an area where the auditor needs to exercise professional skepticism and professional judgment.

We recommend redrafting the requirement in paragraph 31 as a list of factors that the auditor *may* consider, in conjunction with the appropriate level of professional skepticism, in assessing the reliability of confirmation responses. This will allow the auditor to perform the procedures that most appropriately address the risk of material misstatement.

We also recommend that the guidance in this paragraph be revised to only require additional audit evidence to be obtained if the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request.

Paragraph 32

The auditor will likely not be in a position to assess the indications set forth in the first two bullets of paragraph 32 (i.e., that the confirming party is not competent or knowledgeable, and/or has questionable motives). We recommend deleting the first two bullets of paragraph 32 and instead, emphasizing the need to exercise professional skepticism when evaluating the reliability of a confirmation response.

In addition to the above the purpose of, and message in, the note to paragraph 32 is unclear. Although it appears in a section that relates to the evaluation of the reliability of audit evidence, the note describes circumstances that may indicate the need for additional audit evidence to conclude whether the confirmation request “is being sent to or received from a confirming party from whom the auditor can expect the response to provide relevant and reliable audit evidence.” We have two observations regarding this statement:

1. Performing audit procedures to determine whether a confirmation is being *sent* to a confirming party from whom the auditor can expect the response to provide relevant and reliable audit evidence seems to be a confirmation design issue. Paragraph 32 and the section in which it appears do not discuss the design of confirmations.
2. It is not clear why the auditor needs to proceed with a confirmation request if the additional evidence obtained indicates that the auditor cannot expect the response to provide relevant and reliable audit evidence.

We suggest revising the paragraph to more closely align the guidance with the subject of the section (reliability of confirmation responses) and adding guidance on how to proceed if the additional evidence indicates that the auditor cannot expect the confirmation response to provide relevant and reliable audit evidence.

The Note to paragraph 32 indicates that “when the confirming party is the custodian and servicer of a material amount of the company’s assets” may be a circumstance that indicates the need for additional evidence to conclude whether the confirmation request is being sent to or received from a confirming party from whom the auditor can expect the response to provide relevant and reliable audit evidence. We believe this may be referring to situations involving custodians and investment advisors. We request that the Board further clarify what is intended by this reference in the Note, and what additional evidence might be appropriate in this circumstance.

Other Observations

Confirmation of the Accounting Support Fee

Although not mentioned in the Proposed Standard, PCAOB Rule 7103(b) requires auditors to obtain a confirmation from the PCAOB that an issuer has paid its share of the accounting support fee *before* issuing an unqualified audit opinion. This requirement is not addressed in the Proposed Standard. We believe that the Board intended for the requirement to serve as a reliable and cost-effective means of maintaining integrity in the assessment and collection process. However, since adopting the Rule, the PCAOB has developed a mechanism to identify and collect payment from delinquent issuers.⁹

We therefore believe that it is inappropriate for the PCAOB to delegate responsibility for maintaining the integrity of the assessment and collection of the accounting support fees to the registered accounting firms that it is charged with overseeing and for the registered accounting firms to provide collection assistance to the entity responsible for regulating them.

Additionally, we believe it is inappropriate for auditors to have to withhold issuance of an audit report until the required confirmation is obtained from PCAOB. The confirmation that is the subject of Rule 7103 does not constitute audit evidence and the purpose for which it is obtained does not relate to auditing standards or improving audit quality. The Board's standards already address the auditor's consideration of illegal acts such as the one that would result from nonpayment of accounting support fees.¹⁰ Therefore, we believe that the auditing standards provide the appropriate mechanism for addressing accounting support fees in the context of an audit.

Furthermore, issuers have sufficient incentive to pay the support fee in order to avoid late fees and violating SEC rules. Based on the PCAOB's financial statements, the PCAOB's collection rate has been close to 100% every year beginning in 2004 (approximately 99.7% for 2009 and 99.9% for each year prior to 2009).

Based on the above, we recommend that the PCAOB delete Rule 7103(b).

⁹ The PCAOB posts a list on its website of all issuers that have paid the accounting support fee. The list is updated on a weekly basis.

¹⁰ After 90 days of nonpayment, the PCAOB can report the delinquency to the Securities and Exchange Commission, and, according to the Rule, the failure to pay would be deemed a violation of Section 13(b)(2)(C) of the Exchange Act of 1934 and could result in administrative, civil, or criminal sanctions.



Ernst & Young LLP
925 Euclid Avenue
Suite 1300
Cleveland, OH 44115
Tel: 216 861 5000
www.ey.com

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

13 September 2010

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

Dear Office of the Secretary:

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

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

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

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

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

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

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

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

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

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

Importance of principles-based standards

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

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

Operational concerns of certain aspects of the proposal

Concerns related to certain procedures or information required to be obtained

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

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

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

Use of internal audit function in the confirmation process

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

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

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

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

Inclusion of requirements within illustrative examples

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

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


PCAOB standards setting process

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

* * * * *

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

Sincerely,



Attachment

Specific comments

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

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

Confirmation of specific accounts

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

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

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

Confirmation procedures

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

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

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

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

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

Evaluation

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

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

When *the auditor determines that* a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires.

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

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



Federation of European Accountants
Fédération des Experts comptables Européens

13 September 2010

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

Email: comments@pcaobus.org

Ref.: AUD/HvD/HB/LA/SH

Dear Sir or Madam,

Re: FEE Comments on PCAOB Release No. 2010-003, PCAOB Rulemaking Docket Matter No. 028 on Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards

FEE is pleased to provide you below with its comments on the Public Company Accounting Oversight Board (PCAOB) Release No. 2010-003, Rulemaking Docket Matter No. 028 on Proposed Auditing Standard Related to Confirmation And Related Amendments to PCAOB standards.

Our main comments as well as our responses to the questions included in the proposed auditing standard on confirmations are enclosed below.

The benchmark auditing standards are the clarified International Standards on Auditing (ISAs)

FEE welcomes the PCAOB's initiative to align its standards with the clarified ISAs as a step towards the ultimate worldwide application of one set of auditing standards for capital market entities and also other entities.

FEE has been advocating the use of the (clarified) ISAs in the European Union (EU) for over ten years. In addition, the worldwide use of the ISAs has steadily expanded over the last few years, making ISAs the global benchmark auditing standards. In 2009, FEE has reconfirmed its support for ISAs in Europe in the FEE Policy Statement on International Standards on Auditing (ISAs)¹.

1

<http://www.fee.be/fileupload/upload/Auditing%20and%20Assurance%20PS%20I%20International%20Standards%20on%20Auditing%20%28ISAs%29%20I%20090430145200923149.pdf>



In general, FEE believes that uniformity in auditing standards worldwide, to the maximum degree possible, is beneficial for capital market participants with cross-border interests and global activities and enhances the quality of audits based on globally accepted auditing standards at national level, including the acceptance of audit reports beyond home jurisdictions as well as enhancing confidence in the reliability, comparability and consistency of financial statements.

Towards globally accepted auditing standards or convergence?

We acknowledge that the PCAOB issues standards separately from, and different to, those of the IAASB because the PCAOB standards need to take into account other items like national U.S. securities law, U.S. Securities and Exchange Commission (SEC) laws or regulations and other PCAOB rulemaking, for instance resulting from an integrated audit approach. Therefore, some differences between PCAOB standards and ISAs are inevitable.

However, we believe that it is not conducive to international convergence of auditing standards for the PCAOB to issue auditing standards that differ from the (clarified) ISAs at a technical level for other than these US legal reasons. The (clarified) ISAs reflect the product of an intensively overseen and thorough due process involving extensive consultation at an international level, including input from regulators, such as the PCAOB. Consequently, at an international level the ISAs are widely accepted benchmark of high quality auditing standards.

FEE main comments

FEE commented to the Concept Release 2009-002 on Possible Revisions to the PCAOB's standard on Audit Confirmations in its letter from May 2009² and we are pleased to see that the PCAOB has followed our recommendations to align with the international requirements to some extent, especially regarding the objective of the standard, negative confirmations and management requests not to confirm.

However, considering the proposed auditing standard on confirmation, we believe that the response to requests for further guidance and explanations has resulted in additional rules and requirements instead of explanatory material. It is therefore relevant to reiterate our key comments which were the following:

- Although the PCAOB has recently published auditing standards related to the auditor's assessment of and response to risk, the many questions in the proposed standard as to whether auditors should be required to perform specific procedures appear to diverge from a risk-based approach. Such divergence encourages a rules-based and mechanical and procedural approach to auditing standards;
- It might be useful to emphasise that external audit confirmation should not be conducted routinely without the use of professional judgement and to put additional focus on alternative audit procedures, as adequate responses of third parties to all external audit confirmation cannot be taken for granted.

In addition to the above mentioned points, one of the main comments made in response to the previous Concept Release related to the presumed mandatory requirement for external

²

<http://www.fee.be/fileupload/upload/Seymour%20090529%20Possible%20Revisions%20to%20PCAOBs%20Standards%20on%20Audit%20Confirmations256200911853.pdf>



audit confirmations. The PCAOB is proposing to retain, indeed even extend, this presumed mandatory requirement in this exposure draft. In addition, the proposed standard does not carry forward the current exceptions for not confirming receivables; in total a solution about which FEE has serious concerns. In contrast, the IAASB refers to the risk assessment to determine when external audit confirmation ought to be performed. The more rules-based approach chosen by the PCAOB might discourage the use of professional judgement, which may, in comparison with an effective application of a truly risk-based approach, have an adverse affect on audit quality.

Please find hereunder our comments on the main part of the questions raised in the proposal. Please note that we have no further comments on questions 4, 7, 10, 14, 16, 18, 23 and 26.

Question 1

Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

The definitions related to confirmations in the PCAOB proposed auditing standard on confirmations and the ISA on this subject matter, ISA 505³, are clearly comparable and broadly similar. The differences that exist, mainly regarding positive confirmation requests, external confirmations and exceptions, appear to be limited and insignificant with no difference of substance. We appreciate that the PCAOB's and the IAASB's definition of a negative confirmation request are identical.

However, we would like to raise two minor points regarding the definitions:

- The definition of Confirmation Response appears to have to be read in conjunction with the definition of Direct Access, as it is not apparent how information the auditor obtains using direct access, interrelates with the confirmation response unless these definitions of Direct Access and of Confirmation Response are read in conjunction with each other;
- As this section of the proposed auditing standard deals solely with definitions and not requirements, the definitions may be clearer were the phrases "*...is audit evidence, but...*" within the definition of Confirmation Response and "*Rather that information constituted other audit evidence*" within the definition of Direct Access not included.

Question 2

Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?

And

Question 3

What other matters, if any, should the objective include?

³ ISA 505, External Confirmations



The objective according to paragraph 3 of the proposed standard is for the auditor to obtain relevant and reliable audit evidence. We support this objective as a clear and appropriate objective, which is similar to the objective of ISA 505.

We are pleased to see that the PCAOB has followed our recommendations to align the objective of the proposed standard with ISA 505 mentioned in our previous letter commenting on the Concept Release.

However, as noted earlier, the PCAOB appears to retain its presumptively mandatory requirement for external audit confirmations, although this is not explicit in the proposed objective.

In our opinion, the application of this objective allows, and does not prohibit, the auditor to use professional judgment to determine whether to use external audit confirmations as an audit procedure in an individual engagement.

Question 5

Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

In respect of confirmations of cash and other relationships with financial institutions the PCAOB proposes to extend as well as retain its presumptively mandatory requirement for external audit confirmations as paragraph 9 of the proposed auditing standard states that the auditor should perform confirmation procedures for cash with financial institutions. We refer to our main comments above, in which we express concerns at the presumed mandatory requirement for confirmations.

We acknowledge that the fourth sentence recognises the use of professional judgement by stating that the auditor should assess the risk of misstatement due to error or fraud, which is clearly in accordance with the objective in paragraph 3 of the proposed standard.

However, we would recommend that it is made clearer in paragraph 9 whether the external confirmations for cash and other relationships are intended to be mandatory in all cases. This clarification could be within the first sentence of paragraph 9 giving this specific point more prominence in this quite extensive paragraph.

Question 6

Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

The requirements of proposed paragraph 10 essentially achieve the same objective as material in ISA 330⁴. There is a difference in approach, as the IAASB standards are

⁴ ISA 330, The Auditor's Responses To Assessed Risks



drafted in line with principles, rather than a rules-based approach, which is, in our view, preferable.

Question 8

Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

Paragraph 11 of the proposed auditing standard would be more appropriate, and consistent, if it were aligned with the approach adopted by the IAASB in ISA 330, where this aspect is a possible, but not mandatory, use of confirmation procedures. In this way, the standard would make it clear that the auditor should use his professional judgement in determining what might be an appropriate response to obtaining audit evidence. This could be clarified in paragraph 11.

Question 9

Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements for maintaining control over the confirmation process are clear. However, we consider them inappropriate, because they are far too prescriptive and rules-based without the potential to significantly increase the quality of the audit. The excessive attention to detail will result in auditors focussing on compliance with detailed requirements of the standard instead of its ultimate objective, which is for auditors to use their judgement in designing and performing confirmation procedures to obtain relevant and reliable audit evidence.

Question 11

Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

The list of factors for designing confirmation requests in paragraph 16 is very similar to the list in paragraph A4 of ISA 505. FEE appreciates the alignment with the international requirement in this regard. In addition, the part of paragraph 17 of the proposed auditing standard that relates to negative confirmations are almost identical with the requirements on this in paragraph 15 of ISA 505, except for the last two bullet points.

Paragraph 16 of the proposed auditing standard includes a reference to local customs that might influence confirmation responses, such as responding without verifying the information. In our view this comment constitutes guidance, rather than a requirement, and could be included as a footnote to paragraph 16 instead of a requirement. The use of professional judgement is crucial in assessing whether confirmation requests, also under local customs, are an effective and efficient manner of obtaining audit evidence rather than merely stating the fact that such a situation can occur in practice.

When considering negative confirmations in paragraph 17 of the proposed auditing standard, the PCAOB appears to expect that the auditor will be able to overcome anticipated ineffectiveness of confirmations by adjusting the design of confirmation



requests. In some specific industries and cultures, we believe this might not be the case, as, for instance, where companies have a clear policy never to respond to confirmations.

The second sentence of paragraph 17 of the proposed auditing standard reads “*A positive confirmation request provides audit evidence only when a response is received directly by the auditor from the confirming party.*” The sentence appears superfluous as requirements and the definition of positive confirmation covers the issue when stating “*...the confirming party respond directly to the auditor ...*”.

We refer to question 22 regarding our comments related to intermediaries.

Question 12

Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

The part of paragraph 17 of the proposed auditing standard that addresses negative confirmations is almost identical with paragraph 15 of ISA 505, and as mentioned above we appreciate the alignment with the international approach as well as that the PCAOB has followed our recommended approach to this issue in our previous letter from May 2009 on the Concept Release.

The main difference between the proposed auditing standard and ISA 505 is the inclusion of the last sentence of paragraph 17 that requires additional substantive procedures to supplement the use of negative confirmation requests, as it is the view of the PCAOB that even when all factors as set out in the bullet points are fulfilled, the audit evidence obtained remains limited.

FEE questions whether these supplementary substantive procedures would be necessary in every case where of the four required criteria are fulfilled. In this context, the ISAs⁵ require (i) the auditor to obtain more persuasive audit evidence the higher the auditor’s assessment of risk and (ii) the auditor to conclude whether sufficient appropriate audit evidence has been obtained. The IAASB recognised that there may be some circumstances in which the auditor judges that, provided certain criteria (similar to those required by the PCAOB) are fulfilled, negative confirmations can provide appropriate sufficient audit evidence. In our opinion such a risk-based approach, inclusive of the use of professional judgement, would lead to higher audit quality compared to using substantive procedures in all cases.

On the two points where the proposed auditing standard differs from ISA 505, we note the following observations:

- The PCAOB has chosen not to apply the seemingly higher threshold of paragraph 15 (c) of ISA 505 in requiring a “*very low exception rate*” as a condition for conducting negative confirmations, rather than the “*low expectation rate*” set out in paragraph 17 on the PCAOB proposed auditing standard. We find the ISA 505 approach of a “*very low expectation rate*” sufficient and appropriate when it comes to negative confirmations.

⁵ ISA 330 paragraphs 7(d) and 26 supplemented by ISA 200 paragraph 17 and relevant application material



- The last bullet of paragraph 17 of the proposed auditing standard states that “...*The auditor reasonably believes that the recipients of negative confirmation requests will give such requests consideration*”. The corresponding paragraph 15 (d) of ISA 505 states that “*The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests*”. In our view, that approach chosen in ISA 505, requiring a negative judgement (...not aware of ...) instead of the positive (...the auditor believes...) sets a more practicable threshold, and seems appropriate in the context.

Question 13

Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

In our May 2009 response to the Concept Release we highlighted that, when using external audit confirmation procedures, the auditor should be required to maintain control over external audit confirmation requests, including designing the confirmation request, which also includes determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor.

In line with the risk-based approach, guidance would be useful in this respect as provided in paragraph A6 of ISA 505, which specifies that determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out. In practice, it might very well be the case that IT technology will allow for some direct confirmation with a third party in a way, via secure connections, for instance. This should be kept in mind when designing these principles regarding the validity of addresses.

We remain of this view that it is unnecessary to require substantive tests of all addresses. Therefore, we recommend that it is made clearer in paragraphs 18, 19 and 20 in the proposed auditing standard that the auditor should use professional judgement, in accordance with the objective in paragraph 3, to assess to which level of detail substantive procedures are necessary, having the risk of fraud in mind.

Question 15

Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

In our May 2009 response to the Concept Release we recommended alignment with material based on paragraphs 8 and 9 of ISA 505 and accompanying application material. We appreciate that the PCAOB has followed our recommendations as set out in the requirements regarding “*Management Requests Not To Confirm*” in paragraphs 23 and 24.

Although paragraphs 23 and 24 the proposed requirements are not identical with the corresponding ISA requirements, we support the underlying attention of the use of professional judgement to determine whether there are valid reasons for management’s request or refusal not to confirm, the audit evidence and the evaluation in relation to fraud



along with the design of alternative audit procedures, which is clearly in accordance with the objective in the proposed paragraph 3.

If the auditor has previously obtained audit evidence as to the appropriateness of management's request not to confirm particular information and has been able to obtain relevant and reliable audit evidence from the alternative procedures required pursuant to sections a and b of that paragraph, then FEE believes that it should be up to the judgement of the auditor whether this needs to be communicated to the audit committee.

In addition, the communication of the request not to confirm to the audit committee and its inclusion in the management representation letter may be more appropriate if it is done on a summary basis in order to avoid overloading the audit committee and management representation letter with excessive or insignificant information. FEE believes that communicating these matters only where the auditor concludes that management's request is unreasonable, in line with paragraph 9 of ISA 505, would be sufficient and also more appropriate than the proposed approach. FEE suggests the proposed standard be amended accordingly.

Question 17

Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

Paragraph 27 of the proposed standard requires the auditor to follow up a non-response with a second and possibly third request for confirmation.

Audit quality may not necessarily be increased if auditors are required to send audit confirmation requests if both past experience and responses to the first confirmation requests indicate that second or third requests are unlikely to lead to an increase in effectiveness of the confirmations. Similarly, audit quality may not be increased in cases where expected response rates are very low, based on either policies of the third party or industry or jurisdiction customs and habits.

The auditor could also end up spending excessive time without obtaining any valuable audit evidence if it is known in advance that any responses will include disclaimers that render such responses of limited value as audit evidence.

Instead, the auditor could be required to use professional judgement in applying alternative audit procedures to determine how to achieve effective and efficient audit evidence.

Therefore, we suggest paragraph 27 be reworded in terms of "*the auditor should consider follow up with a second request...*", instead of "*the auditor should follow up with a second request...*". In addition, we do not see a need for including requirements related to considerations with regards to a third request in all cases, as a third request, if considered effective, should be left up to the professional judgement of the auditor and not be regulated.



Question 19

Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

Pursuant to the application material in paragraph A21 of ISA 505 if, in investigating exceptions, the auditor identifies a misstatement, the auditor is further required to evaluate whether the misstatement is indicative of fraud. We note that the proposed auditing standard does not mention a similar requirement. This may need to be addressed as the PCAOB completes its risk standards, and a reference to the relevant paragraph in auditing standard 14 is included.

Question 20

Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

There could be a risk that the proposed auditing standard sets too high expectations in respect of the auditor's procedures and their capabilities in relation to the reliability of confirmation responses.

Paragraph 10 of ISA 505 requires the auditor to obtain further audit evidence to resolve doubts about the reliability of a response to a confirmation request only if the auditor identifies factors that give rise to doubts about the reliability. In the absence of such factors the auditor does not seek to confirm or discount reliability. Furthermore, only when the auditor determines that a response is not reliable, then paragraph 11 of ISA 505 requires the auditor to evaluate the implications further.

In contrast, paragraph 31 of the proposed standard states *"The auditor should assess the reliability of confirmation responses"* without qualifying this requirement in any similar manner. The proposed auditing standard sets a far lower threshold in requiring the auditor to obtain additional audit evidence if conditions indicate that a confirmation response might not be reliable.

This may lead to expectations that are impracticable, as the auditor can only react to matters of which the auditor becomes aware or that represent the auditor's own findings and determinations. A more principles-based approach could therefore be preferable.

Question 21

Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

Responses received electronically involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. The main issue is to mitigate the risk of manipulation and fraud which might be, but not necessarily is, greater than with traditionally mailed confirmations.



However, direct contact with the intended confirming party is not necessarily the only way to verify the source of a response received via facsimile or e-mail (e.g., recourse to directories etc. may be an alternative).

In addition, confirming the content of a response directly with that party might not be needed in every case where responses are received by facsimile. This is not required in respect of responses received by any other means, and facsimile does not seem to include higher risk in this respect than other sources.

Therefore, we suggest that the introduction of paragraph 34 be revised as follows:

“Confirmation responses received electronically (e.g. by facsimile, e-mail, through an intermediary, or direct access) may involve additional risks relating to reliability. In such circumstances, in addition to the factors identified in paragraph 31, the auditor should take into account risks that the confirmation process might not be secure or might not be properly controlled.”

Also, we do not agree that fax and e-mail procedures (paragraph 35) should include an automatic requirement to be performed in all cases. They should be expressed in terms of *“the auditor shall consider the need to...”*. The alternate formulation would take account of enhanced security of the electronic confirmation process, for example, the use of encryption.

Question 22

Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

The risks occurring when using an intermediary is dealt with in the third bullet point of paragraph 35 of the proposed auditing standard.

An issue that is not addressed in the proposed auditing standard is the assurance work related to internal controls of intermediaries. If an intermediary is used, assurance could be provided or required to assure the internal controls of the intermediary. Therefore, the PCAOB could add further explanation as to how it foresees that the auditor might review reports by other auditors (e.g., a similar concept to ISAE 3402⁶ or so-called “SAS 70” engagements). In this context the PCAOB could consider how and whether such engagements should be needed and/or performed.

The third bullet point of paragraph 35 could preferably be structured as follows:

- Firstly to address authorisation of the intermediary to respond;
- Secondly to address the auditor’s understanding of appropriate/relevant control processes at the intermediary;
- Thirdly to address the availability of an independent report on the adequacy of those processes; and
- Completion of these processes would facilitate the auditor’s determination to rely or not on the intermediary’s response.

⁶ ISAE 3402, Assurance Reports on Controls at a Service Organization



The current third sentence of the third bullet point deals with risks related to intermediaries. Risks are already addressed in paragraph 34, and the PCAOB is encouraged to consider whether these two paragraphs should be dealt with in the same paragraph or in two paragraphs. In any case, these requirements related to risk could preferably be given a more prominent place in the paragraph.

Question 24

Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

As discussed in our response to question 23 direct access is a complex issue. In this respect, the PCAOB could consider including requirements for the auditor to seek similar verification of the system to which direct access is provided. For example, consideration of the process by which the auditor is registered for limited period direct access might be relevant.

Question 25

Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

Allowing direct access to be used would require that the third party has systems that can provide reliable and high quality confirmation responses. If this is not the case the auditor needs to assess the risk of receiving information that is not sufficient as audit evidence and then design alternative audit procedures. We would not think that this would depend on whether the entity is a financial institution or not, as both financial institutions as well as other companies in practice can provide information of higher or lesser quality. Instead, this would depend on whether the entity has adequate internal control systems.

Question 27

Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

The evaluation of results is described in paragraphs 26-39 of the proposed auditing standard. These paragraphs appear to be very comprehensive, leading to a significant amount of substantive work to be carried out by the auditor.

As such, the requirements appear to be rules-based and clearly not developed having the principles-based objective in paragraph 3 of the proposed standard in mind. We would favour a more principles-based approach in line with paragraph 16 and the application material in paragraphs A24-A25 of ISA 505 as this, in our view, would not lead to reliance on responses that may not be as reliable as alternative procedures in some circumstances. We would like to remind the PCAOB that we suggested this approach in our response to the Concept Release in May 2009 and as set out here, we would like to repeat this recommendation as it in our view would be the most appropriate one.



Overall, it is our view that the approach to use professional judgement to a greater extent would lead to higher quality in the audit evidence compared to the time needed to carry out the procedures set out in paragraphs 26-39 of the proposed auditing standard.

For further information on this FEE⁷ letter, please contact Hilde Blomme at +32 2 285 40 77 or via email at hilde.blomme@fee.be or Lotte Andersen at +32 2 285 40 80 or via email at lotte.andersen@fee.be from the FEE Secretariat.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Hans van Damme', written over a horizontal line. The signature is stylized and includes a large circular flourish on the left side.

Hans van Damme
FEE President

⁷ FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.



September 13, 2010

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

Audit - Tax - Advisory

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687

T 312.856.0200

F 312.565.4719

www.GrantThornton.com

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

Dear Board Members and Staff:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (Board or PCAOB) *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* and respectfully submit our comments and recommendations.

We support the Board's initiative to revise its interim standard extant AU sec. 330, *The Confirmation Process*, by strengthening the auditor's responsibilities related to confirmation procedures, particularly those responsibilities that relate to electronic confirmations and disclaimers and restrictive language. We also acknowledge the Board's consideration of the comments it received in response to its *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (Concept Release) and of International Standards on Auditing (ISA) 505, *External Confirmations*, in drafting the proposed standard. However, we have significant reservations as to the proposed standard's operability, efficacy, and transparency. We provide herein our overarching concerns and responses to the Board's specific questions.

We believe that the proposed standard is overly prescriptive and will unnecessarily increase the cost of an audit without a corresponding benefit in audit quality. The numerous presumptively mandatory responsibilities to confirm certain accounts and transactions, as well as those responsibilities pertaining to the selection of the confirming party and the validity of the addresses on confirmation requests, do not seem consistent with the risk assessment concepts the Board recently approved. We understand the Board's intention to require the use of confirmation procedures to address the risk of material misstatement, primarily due to fraud; however, we believe that the proposed standard over relies on the use of such procedures to attempt to reduce such risk to an acceptable level. In certain situations, confirmation procedures may not be the most effective or efficient procedure to respond to the assessed risk, even those deemed to be significant risks. This can increase the cost of an audit because time and effort will be spent on performing confirmation procedures in lower risk areas when alternative procedures may be more effective. Cost may also increase because of the auditor's

inability to use internal audit to the extent allowed in extant auditing standards. Further, we believe that the proposed standard will significantly increase audit documentation that is, in most circumstances, not commensurate with the assessed risks, which in our view will also unnecessarily increase the cost of performing audits.

We would like to also reiterate concerns we have previously expressed with regard to the Board's drafting conventions. We disagree with the Board's elimination of essential guidance from the proposed standard and the Board's inclusion of additional requirements, or their interpretation of requirements, outside of the proposed standard within the Release. Auditors look to the Board's standards to determine their responsibilities. The Board's approach makes it quite difficult for an auditor to properly comply with those standards and is, therefore, not in the public's best interest. As a much less effective alternative if the Board retains this approach, we suggest that guidance be provided via a Staff Audit Practice Alert (Alert) so that auditors can fully understand the Board's expectations. We have made several recommendations herein with regard to the use of an Alert, particularly in reference to eliminating presumptively mandatory responsibilities that are based on examples of specific situations the auditor may encounter.

Definitions

1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

We believe that, for the most part, the definitions in the proposed standard are sufficiently clear and appropriate. We recommend, however, deleting the last sentence in the definition of the term *non-response*, which addresses situations in which disclaimer or restrictive language in a response to a confirmation request precludes the auditor from treating the response as a confirmation response. Although we agree that such response should be treated as a non-response, as required by paragraph 38 of the proposed standard, the response differs from situations where the confirmation request is either returned undelivered or the response to the confirmation request is incomplete. As indicated in our response to question 26, a response to a confirmation request that precludes the auditor from treating the response as a confirmation response may provide some, but not sufficiently reliable, audit evidence. Accordingly, we believe that such response should not be defined as a non-response and that the requirement in paragraph 38 is adequate to address the auditor's responsibility to obtain reliable audit evidence in these situations.

Objective

2. Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?

We believe the objective of the auditor as proposed is sufficiently clear and appropriate by focusing on the relevance and reliability of audit evidence obtained through the performance of confirmation procedures. We also appreciate that the objective was aligned with ISA 505, as we do not see a need for the objective between these standards to differ.

3. What other matters, if any, should the objective include?

In connection with our response to question 2, we do not believe there are other matters to be included in the objective.

Receivables That Arise from Credit Sales, Loans, or Other Transactions

4. Is the description of “receivables that arise from credit sales, loans, or other transactions” sufficiently clear and appropriate? If not, what changes should the Board make?

We believe that the description of *receivables that arise from credit sales, loans, or other transactions* is sufficiently clear and appropriate. However, we also believe that the requirements in paragraph 8 of the proposed standard to perform confirmation procedures for such receivables require revision to more adequately convey the auditor’s responsibilities.

The Board’s risk assessment standards, if applied properly, eliminate the need for a presumptively mandatory responsibility to confirm receivables. Presuming that an audit procedure should always be performed conflicts with the concept of identifying and responding to the assessed risks of material misstatement present in each audit. Nevertheless, we support the presumptively mandatory responsibility to confirm receivables because we agree with the long maintained auditing tenet that evidential matter obtained from an independent party outside the entity is more reliable than that secured solely within the entity. That said, the requirements proposed in paragraph 8 unequivocally eliminate all auditor judgment in determining whether confirmation procedures will reduce the assessed risk of material misstatement to an appropriately low level or whether confirmation procedures are most effective in reducing such risk based on prior experience, particularly with regard to significant risks that require special audit consideration.

Further, although the proposed standard does not explicitly include the exceptions for not confirming receivables contained in extant AU sec. 330, we note that the Release seems to include additional requirements, specifically pertaining to the effectiveness of confirmation procedures, as well as essential guidance regarding materiality and documentation. The Board particularly makes reference to AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*, as well as Auditing Standard (AS) 3, *Audit Documentation*. We believe that it is unclear whether, with these references, the Board is implicitly retaining some elements of the exceptions identified in the extant standard.

In this regard, we request the Board to maintain the currently allowable exceptions for not confirming receivables and to appropriately modify the requirements in paragraph 8 to more clearly describe the auditor’s responsibilities. We believe that this should include modifying paragraph 8 to require the auditor to consider the assessed risk of material misstatement in determining the nature and extent of the confirmation procedures, including selecting the receivables to be confirmed, rather than requiring the auditor to assess such risk when the auditor is selecting which receivables to confirm. The auditor’s responsibilities to identify and assess the risks of material misstatement are addressed by

AS 12, *Identifying and Assessing Risks of Material Misstatement*. Confirmation procedures, on the other hand, are a response to the auditor's risk assessments.

Cash with Financial Institutions

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

We believe that the requirements in paragraph 9 of the proposed standard to confirm cash and other relationships with financial institutions are fraud oriented and assume that there is always a heightened risk of fraud related to cash accounts in all audit engagements. If this were the case, the requirements may falsely convey that confirmation procedures are an appropriate and sufficient response to reduce the assessed risk of material misstatement in all or most circumstances. However, we note that there may be circumstances in which the auditor assesses risk as low and can perform other more effective and efficient audit procedures. We would not be opposed to a requirement for the auditor to confirm cash and other relationships when the auditor believes there is a heightened risk of fraud. In this circumstance, however, we believe that obtaining the confirmation itself would be insufficient, without further evaluating the related activity, reconciliations, adjustments, and relationships.

Significant Risks

6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

We do not agree with the requirement in paragraph 10 of the proposed standard for the auditor to perform confirmation procedures in response to significant risks that relate to relevant assertions that can be adequately addressed by such procedures. AS 13, *The Auditor's Responses to the Risks of Material Misstatement*, addresses the auditor's responsibilities to design and implement appropriate responses to the risks of material misstatement, including performing substantive procedures that are specifically responsive to significant risks. Although a confirmation procedure may be performed to respond to a significant risk, the auditor may determine that the confirmation procedure may not be the most effective or efficient audit procedure or that the confirmation procedure needs to be combined with other substantive procedures. In our view, to prescribe the performance of confirmation procedures for significant risks (as well as those related to agreements or transactions) as proposed in paragraph 10 challenges the Board's risk assessment standards, including the auditor's ability to vary the nature of audit procedures from year to year.

We are not opposed, however, to including a requirement similar to paragraph 19 of ISA 330, *The Auditor's Responses to Assessed Risks*, which requires the auditor to consider whether confirmation procedures are to be performed as substantive audit procedures. An Alert can

then be developed to provide additional guidance, such as that included in paragraphs A48 through A51 of ISA 330, to assist the auditor in determining whether confirmation procedures would be effective or efficient substantive procedures to respond to significant risks or other risks and, if so, the type of information to be confirmed, such as the terms of an agreement or undisclosed side agreement.

7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

Based on our response to question 6, we believe that the proposed standard should not include additional requirements with regard to sending confirmation requests in response to significant risks. The proposed standard should refer to AS 12 as a reminder to the auditor that confirmations may be the most effective response to the assessed risks.

Other Risks

8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

We believe that auditors will sufficiently understand what the Board describes as other risks, and we agree that confirmation procedures may be an effective and efficient response to certain other risks. However, in consideration of our response to question 6, we believe paragraph 11 of the proposed standard would be better placed in an Alert.

Confirmation Procedures

9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

Overall, we support the requirement in paragraph 12 of the proposed standard for the auditor to maintain control over the confirmation process. However, we have concerns related to the specificity of the supporting requirements in paragraphs 13-22. These concerns are expressed herein and also in response to the Board's related questions.

With respect to paragraph 15, we agree that the confirmation request should be directed to an appropriate confirming party; that is, one who is knowledgeable about the information to be confirmed. In many cases, the auditor selects the confirming party based on the company's records or inquiries of management or other personnel. Paragraph 15, however, requires the auditor to select the confirming party even if the company provides the auditor with the name of the confirming party. This requirement is troubling in that it indirectly implies that the auditor has a responsibility to verify the appropriate confirming party for every confirmation request based on external information. It would also seem that the auditor would need to document the procedures performed in determining that the confirming party is appropriate. Accordingly, we believe the requirement in paragraph 15 would increase the cost, but not the quality, of an audit, unless it is limited to confirmation requests that are in response to a heightened risk of material misstatement due to fraud. In

addition, for all other risks, the auditor may consider selecting a sample of the population to test based on the information being confirmed and the assessed risk of material misstatement. Regardless of the type of risk, the auditor can test the appropriateness of the confirming party in conjunction with testing the validity of the addresses on the confirmation requests.

We also believe that the examples provided in paragraphs 14 and 15 of the proposed standard should either be removed and included in an Alert or modified to eliminate the requirement. Examples should not include presumptively mandatory audit responsibilities.

10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

We believe that the proposed standard does not adequately describe the use of internal audit in the confirmation process. We also believe that the proposed standard appears to be inconsistent with the Release and with the direction provided to auditors as it relates to the use of the work of others in connection with AS 5, *An Audit of Internal Control Over Financial Reporting That is Integrated With an Audit of Financial Statements*.

Paragraph 26 of the proposed standard requires the auditor to evaluate the audit evidence obtained from performing confirmation procedures and does not permit the auditor to rely on the company or any other party for this evaluation, which includes such matters as performing alternative procedures for non-responses and investigating exceptions. The Release, however, seems to indicate that it would be appropriate to use internal audit, for example, in assembling information for the auditor to resolve exceptions. The Board seems to be drawing a fine line between what is required by the proposed standard and what is permitted by the Release. We believe that this will cause uncertainty as to the use of internal audit, as well as inconsistency in applying the standard in practice.

AS 5 adopts a risk-based approach related to the use of the work of others in consideration of their competence and objectivity. The same would seem to apply to the use of internal audit when the auditor performs confirmation procedures. We acknowledge that the Release addresses the use of internal audit in a similar manner; however, the Release is interpreting how to apply AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, in this context. We believe that the guidance provided by the Release belongs within the standard. Further, although we agree that the auditor should be responsible for maintaining control of the confirmation process and performing an overall evaluation of the results of that process, the auditor should clearly be permitted to use the work of internal audit in all other aspects of the confirmation process, while applying the same risk-based principles.

Designing the Confirmation Requests

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

We support including the factors that the auditor may consider in designing confirmation requests within the proposed standard. For the most part, we believe these factors are clear and appropriate. To provide additional clarity with regard to the auditor's consideration of these factors, however, we propose the following changes to paragraph 16:

- Stating that the factors *may* include the matters identified, rather than using the present tense to describe the auditor's responsibility. The present tense implies a required auditor action that may necessitate documentation.
- Eliminating or revising the second to last bullet pertaining to the company's authorization to the confirming party to respond to the auditor. The company's authorization is normally included within a confirmation request; it does not seem to be a factor to consider when designing the request.
- Eliminating or revising the last bullet pertaining to the consideration of local customs. Although local customs may indicate that confirmation requests are not customary in a specific jurisdiction, such customs may not indicate whether a particular confirming party will respond without verifying the information. Even so, this factor would pertain to the auditor's consideration of whether confirmation procedures will be effective in responding to the assessed risk of material misstatement, or whether, in the auditor's judgment, alternative procedures may be more effective. In this circumstance, any revisions made to the confirmation request would not seem to alter the confirming party's actions to respond without performing any verification.

Determining the Type of Confirmation Requests to Send

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

We do not concur with, nor do we fully understand, the Board's divergence from ISA 505 with regard to the use of negative confirmation requests. Although the proposed standard continues to permit the use of negative confirmation requests, it does not provide any weight to their use in consideration of the risks they are intended to address. With respect to certain financial statement assertions with a low risk of material misstatement, we believe that negative confirmation requests provide more than limited, although less persuasive, audit evidence; for example, the existence of deposits in a bank.

Under ISA 505, negative confirmation requests are permitted as the sole substantive procedure to respond to a low risk of material misstatement, whereby the auditor has obtained sufficient appropriate audit evidence with regard to the effectiveness of controls relevant to the assertion. The Board's proposed approach for these types of risks, however,

would only allow the use of negative confirmation requests when the auditor also performs other substantive procedures. In addition, for all other risks where the auditor has determined to use negative confirmation requests, the proposed standard appears to require the auditor to use a combination of negative and positive confirmation requests, regardless of the other types of substantive procedures that are available for the auditor to perform. We believe that neither of these proposed requirements is warranted in consideration of the Board's risk assessment standards. Nor do we believe that the requirements permitting the use of negative confirmation requests would need to differ for audits of financial statements of issuers, as ISA 505 establishes a rather high-bar in allowing their use as the sole substantive procedure.

Accordingly, we suggest aligning the requirements for the use of negative confirmation requests with ISA 505 and also providing guidance in an Alert to more thoroughly describe the situations in which such confirmations are typically used, particularly as the sole substantive procedure.

Determining that Confirmation Requests are Properly Addressed

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

As previously expressed in our letter to the Board in response to the Concept Release, a requirement to test all addresses would be onerous on large audits. Furthermore, a requirement to test addresses only provides limited audit evidence as to whether the confirmation reached the intended, knowledgeable confirming party. In this regard, we believe that the requirements in the proposed standard to determine the validity of the addresses on confirmation requests are both unclear and inappropriate.

Although the proposed standard permits the use of either substantive procedures or tests of controls to determine the validity of the addresses on confirmation requests and also acknowledges that the nature and extent of these procedures depend on the associated risk and materiality of the items being confirmed, the requirements in paragraph 19 are contradictory in that they also require the performance of substantive procedures for transactions or accounts that involve significant risks or are material to the financial statements. This essentially requires the auditor to determine the validity of all of the addresses on all of the confirmation requests required by paragraph 10 by only performing substantive procedures. Furthermore, while the auditor may be able *test* the validity of the addresses, the auditor cannot *determine* with certainty that all addresses are valid. In addition, as indicated in our response to question 14, invalid addresses are ordinarily identified when the confirmation request is returned undeliverable or, sometimes, when no response is received. Accordingly, we believe that the proposed requirements are not operational and that the anticipated benefits do not outweigh the costs.

We propose a requirement for the auditor to test, either through tests of controls or substantive procedures, the validity of some of the addresses on confirmation requests. In consideration of our response to question 9, such tests would ordinarily be performed in conjunction with testing the appropriateness of the confirming party when there is a heightened risk of material misstatement due to fraud. For all other risks, the auditor may consider selecting a sample of the population to test based on the information being confirmed and the assessed risk of material misstatement. For example, an auditor might be more likely to test the address of a party confirming a large, unusual transaction, and less likely to test the addresses of parties confirming many, small account balances. The factors the auditor may consider in testing the validity of the addresses and examples of tests of controls and substantive procedures the auditor may perform can be included in an Alert.

14. Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

We agree that the auditor should have a responsibility to develop an appropriate response when the auditor believes that the addresses on confirmation requests are invalid. Nevertheless, we believe that the requirement in paragraph 20 is unnecessarily prescriptive.

As indicated in our response to question 13, the auditor may be able to test the validity of the addresses, but cannot determine with certainty that the addresses are valid. We assume that the circumstances in paragraph 20 would primarily relate to situations in which the address provided by management on the confirmation request does not agree with the company's records or, in some cases, an external source. Yet, we believe that invalid addresses are ordinarily identified when the confirmation is returned undeliverable or, sometimes, when no response is received. In such cases, however, the auditor treats the confirmation as a non-response.

Accordingly, we suggest streamlining the requirement. For example, if the auditor believes that based on the tests performed that an address is invalid, the auditor should perform additional audit procedures as necessary to resolve the matter. If the matter appears to be intentional and therefore, is indicative of a risk of material misstatement due to fraud, the auditor should evaluate the implications on the audit.

Management Requests Not to Confirm

15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

We agree with the requirement in paragraph 23 of the proposed standard, which addresses the auditor's responsibility to understand management's reasons for the request not to confirm, as well as to obtain audit evidence as to the appropriateness of those reasons.

We do not entirely agree with the requirements in paragraphs 24 and 25 of the proposed standard, which differentiate the auditor's responsibility based on whether the auditor determines that management's request is appropriate, and therefore, agrees to the request. For example, we believe that regardless of whether the auditor agrees to management's request, the auditor should evaluate the implications on the auditor's relevant risk assessments and other audit procedures. Also, the auditor should not be required to communicate management's request to the audit committee or obtain written representations from management for each instance in which the auditor agrees with the request and is also able to perform alternative audit procedures to obtain sufficient appropriate audit evidence. Such communications and representations may be based on the nature of the information being confirmed, the assessed risk of material misstatement, and the audit evidence obtained to determine the appropriateness of management's request. Further, if the auditor agrees to management's request and also obtains sufficient appropriate audit evidence by performing alternative audit procedures, a significant management-imposed scope limitation does not exist and there is no associated implication on the audit report.

Our proposal to address these matters is to align the requirements in paragraphs 24 and 25 with the requirements in paragraphs 8(b-c) and 9 of ISA 505.

Evaluation

16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?

In most circumstances, we believe that the auditor should perform alternative procedures for all non-responses to positive confirmation requests. However, we are uncertain as to why the Board chose to eliminate the possible exception to this rule in paragraph .31 of extant AU sec. 330. If the auditor meets the criteria for the omission of alternative procedures in this paragraph, it may be appropriate not to perform alternative procedures. We believe this would be an acceptable audit strategy because the non-response is treated as an error and projected to the population, and the potential misstatement is then evaluated individually and in the aggregate. Accordingly, we suggest that the Board retain the exception in extant AU sec. 330, but also clarify that, even if the criteria were met, omitting alternative procedures would not be appropriate if the confirmation request was in response to a specific, heightened risk of fraud.

17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

We believe that the additional procedures that are required in paragraph 28 with regard to the terms of a significant transaction or agreement, as well as those in the note to paragraph 28 with regard to accounts receivable and accounts payable are not appropriate because they are too prescriptive. Such requirements do not belong in the Board's

standards; rather, they would be better placed as guidance to the standard or in an Alert that provides guidance on how to apply the requirements. We believe that the Board's standards should remain principles-based.

When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence

18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

We are concerned by the question posed by the Board. Although there may be other circumstances that the auditor encounters where the auditor concludes that a positive confirmation request is necessary, we do not believe the proposed standard should include a rigid list of circumstances that will always yield this conclusion. We prefer the ISA approach, which identifies the same circumstances as being situations that *may* result in this conclusion. For instance, the second bullet in paragraph 29 does not seem operational with respect to being a circumstance where a positive confirmation is necessary because the risk of management override of controls always exists. Yet, the fact that there is a specific fraud risk factor pertaining to management override may cause the auditor to make this conclusion. It is a matter of judgment, however, in determining whether the positive confirmation request is necessary in the particular circumstances.

Exceptions

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

We believe that the requirement in paragraph 30 of the proposed standard to investigate all exceptions in confirmation responses is clear and appropriate, except as it relates to the use of internal audit, as indicated in our response to question 10.

Reliability of Confirmation Responses

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

We have several concerns related to the requirements in paragraphs 31 and 32 of the proposed standard addressing the reliability of confirmation responses.

Paragraph 31 contains a list of factors that the auditor should take into account in assessing the reliability of confirmation responses. Although this list is rather helpful, we believe the requirement itself will create an excessive and needless documentation burden in illustrating how the auditor complied with this presumptively mandatory responsibility for each confirmation response. Accordingly, we suggest that the proposed standard be revised to

indicate that the list represents factors that the auditor *may* consider in assessing reliability. Alternatively, the factors may be included in an Alert. We also refer the Board to our response on question 11 as it relates to local customs. As local customs may be considered by the auditor in determining whether to use external confirmation procedures, we believe that this particular factor should be removed.

Paragraph 32 requires the auditor to assess any indication that the confirming party is not competent or knowledgeable, has questionable motives, or is not objective or free from bias with respect to the company. We believe that the auditor is incapable of making this assessment by simply evaluating the confirming party's written response. Any such assessment can be made, albeit limited, through direct contact and inquiry of each confirming party or through other information that may come to the auditor's attention during the course of the audit that may indicate such. We strongly recommend that this requirement be eliminated.

Additional Procedures for Electronic Confirmation Responses

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

As electronic confirmation procedures are becoming more widespread, we commend the Board for addressing the auditor's responsibilities related to such procedures. Overall, we support the additional requirements regarding electronic confirmation procedures and believe they are adequate. We do have some specific comments and concerns about the requirements related to the use of an intermediary and direct access, which are provided below in response to the Board's related questions.

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

We agree with the requirements pertaining to the use of an intermediary to process confirmation requests, including the risks the auditor considers in determining whether to use the intermediary's process. We believe that such risks have been adequately addressed by the proposed standard.

We do, however, recommend that the Board clarify the following matters:

- That the nature and extent of the auditor's procedures to determine whether the auditor can use the intermediary's process *may* take into account the information being confirmed, the assessed risk of material misstatement, and other tests of controls or substantive procedures being performed to respond to the assessed risk.
- That the audit team may rely on the firm's system of quality control in determining whether to use the intermediary's process and that the related audit documentation need only include a reference to the firm's central repository, in accordance with AS 3, *Audit Documentation*.

23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.

It is our understanding that the PCAOB staff has obtained some information with regard to the services that an intermediary provides and the related responsibilities of the parties involved based on discussions held in association with the Concept Release. We suggest that the Board hold similar discussions with the intermediaries themselves.

24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

The proposed standard does not include specific risks related to direct access. However, regardless of the form of the confirmation response, there is an inherent risk of alteration or fraud, particularly when there is a risk of collusion. Accordingly, we believe that the risks related to direct access are similar to the risks related to the use of an intermediary's process; that is, the information might not be secure or from a proper source, or the integrity of the information might have been compromised. We believe that these risks are mitigated by the requirement to obtain a written affirmation from the confirming party, as described in the note to paragraph 35 of the proposed standard. The auditor, however, may also consider inquiring of the confirming party as to management's ability to modify the information held by the confirming party.

With respect to paragraph 35, we do not agree with the requirement related to revenue agreements. We believe that requirements should not be based on examples. Also, we do not believe that revenue agreements can be confirmed via direct access, which this paragraph inappropriately implies. An Alert can include examples of situations in which direct access is most likely used and effective.

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

We believe that a principles-based standard should allow direct access as a confirmation response regardless of the type of entity providing such access. A standard that appropriately addresses the risks involved need not limit the use of direct access as a confirmation response from a financial institution. Also, other entities that may not be considered financial institutions, such as mortgage servicers, may also provide direct access.

Disclaimers and Restrictive Language

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

We concur with the Board that "...the use of disclaimers and restrictive language has become more prevalent and that it raises issues for auditors regarding their reliance on

confirmation responses.” Accordingly, we support the additional requirements in the proposed standard related to such disclaimers and restrictive language.

Nonetheless, because the extent of reliance on a confirmation response is affected by the nature of the disclaimer or restrictive language, we believe that an Alert can provide additional guidance to the auditor by comparing and contrasting boilerplate disclaimers and restrictive language that may not affect reliability and other language that causes doubts about reliability. This Alert can also differentiate situations in which the entire confirmation may be unreliable from those whereby only a portion of the confirmation may be unreliable because the disclaimer or restrictive language only affects certain financial statement assertions. The Alert can further include the illustrative disclaimers and restrictive language identified by the Board in the Release and can also provide examples of language that could preclude the auditor from treating the response as a confirmation response. It should be noted, however, that even if the disclaimer or restrictive language precludes the auditor from treating the response as a confirmation response, such response may provide some, but not sufficiently reliable, audit evidence about the matter being confirmed.

Evaluating Results

27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

We believe that the requirements related to evaluating the results of confirmation procedures are clear and appropriate and that no changes need to be made by the Board.

Proposed Amendments to PCAOB Auditing Standards

In consideration of our comments herein, we also request the Board to reconsider the proposed amendments in Appendix 2. In particular, we believe the following:

- We believe that the amendment to AU sec. 322 may be misinterpreted as a simple modification of the examples of assertions that might have low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence. However, in concert with the statements made in the Release, it can be interpreted to imply that cash and pre-paid assets should never be assessed as having low risk, and the auditor should not use the work of internal audit in these areas. Depending on the nature of the entity and the assessed risks of material misstatement, we believe that this often is not the case. Regardless, the Board should unambiguously indicate its position on this matter, rather than modifying what is clearly just an example.
- The amendment to AU sec. 331, *Inventories*, will now require the auditor, in all circumstances, to confirm inventories that are in the hands of public warehouses or other outside custodians. The Board should reconsider the necessity of this requirement if the auditor performs the procedures listed in paragraph .14 of AU sec. 331 when the inventory

represents a significant proportion of current or total assets. In this situation, we believe that the auditor need not confirm inventories with the custodians.

We also believe that the amendments to AU sec. 333, *Management Representations*, should be eliminated based on our responses to questions 15 and 17.

Comparison of Objectives and Requirements with Other Analogous Standards

We support and appreciate including a comparison of the significant differences in the objectives and requirements of the Board's standards and those of the International Auditing and Assurance Standards Board (IAASB) and the American Institute of Certified Public Accountants (AICPA). However, we believe that the comparison in the proposed standard is quite cumbersome and propose that the Board consider the following:

- Eliminate comparisons in which the Board believes that the IAASB and AICPA include similar objectives or requirements whereby the auditor's actions are not expected to differ.
- Indicate the additional objectives or requirements included in the Board's standards that are not included in the IAASB or AICPA standards by simply referencing the relevant paragraphs and the related topic, rather than repeating those objectives or requirements.
- Not include objectives or requirements, or any essential guidance that is necessary to understand the auditor's responsibilities that is not also included in the Board's standards.

We would be pleased to discuss our letter with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Sincerely,





September 13, 2010

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the *Proposed Auditing Standard Related to Confirmation*. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of our Committee are outlined in Appendix A to this letter.

While we support the PCAOB’s standard setting project to update its interim standards related to confirmation to more appropriately acknowledge environmental and other changes over the past 15 years, the Committee is concerned that the prescriptive requirements in this proposed standard may result in significant inefficiencies in the audit process without an offsetting increase in audit effectiveness and quality in many circumstances. We acknowledge that a confirmation response from a third-party generally may provide more reliable evidence than company-provided or prepared evidence; however, we also believe that confirmations are not always the most effective or efficient means to gather audit evidence that adequately mitigates the perceived risks. As such, we encourage the staff to reconsider what we perceive as a limitation on the use of auditor judgment in determining when confirmation requests should be made based on risk assessment. We note that such limitations do not appear to be part of the proposed Auditing Standards Board’s or International Auditing and Assurance Standards Board’s proposals on confirmation.

The Committee also notes that in addition to the potentially significant increase in the auditors’ use of confirmations, that a similar increase will be imposed on the third parties that are requested to confirm. We encourage the staff to consider whether this incremental effort required by third parties might serve to lessen the reliability of confirmation responses, increase the use of restrictive language and disclaimers and/or increase the level of non-responses which would require additional audit effort to address.

Following are the Committee’s responses to the specific questions included in the Appendix:

- 1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?*

The Committee believes that the definitions are sufficiently clear and appropriate, but suggest some potential added clarity, including:



A1, A2 and A3 – As some may interpret ‘other medium’ to include oral responses, consider using ‘other non-oral medium’ to avoid confusion with A3’s indication that oral responses do not meet the definition of a confirmation response.

Consider defining ‘intermediary’ in Appendix A rather than in a footnote to paragraph 21.

2. *Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?*

The Committee feels that the objective is sufficiently clear and appropriate.

3. *What other matters, if any, should the objective include?*

None.

4. *Is the description of "receivables that arise from credit sales, loans, or other transactions" sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee feels that additional clarity is required. The opening sentence of paragraph 8 states that the auditor ‘should’ perform confirmation procedures for receivables, which makes confirmations presumptively mandatory. It is not clear if the staff’s intention is that confirmations be sent in every receivable situation where confirmation responses might add audit evidence. Such a position would seem to unduly limit auditor judgment as to whether confirmation is the most effective means to gather audit evidence or whether more efficient means of gathering adequate audit evidence could be used based on the risk assessment of the relevant assertion. It would also be helpful to include some of the other examples of receivables the staff is considering as being included in ‘other transactions,’ such as the examples provided on page 12 of the Release. Furthermore, the Committee feels that the staff should reconsider including the current standard’s guidance on exceptions to performing confirmation of receivables. The Committee also notes that page 13 of the Release suggests that the auditor look for ways to make an otherwise ineffective confirmation process more effective but does not appear to allow auditor judgment in deciding whether non-confirmation procedures would provide assurance at least as adequate as a more effective confirmation process based on the risk assessment of the relevant assertion.

5. *Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee feels that additional clarity is required. The opening sentence of paragraph 9 states that the auditor ‘should’ perform confirmation procedures for cash, which makes confirmations presumptively mandatory. It is not clear if the staff’s intention is that confirmations be sent for every cash balance where confirmation responses might add audit



ILLINOIS CPA SOCIETY.

evidence. Such a position would seem to unduly limit auditor judgment as to whether confirmation is the most effective means to gather audit evidence or whether more efficient means of gathering adequate audit evidence could be used based on the risk assessment of the relevant assertion. Additionally, it is not clear whether, when sending confirmation to gather audit evidence of other relationships, that the cash balance itself is also required to be confirmed.

6. *Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?*

The Committee feels that the proposed standard is not appropriate. The opening sentence of paragraph 10 states that the auditor ‘should’ perform confirmation procedures in response to significant risks, which makes confirmations presumptively mandatory. It is not clear if the staff’s intention is that confirmations be sent in response to every significant risk for which a confirmation may provide adequate assurance. Such a position would seem to unduly limit auditor judgment as to whether confirmation is the most effective means to gather audit evidence or whether more efficient means of gathering adequate audit evidence could be used based on the risk assessment of the relevant assertion.

7. *Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?*

No. The Committee feels that the use of confirmations to respond to significant risks should be subject to auditor judgment. Guidance is welcome; however, prescriptive requirements may reduce audit efficiencies without an increase in audit quality and effectiveness.

8. *Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee feels that the proposed standard of other risks is sufficiently clear and appropriate, but notes that paragraph 11 essentially only elaborates on the auditors’ responsibility to appropriately plan and perform the audit.

9. *Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?*

Unless otherwise noted in this response and the responses to questions 10 – 15, the Committee feels that the proposed standard for maintaining control over the confirmation process is sufficiently clear and appropriate. Paragraph 15 states that the auditor should direct the confirmation request to an appropriate confirming party within the third party organization and further suggests that the person’s name provided by the company may not



ILLINOIS CPA SOCIETY

necessarily be an appropriate person. The Committee is unclear how the auditor would reasonably assess whether the company-provided name was or was not an appropriate person within the third party organization and requests that clarification of this matter be added to the proposed standard.

- 10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee feels that while the Release adequately clarifies the particular procedures that an internal auditor can and cannot perform on behalf of the auditor, the proposed standard itself does not. Because the current standard has significant references to the use of internal auditors in the confirmation process, lack of specific mention in the proposed standard itself may inappropriately result in auditors using internal audit less than allowed, thereby creating audit inefficiencies.

- 11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee is unclear how the auditor would reasonably be expected to know whether a local custom includes responding to confirmation requests without verifying the information.

- 12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?*

Paragraph 17 appears to require the additional use of positive confirmations if all of the listed factors are not present; however, the Committee feels that even with some missing factors, negative confirmation does provide some audit evidence and the decision to supplement negative confirmations with positive confirmations should be based on the auditors judgment in regards to the incremental audit evidence necessary to support the relevant assertion. Similarly, even when all of the factors are present, the proposed standard requires additional substantive audit procedures to be performed to supplement negative confirmations. Again, the Committee believes that auditor judgment in regards to the need for additional procedures, including tests of controls, should be allowed. Furthermore, the Committee believes that the indirect receipt of a positive confirmation can provide some audit evidence (albeit less persuasive evidence) and therefore objects to the staff's statement in paragraph 17 to the contrary. Lastly, the Committee is unclear how the auditor would reasonably have adequate knowledge to reasonably believe that recipients of negative confirmation requests will give such requests consideration.



ILLINOIS CPA SOCIETY.

13. *Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?*

In paragraph 19, it is not clear whether the staff's intention for the auditor to consider the nature and extent of the procedures to validate addresses includes consideration of validating all or just a sample of the addresses (as opposed to 'nature and extent' just referring to level of validation to perform). Additionally, it appears that the staff would not allow test of controls as an appropriate procedure to validate addresses on confirmation requests for transaction or accounts that involve significant risks or are material to the financial statements. Was this prohibition intentional? The Committee also would recommend that the staff consider examples of control tests and substantive procedures that the auditor might consider using for various types of confirmation requests (paper, electronic or other mediums).

14. *Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?*

No further comment.

15. *Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?*

The staff might consider adding clarification as to whether the procedures described in paragraphs 23 through 25 relate to each individual confirmation request that the auditor might otherwise have made (e.g., several individual account balances of retail consumers) or to homogeneous groups (such as 'retail consumers'). Additionally, the Committee feels that the requirement to inform the audit committee of management's requests not to confirm (paragraph 24 c.) should be limited to those requests that related to significant risks and material items or limited to those requests with which the auditor does not agree.

16. *Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?*

The Committee feels that if the auditor assesses the risk of fraud to be low and if the auditor assumed the non-response was an error and the extrapolated amount would not be material, then no further procedures should be required.



ILLINOIS CPA SOCIETY

17. *Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?*

We feel that the requirement to send second request letters and consider sending third request letters will not provide the auditor sufficient time to complete the audit procedures before the applicable SEC filing deadlines, especially in the case of large, accelerated filers. As a result, we feel that the standard indirectly requires or encourages interim confirmation procedures instead of year-end testing. The Committee believes that year-end testing provides the highest level of assurance.

18. *Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?*

The Committee does not feel there are additional circumstances that require a response to a positive confirmation.

19. *Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?*

We feel the requirement is clear.

20. *Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?*

The requirements are clear and appropriate.

21. *Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?*

The Committee feels that the Board has inappropriately limited the electronic confirmation process. We feel that if the auditor and a member of management logs onto a website known to the auditor on the auditor's computer to obtain audit evidence from a third party website, this should be considered a confirmation or sufficient audit evidence that would meet the confirmation requirements. This process would provide a high level of assurance related to the information obtained.



ILLINOIS CPA SOCIETY.

22. *Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?*

The Board has incorrectly assumed that information obtained from third party services is accurate and of the highest assurance level. It has been certain members' experience that information obtained from third party services is incorrect periodically. Most cases, the third party service has corrected the confirmation when the information obtained from certain websites or statements has been provided to the service. Despite using a third party service, the auditor should consider the risk that the information provided is not accurate.

23. *The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.*

One obligation that exists between an intermediary and the auditor is a financial obligation. Most intermediaries will not process a confirmation until a fee is paid. The fees range but can start at around \$100 for the first account. Therefore, the cost of an intermediary can be high on smaller engagements.

24. *Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?*

Direct access has the same fraud risks as any other confirmation procedure. A direct portal could be manipulated the same as a client providing a fictitious website.

25. *Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?*

The Committee feels that direct access should be permitted in any circumstance in which the auditor feels it meets the appropriate audit evidence requirements.

26. *Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee requests that the Board consider moving the section on disclaimers and restrictive language earlier in the standard. This section directly impacts the planning and execution of the confirmation process if the auditor has historically or expects restrictive language or disclaimers to be received by the confirming party. We would like the Board to expand the examples of restrictive language and disclaimers in addition to providing guidance on how to address this issue. The Committee asks for guidance on what type of language would be acceptable in the confirmation responses.



27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements in the proposed standard to evaluate the confirmation results are clear and appropriate.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

Kevin V. Wydra, CPA

Chair, Audit and Assurance Services Committee

James Gerace, CPA

Vice Chair, Audit and Assurance Services Committee



ILLINOIS CPA SOCIETY

APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE
 ORGANIZATION AND OPERATING PROCEDURES
 2010 – 2011

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public practice. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:**Large:** (national & regional)

James J. Gerace, CPA	BDO Seidman LLP
William P. Graf, CPA	Deloitte & Touche LLP
Howard L. Gold, CPA	LarsonAllen LLP
Jon R. Hoffmeister, CPA	Clifton Gunderson LLP
James R. Javorcic, CPA	Mayer Hoffman McCann, P.C.
Michael J. Pierce, CPA	McGladrey & Pullen LLP
Elizabeth J. Sloan, CPA	Grant Thornton LLP
Kevin V. Wydra, CPA	Crowe Horwath LLP

Medium: (more than 40 professionals)

Jennifer E. Deloy, CPA	Frost, Rittenberg & Rothblatt, P.C.
Andrea L. Krueger, CPA	Corbett, Duncan & Hubly, P.C.
Stephen R. Panfil, CPA	Bansley & Kiener LLP
Marites U. Sy, CPA	E.C. Ortiz & Co, LLP

Small: (less than 40 professionals)

Scott P. Bailey, CPA	Bronner Group LLC
Julian G. Coleman, Jr., CPA	Horwich Coleman Levin LLC
Sharon J. Gregor, CPA	Selden Fox, Ltd.
Loren B. Kramer, CPA	Kramer Consulting Services, Inc.
Ludella Lewis	Ludella Lewis & Company
Richard D. Spiegel, CPA	Steinberg Advisors, Ltd.

Industry:

Janis D. Potter, CPA	MTL Insurance Co.
Brian D. Wetters, CPA	BP

Education:

James C. Westland, CPA	University of Illinois Chicago
------------------------	--------------------------------

Staff Representative:

Paul E. Pierson, CPA	Illinois CPA Society
----------------------	----------------------



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

By E-mail: comments@pcaobus.org

Institut der Wirtschaftsprüfer
 in Deutschland e.V.

Wirtschaftsprüferhaus
 Tersteegenstraße 14
 40474 Düsseldorf
 Postfach 32 05 80
 40420 Düsseldorf

TELEFONZENTRALE:
 +49 (0)211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
 +49 (0)211 / 454 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
 Deutsche Bank AG Düsseldorf
 BLZ 300 700 10
 Kto.-Nr. 7480 213

September 13, 2010

Dear Sir(s):

**Re.: PCAOB Rulemaking Docket Matter No. 028
 PCAOB Release No. 2010-003
 Proposed Auditing Standard related to Confirmation and Related
 Amendments to PCAOB Standards**

The Institut der Wirtschaftsprüfer in Deutschland [Institute of Public Auditors in Germany], the professional organization representing public auditors in Germany, appreciates the opportunity to comment on the above-mentioned Proposed Auditing Standard.

We have submitted comments previously to the PCAOB on Rulemaking Docket Matter No. 028 in a letter dated May 29, 2009 in respect of the PCAOB's related Concept Release. We subsequently include references to that letter, rather than repeating any of its content verbatim. In this letter, we discuss particular matters that we consider to be of specific concern, and also respond to selected questions posed in the Release in the accompanying Appendix.

Alignment of the PCAOB's Auditing Standards with corresponding ISAs

We are pleased to note that the PCAOB appreciates that "Several commenters encouraged the Board to more closely align a revised confirmation standard with ISA 505." (page 6 of the Release). This reflects our firmly held view, which we have repeatedly commented to the PCAOB in previous correspondence,

GESCHÄFTSFÜHRENDER VORSTAND:
 Prof. Dr. Klaus-Peter Naumann,
 WP StB, Sprecher des Vorstands;
 Dr. Klaus-Peter Feld, WP StB CPA;
 Manfred Hamannt, RA



Page 2 of 12 to the comment letter dated September 13, 2010, to the PCAOB

that, in the interests of global comparability, differences of substance between the PCAOB's auditing standards and those of the IAASB should be minimised where possible, deriving solely from U.S.-specific legal requirements.

The PCAOB also needs to bear in mind that its standards do not apply exclusively to audits performed in the United States, such that whilst its standards need to be robust, they must also be capable of application in many different jurisdictions and many different industries around the world. Indeed, in a number of past letters to the PCAOB we have expressed concern that the standards issued by the PCAOB are overly rules-based (i.e., our concern is that the exercise of professional judgement by an auditor is increasingly restricted, leading auditors to adopt a "checklist" approach rather than use the "thinking mentality" essential in exercising appropriate professional judgment and thus potentially detrimental to audit quality). This approach causes the PCAOB's standards to differ from those of the IAASB, which generally follow a more principles-based approach.

Whilst we recognize that the Proposed Auditing Standard does reflect the objective and requirements of ISA 505 in many major respects, our comments in this letter reflect the fact that we are not convinced that alignment has been achieved to the maximum extent possible, nor does the Proposed Auditing Standard itself contain guidance and other explanatory material sufficient to facilitate consistent application of the requirements in all cases. We therefore urge the Board to make further progress in these respects before finalizing its Standard.

Proposed Retention of the Presumption in the Board's Interim Standards

While, for the reasons previously detailed in our above-mentioned letter, we remain concerned about the retention of the presumption that the auditor's confirmation procedures will apply to accounts receivable – and proposed expansion thereof – our concerns have intensified, as the PCAOB is now proposing not to carry forward the exceptions for not confirming receivables (page 12 of the Release). Also of concern is the fact that the proposal to disallow exceptions was not mentioned in the earlier Concept Release, such that commenters' views have not yet been solicited on this aspect. We discuss this aspect of the proposal further in the subsequent section of this letter.

Although we appreciate that in the vast majority of audit circumstances confirmations may well be the most effective audit procedure, and their extensive use would be common in many jurisdictions and in many industries, our concern is



Page 3 of 12 to the comment letter dated September 13, 2010, to the PCAOB

that in proposing a rule without exception the PCAOB not only fosters the checklist approach mentioned above, but will also require audit resources to be expended for the sake of compliance without any attaching enhancement of audit quality. Indeed, in addition to the obvious issue of cost, other potential drawbacks may arise as auditors seek to be seen to comply with the letter of the standard rather than performing those alternative procedures that would be the most effective ones in the particular audit circumstances. In our view, this lack of flexibility may be detrimental to audit quality, for the reasons we explain below.

In practical terms, the presumption as currently proposed means that even in those circumstances where an auditor anticipates that confirmation procedures will be ineffective (e.g. when the auditor has had past experience with the audit client encountering especially low response rates, respondent errors including lack of verification, or directional bias in detecting errors – all of which the PCAOB noted as being key barriers to confirmation effectiveness in the Concept Release), confirmation requests will still have to be made (at least twice, and possibly a third time pursuant to paragraph 27 of the Proposed Auditing Standard), without exception.

The two reasons for retaining the presumption the PCAOB has given on pages 11, 12 and A3-3 of the Release (1. audit evidence from third parties is generally more reliable than company generated evidence, and 2. academic research supports effectiveness of confirmations in testing receivables) are not relevant in those audit situations where such key barriers exist. We would like to point out that neither auditor confirmation procedures nor rules-based auditing standards can compel external parties to respond to confirmation requests or to verify the information therein before responding. In this context, we refer to our aforementioned previous letter as to the potential for legislative or regulatory measures to improve cooperation by external parties. In our view the fact that such barriers may, in some cases, indeed preclude the auditor from obtaining effective confirmation indicates that there is a clear case for allowing exceptions in certain particular limited circumstances.

The Proposed Auditing Standard also requires the auditor perform alternative procedures in response to ineffective confirmation. This means that when confirmation is expected to be ineffective the auditor has to double-count procedures, i.e., sending confirmation requests and follow-up requests would be essentially a “wasted” effort. In the best case, this could lead to auditors “going through the motions” in sending confirmation requests to comply with the Standard which would neither enhance audit quality, nor be justified from a cost efficiency perspective. However, in the worst case, should the auditor fail to recog-



Page 4 of 12 to the comment letter dated September 13, 2010, to the PCAOB

nize the full extent of respondents' behaviour e.g., neglecting to verify the information, or incorrectly gauge the significance thereof to the audit, the receipt of positive confirmations would allow the auditor to appear to have complied with the requirements, when other procedures would have been more effective in the particular circumstances.

Introduction of a Proposal Not to Carry Forward Hitherto Recognized Exceptions

As mentioned above, the proposed removal of exceptions to the presumption was not discussed in the earlier Concept Release. Furthermore none of the 27 questions posed by the PCAOB in this Release relate directly to this aspect. We regard this as an important issue worthy of full discussion with the PCAOB's constituents during the standard setting process, and we were disappointed that the PCAOB has not sought specific comment on this aspect of the proposal.

The arguments put forth by the PCAOB in favor of its proposal to eliminate the exception currently permitted, contend that auditors can look for ways to improve the effectiveness of confirmation procedures (e.g., rather than seeking confirmation of a specific balance requesting confirmation of the individual transactions that make up that balance, or where the local custom is to respond without verifying information to use a positive confirmation request that does not state the balance or amount or certain other information). In our opinion, such measures will not result in satisfactory confirmation in all cases, since as discussed above, neither auditor confirmation procedures nor rules-based auditing standards can compel cooperation by external parties.

Confirmation Procedures Prescribed as a Response to Significant Risks

The proposed requirement relating to significant risks is a further example of the adoption of a rules-based approach on the part of the PCAOB. Paragraph 10 of the Proposed Auditing Standard specifically requires the auditor to "...perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures". In contrast, the ISAs adopt a principles-based approach, as the corresponding requirements of ISA 330.19, in conjunction with ISA 330.21 read together with accompanying application and other explanatory material in paragraphs A48-A51 and A53 of ISA 330 require the auditor to perform substantive procedures specifically responsive to a significant risk, and to consider the appropriateness of confirmation as a possible such substantive procedure.



Page 5 of 12 to the comment letter dated September 13, 2010, to the PCAOB

The PCAOB's approach requires the auditor perform confirmation procedures whenever an assertion is, in theory, capable of being adequately addressed by confirmation procedures – irrespective of whether the auditor expects that they will prove effective or not. This limitation on the auditor's exercise of professional judgement will prevent auditors from considering whether a procedure other than confirmation procedures might be more effective or otherwise preferable and, for the same reasons as explained above, may not be conducive to fostering audit quality.

Comparison of the Requirements of the Proposed Auditing Standard and Analogous Standards – Appendix 3

We note that the detailed comparison of objectives and requirements of the Proposed Auditing Standard and the analogous standards of the IAASB and the AICPA's Auditing Standards Board set forth in Appendix 3 of the Release reveals a number of proposed requirements having [apparently] no equivalent requirement in ISAs.

In part these differences arise as ISAs take a more principles-based approach to arrive at, what is, essentially a common objective. In certain other cases, statements to the effect that there are no similar requirements may simply be misleading. For example, in respect of paragraph 10 of the Proposed Auditing Standard, the text under the heading *IAASB and ASB* on page A3-6 states: "ISA 505 and the ASB's proposed SAS do not contain similar requirements." As far as ISA 505 is concerned this is true; such requirements are not found in ISA 505. However, as noted above, the requirements of ISA 330.19, in conjunction with ISA 330.21 read together with accompanying application and other explanatory material in paragraphs A48-A51 and A53 of ISA 330 effectively require the auditor to consider the appropriateness of confirmation as a substantive procedure in response to a significant risk. In this instance, we consider the impression portrayed unfortunate.

Effective Date

As confirmation procedures may be used during the period subject to audit or to confirm period end balances and transactions, we are concerned that the proposed effective date may be overly tight, given that the standard has yet to be finalized, approved by the PCAOB and approved by the SEC. For periods ending December 31, 2011 auditors will plan and perform procedures from early 2011 onwards.



Page 6 of 12 to the comment letter dated September 13, 2010, to the PCAOB

We hope that our comments are useful for the Board's further deliberations. Should you have any questions about our comments, we would be pleased to be of assistance.

Yours very truly,

Klaus-Peter Feld
Executive Director

Gillian G. Waldbauer
Technical Manager



Page 7 of 12 to the comment letter dated September 13, 2010, to the PCAOB

Appendix

Responses to specific questions in the Release

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

The wording of the second and fourth sentences of paragraph 9 appears to infer that requesting confirmation of a sample of cash accounts and other relationships with financial institutions might be appropriate. This seems to us to be in direct conflict with the last three sentences of that paragraph. In our view, further clarification of this aspect of the PCAOB's requirement would be useful. For example, does the PCAOB intend the second and fourth sentences to mean that in preparing confirmation requests it would be acceptable for the auditor to leave out particular financial institutions altogether as potentially not material or not posing a significant risk, or alternatively might the auditor specifically exclude certain specific accounts or relationships from requests for these reasons.

The German auditing standard promulgated by the IDW "IDW Auditing Standard 302: External Confirmations" requires bank confirmations be obtained in respect of all types of business relations between the entity and credit and financial services institutions (or their branches) as well as for all business relations with financial enterprises as defined by § [Article] 1 (3) KWG ["Kreditwesengesetz": German Banking Act]. In our opinion, the confirmation of such information is, certainly in Germany, less likely to be ineffective than may be the case for other receivables, thus whilst we would generally see less of a necessity to foresee possible exceptions in respect of confirmation requests to credit institutions, we refer to our comments in the attached letter relating to the presumptive requirement and the proposal not to carry forward exceptions, as the PCAOB should recognize that in some circumstances or cultures it may be conceivable that even these types of confirmations may prove ineffective.

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

As discussed in our attached letter, we are concerned at the PCAOB's apparent expectation that the auditor will essentially be able to overcome anticipated ineffectiveness of confirmations by adjusting the design of confirmation requests. In



Page 8 of 12 to the comment letter dated September 13, 2010, to the PCAOB

some specific industries and cultures, we believe this expectation to be unrealistic.

In any case, to the extent that conformation requests for individual items rather than for an account balance are considered an “alternative”, there may be a need for additional procedures e.g., to address the completeness assertion, or cut off. This aspect needs to be addressed in the Standard more clearly.

We further suggest the PCAOB expand the material relating to designated intermediaries, as this is one aspect in which the auditor may not retain full control of the confirmation process, which, whilst not common, nevertheless may be encountered in practice.

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

No, in our opinion, the requirements are not entirely appropriate.

As we have previously stated, we agree that the use of negative form requests should not be forbidden, but instead used only under certain conditions.

We therefore question whether supplementary substantive procedures as required by the last sentence of paragraph 17 would be necessary in every case where negative confirmations are used, and even though each and every of the four required criteria are fulfilled. In this context, the ISAs require the auditor to obtain more persuasive audit evidence the higher the auditor’s assessment of risk (ISA 330.07(d) together with supporting application material) and also to conclude whether sufficient appropriate audit evidence has been obtained (ISA 330.26 and ISA 200.17 together with supporting application material). The IASSB recognized that there may be some circumstances in which the auditor judges that, provided certain criteria (similar to those required by the PCAOB) are fulfilled, negative confirmations can provide appropriate sufficient audit evidence. We suggest the PCAOB take a similar risk-based approach in drafting paragraph 17.

In addition, we do not agree that requiring the auditor to “reasonably believe that recipients of negative confirmation requests will give such requests consideration” sets an appropriate threshold. The corresponding text in ISA 505.15(d) states “the auditor is not aware of circumstances or conditions that would cause the recipients of negative conformation requests to disregard such requests”, which, in our opinion, sets a more practicable threshold.



Page 9 of 12 to the comment letter dated September 13, 2010, to the PCAOB

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

We had previously commented that given the technological advances that facilitate direct confirmation with a third party, the auditor will need to perform procedures directed at ensuring the security and integrity of the auditor's direct interaction with that third party, i.e., procedures to determine whether the third party supplied link is secure and cannot be subject to manipulation and whether access granted by that third party does indeed relate to all the information requested.

We do not believe the procedures are sufficiently clear in the Proposed Auditing Standard to cover all circumstances auditors may face in practice, and suggest, once again, that the PCAOB include additional material to assist the auditor in addressing such validity issues, especially in cases where responders grant direct access rather than providing a specific response. For example, this issue is not discussed in paragraphs 19-21 where an auditor may wish to use electronic or other medium to request a confirmation. We also refer to our responses to questions 21, 22 and 24.

15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

We had previously commented that we would support the inclusion of material based on paragraphs 8 and 9 of ISA 505 and accompanying application material.

In this context, we question why the PCAOB deems it necessary to perform the procedures listed in sections c. and e. of paragraphs 24 of the Proposed Auditing Standard even in those circumstances where the auditor has both previously obtained audit evidence as to the appropriateness of management's request not to confirm particular information and been able to obtain relevant and reliable audit evidence from the alternative procedures required pursuant to sections a. and b. of that paragraph. This is a further example of the PCAOB adopting a rules-based approach, ultimately leading to the need for auditors having to report all such refusal(s) to the audit committee, and evaluate potential implica-



Page 10 of 12 to the comment letter dated September 13, 2010, to the PCAOB

tions for the audit report regardless of their validity and significance for the audit. In contrast, ISA 505 requires this communication and a determination of implication for the audit and auditor's opinion only in the case of either unreasonable refusal(s) by management, or of reasonable refusal(s) that have resulted in the auditor being unable to obtain relevant and reliable audit evidence from alternative procedures.

17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

We refer to our attached letter in respect of the appropriateness of retaining the presumption without exception which will result in confirmation requests having to be made (at least twice, and possibly a third time) pursuant to paragraph 27 of the Proposed Auditing Standard. In this context, should the PCAOB reject our suggestions and decide not to allow for exceptions, we suggest that when both past experience and responses to the first confirmation requests indicate that second or third requests are unlikely to lead to an increase in effectiveness of the confirmations, the auditor not be required to follow up with a second and possibly third request.

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

Pursuant to the ISAs if, in investigating exceptions, the auditor identifies a misstatement, the auditor is further required to evaluate whether the misstatement is indicative of fraud (ISA 505.A21). We note that the Proposed Auditing Standard does not mention a similar requirement. This may need to be addressed as the PCAOB completes its risk standards, and a reference to the relevant paragraph in AS-14 included. (Currently AU 316.68 deals with this aspect.)

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?



Page 11 of 12 to the comment letter dated September 13, 2010, to the PCAOB

We are concerned that, in comparison to ISA 505, the Proposed Auditing Standard sets overly high expectations in respect of the auditor's procedures in relation to the reliability of conformation responses.

ISA 505.10 requires the auditor obtain further audit evidence to resolve doubts about the reliability of a response to a confirmation request only if the auditor identifies factors that give rise to doubts about the reliability. In the absence of such factors the auditor does not seek to confirm or discount reliability. In contrast, paragraph 31 states "The auditor should assess the reliability of confirmation responses." without qualifying this requirement in any similar manner.

Furthermore, only when the auditor determines that a response is not reliable does ISA 505.11 require the auditor to evaluate the implications further.

The Proposed Auditing Standard sets a far lower threshold in requiring the auditor to obtain additional audit evidence if conditions indicate that a confirmation response might not be reliable.

This may lead to expectations that are impracticable, as the auditor can only react to matters of which the auditor becomes aware, or represent the auditor's own findings and determinations.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

We do not agree that direct contact with the intended confirming party is the only way to verify the source of a response received via facsimile or e-mail (e.g., recourse to directories etc. may be an alternative).

We question whether there is a need to confirm the content of a response directly with that party in every case where responses are received by facsimile – this is not required in respect of responses received by any other means.

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

If an intermediary is used, we are unsure whether the PCAOB foresees that the auditor might review reports by other auditors (e.g., a similar concept to SAS 70 or ISAE 3402 engagements), should such engagements have been performed?



Page 12 of 12 to the comment letter dated September 13, 2010, to the PCAOB

Further clarification of the PCAOB's expectations as to how the auditor should address the risks would be appropriate.

24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

In respect of direct access, the PCAOB has not included requirements for the auditor to seek verification of the source or content. For example, consideration of the process by which the auditor is registered for limited period direct access might be relevant.



Richard F. Chambers
Certified Internal Auditor
Certified Government Auditing Professional
Certification in Control Self-Assessment
President and Chief Executive Officer

T: +1-407-937-1200
E-mail: richard.f.chambers@theiia.org

September 7, 2010

Office of the Secretary, PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Response e-mailed to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 028

Dear PCAOB Board:

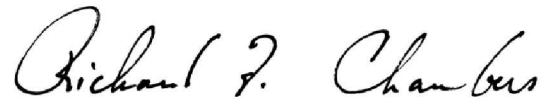
The Institute of Internal Auditors (IIA) welcomes the opportunity to comment on the PCAOB's proposed auditing standard, *Confirmation*, which would supersede the Board's standard AU section 330, *The Confirmation Process*. Our comments are based on a thorough analysis and discussion, utilizing a core team of audit experts who serve on The IIA's professional guidance committees. These individuals consist of experienced Certified Public Accountants and Certified Internal Auditors who have worked in public accounting and in audit management positions in small, medium, and large multinational companies.

The following are our principal comments and observations. More detailed responses to the exposure document are included in Attachment A.

1. We believe that some sections of the proposed standard could restrict the ability of external auditors to fully and effectively utilize the work of internal auditors. This is not the intent of the guidance in *AU sec. 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements."* Internal auditors who conform to the professional standards as issued by The Institute of Internal Auditors have the essential competency, independence, and objectivity to assist external auditors with aspects of the confirmation process. We strongly encourage you to reconsider these restrictions as they may have the effect of creating inefficiencies and increasing the cost of external audit services for organizations.
2. The use of alternative procedures is significantly restricted in the proposed standard and may have the effect of creating additional work and expense in audit engagements. These restrictions eliminate the consideration and reliance on other controls and procedures. Engagements might need to be extended while external auditors wait for second and third requests for confirmations to be answered. The inflexibility of the requirement to re-verify facsimile and e-mail confirmations, regardless of risk or materiality, could add to the cost and time required to complete confirmation procedures.

The IIA welcomes the opportunity to discuss any and all of these recommendations with you. We offer our assistance to the PCAOB in the continued development of this guidance.

Best Regards,

A handwritten signature in black ink that reads "Richard F. Chambers". The signature is written in a cursive style with a large, prominent 'R' and 'C'.

Richard F. Chambers, CIA, CGAP, CCSA
President and Chief Executive Officer

About The Institute of Internal Auditors

The IIA is the global voice, acknowledged leader, principal educator, and recognized authority of the internal audit profession and maintains the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These principles-based standards are recognized globally and are available in 29 languages. The IIA represents more than 160,000 members across the globe and has 103 affiliates in 165 countries that serve members at the local level.

Attachment A

Comments on PCAOB Rulemaking Docket Matter No. 028, *Confirmation*

Our responses will focus on items where we have suggested changes or have recommendations for your consideration. For all other items and questions in the exposure draft we do not have any suggested changes or comments.

1. In the section “Cash with Financial Institutions” the fourth paragraph (page 15 and paragraph 9 of Appendix A1) states “*The auditor should not base his or her selection of cash accounts to confirm only on the reported balances of the cash accounts. There might be significant activity in, and risks associated with, a cash account that has an immaterial or zero balance.*” Since you are only confirming balances, the confirmation will not provide any indication of activity in immaterial or zero balance accounts. It would help clarify this rationale by indicating that the primary financial reporting risk in accounts with an immaterial or zero balance is the risk of understatement. Confirmation of balances for such accounts will not provide any insight into significant activity that may be conducted in such accounts. Procedures other than confirmation will be necessary on such accounts to detect significant activity or risks other than potential understatement of balances. So, for these reasons, in answer to question 5, we believe the requirement in the proposed standard to confirm cash and other relationships with financial institutions could be made clearer.
2. In the section “Confirmation Procedures” the fourth paragraph (page 20) states “*The Board is not retaining the reference to the use of internal auditors in the proposed standard because the requirements for considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor are included in AU sec. 322, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements.*”

However, the fifth paragraph (page 20) states “*The requirement in the proposed standard to maintain control over the confirmation process, however, limits the auditor’s ability to use internal auditors to perform certain procedures in the confirmation process for the auditor.*” Later in the same paragraph it states “*Therefore, the auditor cannot use internal auditors to send confirmation requests, receive confirmation responses, or evaluate the audit evidence obtained from performing confirmation procedures.*”

This appears to conflict with AU section 322 and restricts the ability to use internal auditors for certain assistance to external auditors. So even if through application of AU section 322 the external auditor determines that reliance can be placed on the work of internal auditors, this standard seems to counter that conclusion, regardless of the specific circumstances related to the internal audit function or the risk of the items being confirmed. We do not understand the rationale for this blanket restriction and question whether such restriction is necessary.

Years of cooperation and experience have created opportunities to coordinate and leverage activities between internal and external auditors to the benefit of both groups, and thus we believe the standard should promote the effective working relationship that has developed over time. Admittedly the focus of an internal audit function is risk based and control focused and it may be therefore that they as a matter of course do not include such confirmation processes in their scope of work. However, we do not believe the standard

should preclude reliance on their processes if such confirmations are included in their work plans.

While the recent economic crisis has prompted many to call for regulatory reform and increased financial oversight, the relationship between internal and external auditors has not been criticized or cited as a contributing factor to the financial difficulties and failures experienced by many organizations. Restricting the dependence on and cooperation between internal and external auditors would seem to be counterproductive and simply increase the cost of external audit services for organizations. This increased cost would not be based on any broad based evidence of financial statement audit failures due to inappropriate reliance on internal audit.

Multiple studies and surveys have confirmed the effectiveness of internal audit in supporting the accuracy of financial reporting. For example, the following statistics from the Association of Certified Fraud Examiners' *Report To The Nations On Occupational Fraud And Abuse* indicate the effectiveness of internal auditors in detecting fraudulent activities.

Initial Detection of Occupational Frauds

	<u>2006</u>	<u>2008</u>	<u>2010</u>
By Internal Audit	20.2%	19.4%	13.9%
By External Audit	12.0%	9.1%	4.6%

If the rationale for restricting the use of internal audit is so that external auditors might better detect fraudulent activities, then these statistics would suggest otherwise. We do not point this out to suggest that external auditors are not effective in their responsibilities, because we believe they are, but rather that internal auditors are effective and often better situated to detect fraudulent activities given our role within organizations. Hence, leveraging the work of internal auditors would seem to promote better financial reporting.

In answer to questions 9 and 10, we believe the requirements for maintaining control over the confirmation process and the description with respect to the use of internal auditors could be changed to explicitly allow reliance on the work of internal audit, based on the specific attributes of the internal audit function and the risk of the areas being addressed through confirmations.

3. In the section "Determining That Confirmation Requests Are Properly Addressed" the second paragraph (page 26) states "*The proposed standard requires the auditor to perform procedures to determine the validity of addresses on the confirmation requests, including substantive procedures or tests of controls.*" It is possible that through validation of other controls, such as controls over address change requests, the external auditors will have already concluded that reliance can be placed on these controls. Hence, performing additional substantive procedures to validate addresses on confirmation requests would not be necessary and could increase the cost of external audit services. We believe this standard should allow external auditors to rely on other controls and tests in lieu of performing additional, duplicative tests where appropriate.

In response to question 13, we do not believe the procedures the auditor should perform to determine the validity of addresses are the most appropriate and the necessity for such procedures should be assessed on a case-by-case basis.

4. In the section, “Determining the Type of Confirmation Requests to Send” the first paragraph (Page 25) states, *“In developing the proposed standard, the Board took into account comments that negative confirmation requests may provide audit evidence in limited circumstances. For example, when performing audit procedures for demand deposit accounts in a financial institution audit, it may be appropriate for an auditor to use negative confirmation requests with copies of the customers' regular account statements attached to the confirmation requests when the risk of material misstatement is low, the auditor reasonably expects a low exception rate, and the auditor reasonably believes that recipients of the negative confirmation requests will give such requests consideration. Negative confirmation requests also might provide some evidence of the existence of confirming parties if the requests are not returned with an indication that the addressees are unknown. In addition, negative confirmation requests might be used effectively in conjunction with positive confirmation requests.”* We believe that a negative confirmation may not provide meaningful audit evidence because any increase in the perceived level of assurance is speculative. If the risk is so low that speculative evidence will suffice, then the risk is so low that confirmations should not be required. There are many reasons why the recipient may not respond to a negative confirmation request and to assume that the lack of response indicates approval is too speculative to be reliable.
5. In the section “Management Requests Not to Confirm” the third paragraph (page 29 and paragraph 24 of Appendix A1) includes several procedures to perform if management requests certain accounts not be confirmed. Steps “c” and “d” appear to discount the external auditor’s judgment and pass this responsibility to the audit committee for all situations, regardless of the risk involved. There could clearly be different levels of risk associated with different confirmation items, and the proposed standard apply a requirement which may easily be inconsistent with the risk of some items. Documenting management’s reason for the request may be better suited for the audit workpapers for some lower risk items than the management representation letter. The risk of the item in question and auditor judgment should be part of the decision in how to respond to this situation. In answer to question 15, we believe the proposed procedures are not the most appropriate.
6. In the section “Non-responses” question 16 (page 32) states *“Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests?”* The answer is yes – if, in anticipation that some confirmations will not be returned timely, a larger than required sample is selected. In this situation, it would not be necessary to perform alternate procedures if the number and amount of non-responses was reasonable and as anticipated, and if fraud was not suspected or otherwise indicated. Auditors would however need to use their judgment in making such assessments.
7. In the section “When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence” the second bullet of the second paragraph (page 32 and paragraph 29 of Appendix A1) states *“Specific fraud risk factors, such as the risk of management override of controls or the risk of collusion, which can involve employee(s), management, or outside parties, prevent the auditor from relying on the evidence from the*

company.” The standard indicates that if these circumstances are present, then the auditor must receive a positive confirmation and cannot perform alternative procedures. In reality, these risk factors are always present and can never be totally eliminated. As written, alternative procedures could never be performed if a confirmation is not received. This is inconsistent with other wording in the standard and not consistent with consideration of risk. It would seem to make sense to indicate that if this risk was judged to be low or acceptable, then alternative procedures could be performed.

8. In the section “Reliability of Confirmation Responses” the fourth paragraph (page 35 and paragraph 31 of Appendix A1) includes several bullets that the auditor should take into consideration in assessing the reliability of confirmation responses. The fourth bullet states “*Come from addresses other than the address to which the auditor sent the confirmation requests.*” There are many situations or reasons why returned confirmations may come from a different address than the one to which it was sent. For example, larger organizations usually have multiple departments and locations so that operational activities, such as responding to confirmation requests, may be handled at a different location than from where the account officer is located, or where account statements are mailed from, or where the organization’s headquarters is located. Different organizations may use various combinations of centralized and de-centralized operations for responding to confirmation requests. Also, the auditor could send the request to the wrong location or address in the first place. We suggest deleting this bullet from the list as the risk is adequately covered by the second and third bullet points in the list.
9. In the section “Additional Procedures for Electronic Confirmation Responses” the first two bullets under the second paragraph (page 37 and paragraph 35 of Appendix A1) that require the auditor to contact the confirming party directly in the case of facsimile or e-mail responses can create duplicative and possibly unnecessary procedures. This effectively negates and eliminates these electronic confirmation methods. We question why an auditor would use these methods if they had to contact the confirming party directly anyway. In the absence of suspicion of fraud it would seem unnecessary to require procedures to re-verify confirmations received by facsimile or e-mail. We suggest deletion of these bullets.



KPMG LLP
757 Third Avenue
New York, NY 10017

Telephone 212 909 5600
Fax 212 909 5699
Internet www.us.kpmg.com

September 13, 2010

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

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

Dear Mr. Secretary:

KPMG appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2010-003, "*Proposed Auditing Standard Related to Confirmation, and Related Amendments to PCAOB Standards*" (the "Proposal"). Appendix 1 of the Proposal contains the Proposed Auditing Standard and is referred to herein as "the proposed auditing standard."

We support the Board's objective of updating its interim standards related to confirmation. AU section 330, *The Confirmation Process* ("AU 330") was written nearly 20 years ago and changes in business and the business environment since then have affected the way in which confirmation can be performed and in its effectiveness. Advances in information technology and the widespread use of the Internet, for example, have had a significant impact on the confirmation process and, if properly used, have the potential of further increasing the efficiency and effectiveness of the confirmation process. At the same time, however, response rates to confirmation requests are lower than we desire, and respondents to confirmation requests increasingly are including disclaimers or other limiting language in their responses.

We support the Board's consideration of the work of the International Auditing and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB) in the development of the Proposal. We also recognize that the Board may decide that different procedures are appropriate in the U.S. public company audit environment. In this case, the Board has included more prescriptive requirements in the proposed auditing standard than are included in the respective standards of the IAASB and ASB. The Board has not provided much explanation, however, as to why these additional prescriptive requirements are necessary or how they would result in a more effective audit. We believe the Board should more fully explain the rationale as to why such additional prescriptive procedures are necessary. As described elsewhere in this letter, however, we believe that certain of these additional requirements are not necessary.



Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 2

We also support the PCAOB's efforts to provide a comparison of its standards to those of the IAASB and the ASB. Such comparisons facilitate the identification of differences between the various standards and provide additional perspective on the PCAOB's intended changes to practice. In several sections of the analysis in which proposed PCAOB requirements are compared to the analogous IAASB and ASB standards, however, the comparison indicates only that the IAASB and ASB standards "do not include similar requirements" to those being proposed by the Board. Although the PCAOB's proposed requirements are not included as requirements in the respective IAASB and ASB standards, the other standard setters require the auditor to use judgment in determining the appropriate audit procedures to be performed and supplement the requirement to use judgment with additional application guidance similar in content to the PCAOB's requirements. To avoid for a potentially misleading comparison, we recommend the PCAOB acknowledge the additional application guidance and further clarify why establishing requirements where other standard setters have required auditors to use judgment in determining the appropriate audit procedures (supplemented by application guidance) will result in a more effective audit, rather than simply indicating in the comparison provided that the proposed requirements are not required by the other standard setters.

While we support the PCAOB's standard setting project to revise AU section 330, *The Confirmation Process*, given the significance of our comments, we believe that substantial changes should be made to the proposed auditing standard prior to its issuance. Specifically, we believe that the proposed auditing standard is too prescriptive and does not fully allow the auditor to respond to assessed risk in a manner consistent with the PCAOB's recently issued risk standards. Furthermore, we believe that it is doubtful that the proposed auditing standard, or any proposal related to confirmations, will significantly improve audit quality until marketplace issues are addressed that result in increasing the response rate to confirmation requests and decreasing the use of disclaimers and restrictive language by confirmation responders.

This letter is organized by first providing general observations and comments on the Proposal as a whole, followed by comments on specific issues in an Attachment. Our general observations discussed below are organized as follows:

- Overarching Concerns
- Principles-based Standards
- Risk Assessment
- Use of Internal Audit in the Confirmation Process
- Drafting Conventions

Overarching Concerns

We are concerned that the proposed auditing standard is overly prescriptive and does not adequately recognize that confirmations may not always be the most cost-effective means of



Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 3

gathering sufficient appropriate audit evidence. The proposed auditing standard inappropriately limits the auditor's ability to use judgment in determining the audit procedures that are necessary based on the assessed level of risk at the assertion level and is not consistent, we believe, with the PCAOB's recently adopted risk assessment standards. As a consequence, the proposed auditing standard may result in a significant increase in the use of confirmation requests in areas such as consumer receivables (e.g., health care receivables, credit card receivables and telecommunications receivables) and receivables resulting from an ongoing estimation process (e.g. certain reinsurance recoveries) and, as a result, require additional audit procedures regarding the design and evaluation of confirmations, without a corresponding increase in audit quality or effectiveness. As discussed in Principles-based Standards below, we are concerned that the Proposal does not adequately recognize that confirmations may not always be the most effective means of gathering evidence and, as a result, limits the auditor's ability to use judgment in determining the audit procedures that are appropriate based on the assessed level of risk at the assertion level (see Risk Assessment below).

We believe the proposed auditing standard also would require an increase in the effort by responding parties. We are concerned that the expanded requirements imposed solely on auditors without consideration of the increased obligation being requested of third parties from whom confirmations are sought, present operational challenges that will either increase the auditor's effort to obtain responses or reduce the response rates, or both. We recommend that the PCAOB consider the practical implications of the proposed standard and liaise with other organizations, such as the American Bankers Association and Financial Executives International, to understand the impact of the proposed auditing standard on these organizations' members. The Board should discuss with these organizations whether their members will be willing and able to respond timely to an increase in confirmation requests. Further, and especially if the Board proceeds to increase audit requirements in this area, the Board should undertake to work with these and other organizations that represent entities that routinely receive requests for confirmation to identify actionable ways to increase response rates.

We share the PCAOB's concern regarding the growing prevalence of restrictive language in confirmation responses. However, the fact that some respondents use disclaimers and other restrictive language highlights a fundamental flaw of imposing unilateral requirements on auditors without also addressing the fact that respondents have a variety of reasons for including such language – and can do so regardless of the impact on the audit. This issue should be addressed at its root cause; an approach that only places additional requirements on auditors when confirmations are received with disclaimers and restrictive language would not be in the public interest. As we indicated in our letter dated May 29, 2009, in response to the Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations, we believe the Board should play an active role in trying to increase both the response rate and quality of the responses to auditor requests for confirmation. We also believe it would be helpful if the PCAOB would provide more clarity as to what type of restrictive language is acceptable.



Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 4

Principles-based Standards

As mentioned above, while we support the Board's efforts to improve the existing confirmation standard, we are concerned that the proposed auditing standard is overly prescriptive. We believe a high quality audit does not result from the performance of a predefined set of steps that are applied to each and every engagement, but instead results from a customized set of procedures designed to be responsive to the risks identified. Accordingly, standards should not represent a checklist of requirements, but a collection of guiding principles for the auditor to apply to the particular facts and circumstances of a given audit using professional judgment.

We have concerns related to the aspects of the proposed auditing standard related to the presumption that the auditor will request confirmation of accounts receivable. While the PCAOB's interim standards (paragraph 34 of AU 330) include a presumption that the auditor will request the confirmation of accounts receivable during an audit, the extant standard permits the auditor to exercise professional judgment in determining whether the use of confirmations would be effective. In situations, for example, where an auditor determines that confirmations would not be effective or the auditor's combined level of control and inherent risk are at a sufficiently low level (combined with other evidence obtained as part of the audit), existing PCAOB standards do not require the auditor to request confirmations. We believe that the proposed auditing standard, which eliminates these exceptions, combined with the Board's rationale contained in the accompanying release, will significantly reduce the auditor's ability to use his or her judgment in determining whether confirmations are an appropriate procedure based on the assessed level of risk.

In addition, because the proposed auditing standard significantly broadens the requirement of when confirmations are to be used (e.g., paragraph 10 includes a presumptive requirement that the auditor will perform confirmation procedures in response to significant risks that relate to the assertions that can be adequately addressed by confirmation procedures and paragraph 11 includes a statement that "the performance of confirmation procedures still might be an appropriate response to obtain audit evidence" for other risks) we believe this will, at a minimum, result in an increased documentation burden in situations where an auditor determines that confirmation procedures would not be appropriate. This could also have the unintended result of shifting the auditor's focus from obtaining sufficient appropriate audit evidence to support his or her conclusions to justifying a decision not to send confirmations and/or whether the confirmations were used in an appropriate manner. Ultimately, this may result in an increase in the performance of confirmation procedures in order to satisfy the "checklist" requirement, regardless of whether the audit procedure provides the most effective or efficient means of obtaining sufficiently persuasive audit evidence.

Further, we note the accompanying release currently states, "if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for



Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 5

ways to improve the effectiveness of confirmation procedures.” However, the Board fails to acknowledge that in certain situations the auditor cannot improve the effectiveness of confirmation procedures. For example, the health care industry traditionally experiences low response rates to confirmation requests. Under the extant standard, the auditor would have the discretion to determine whether alternate procedures would be a more effective and efficient means for obtaining audit evidence. However, the proposed standard would significantly limit the auditor’s ability to use judgment in determining the appropriate audit procedures for obtaining sufficient audit evidence. As a result, we believe that auditors may expend significant efforts performing confirmation procedures in situations where confirmations are neither the most effective nor efficient means of gathering evidence.

Any of these outcomes would not enhance the persuasiveness of audit evidence obtained by the auditor. Therefore, we encourage the PCAOB to reconsider these provisions and allow the auditor to use his or her judgment in determining whether confirmations procedures are appropriate in the circumstances to address the identified risks.

Risk Assessment

In an audit performed in accordance with the PCAOB’s recently issued risk standards, risk assessment and response underlies the entire audit process. We are concerned, however, that the proposed auditing standard removes the auditor’s judgment to assess and respond to risk and instead includes prescriptive requirements for the confirmation process, regardless of the assessed level of risk. For example:

- Paragraph 10 states that “[t]he auditor should perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures.” This indicates that the Board intends that the auditor perform confirmation procedures in response to significant risks in every circumstance in which an auditor *can* perform them. We do not agree with this position. Rather, we believe the Board should allow the auditor to determine the most effective and efficient audit response that would provide sufficiently persuasive audit evidence to address the identified risk.
- Paragraph 15 requires the auditor to select the confirming party, even if the company provides the auditor with the name, regardless of the assessed level of risk. We recommend that the Board allow the auditor to use judgment, based on risk, in determining the nature and extent of verification procedures necessary to identify the confirming party. For example, sending a deposit account confirmation to a bank generally would be considered lower risk than confirming for the possibility of side agreements on revenue contracts. Given the assessed level of risk, it may be appropriate for the auditor to use the names and addresses provided by the bank when sending deposit account confirmations but an auditor may want to perform additional procedures



Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 6

to select and verify the confirming party relative to addressing side agreement risk, given the higher risk.

As noted above, the proposed auditing standard appears to disregard the auditor's risk assessment process and instead appears to require that the existence of bank deposits, receivables, accounts payable, debt, etc., always should be assessed as higher risk, and prescribes confirmation procedures as the appropriate audit response to address this risk. Although auditors routinely incorporate confirmation procedures when auditing these balances, prescribing that auditors do so negates the risk assessment process and the ability for an auditor to determine the appropriate audit response.

Given these concerns, we recommend the Board align the procedures in the proposed auditing standard to the assessed level of risk in a manner consistent with the Board's recently issued risk standards so the auditor may apply his or her time and attention to the specific area that would have the greatest effect on improving audit quality.

Use of Internal Audit in the Confirmation Process

In the proposed auditing standard and accompanying release, the PCAOB notes that the auditor cannot use internal auditors or others within the company to send confirmation requests, receive confirmation responses or evaluate the evidence obtained from performing confirmation procedures. Further, the proposed auditing standard significantly reduces the auditor's ability to use judgment in determining the extent to which the work of others can be used in confirmation procedures. The Board's rationale for restricting the role of the internal audit function as well as the auditor's ability to use judgment in the confirmation process is unclear. In areas of lower risk for which confirmations may be an effective and efficient source of evidence, we believe an appropriately competent and objective internal audit department could assist in the confirmation process by, for example, tracing confirmations back to source documentation. We believe such assistance, appropriately supervised, increases audit quality by allowing the auditor to focus his or her efforts on the areas of higher risk, which is consistent with extant PCAOB guidance (e.g., PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*), and the risk standards recently adopted by the Board. While we believe the Proposal should emphasize the auditor's responsibility to maintain control over the confirmation process as well as to evaluate the responses, we believe that the auditor should be able to use his or her assessment of risk and the framework provided in AU Section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, in determining the appropriate manner to use the work of the internal audit function.



Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 7

Drafting Conventions

We appreciate the Board's inclusion of a number of examples to illustrate requirements in the proposed auditing standard. However, we note the examples included in the proposed auditing standard state that an auditor "should" perform certain auditing procedures. Consistent with the Board's drafting conventions, the word "should" is used to identify procedures that the auditor is presumptively required to perform. We do not believe examples should be determinative of required audit procedures. We urge the Board to replace the term "should" with "may" in each of the illustrative examples. To the extent the PCAOB intends to communicate requirements in certain examples, we encourage the Board to develop the appropriate principle or provide guidance outside of an example, as it may be difficult for auditors to apply such guidance broadly when it is contained only within a narrow example. The following instances illustrate this observation:

- Paragraph 14 states, "when an auditor performs confirmation procedures for receivables at an interim date, the auditor *should* perform sales cutoff testing at the balance sheet date to reduce audit risk to an appropriately low level for the existence and completeness assertions." We recommend the Board change the "should" to "may" as this procedure is only one example of an audit procedure the auditor may perform to obtain relevant and reliable audit evidence. Rarely is there only one audit procedure that would be acceptable to reduce the risk of misstatement to an appropriately low level. In addition, the Board should consider whether this is the most appropriate example given (1) it does not relate specifically to the use of confirmations, but rather provides guidance regarding an auditor's consideration of obtaining evidence at an interim date (AU Section 313, *Substantive Tests Prior to the Balance Sheet Date*), and (2) it could be misleading as there may be other procedures, in addition to sales cutoff procedures, that would be necessary in order to fully address the completeness and existence assertions, depending on the specific facts and circumstances.
- The examples included in paragraph 28 (Note) are intended to illustrate audit procedures that could be performed in order to satisfy an auditor's responsibilities related to performance of alternative procedures for non-responses. However, the examples are narrowly focused and include a number of "should" requirements specific to confirmation of terms of transactions or agreements. We recommend the Board replace the term "should" with "may." Further, to supplement these examples, the Board should consider including general principles or considerations for alternative procedures, which would enhance an auditor's understanding of the Board's view of the nature and extent of alternative procedures to be performed.

In addition, we are concerned with the inconsistent requirements in the accompanying release versus the proposed auditing standard and vice versa. For example, page 33 of the accompanying



Office of the Secretary
Public Company Accounting Oversight Board
September 13, 2010
Page 8

release requires an auditor to consider whether an exception to a confirmation indicated a previously unidentified risk of material misstatement due to error or fraud or deficiencies in the company's internal control over financial reporting. The notion of the impact of confirmation procedures on the auditor's consideration of the company's internal control over financial reporting is not included within the proposed auditing standard, thus we recommend such guidance specifically be incorporated into paragraph 30 as opposed to only in the accompanying release. In order to avoid possible confusion, we recommend the Board reconcile these inconsistencies before finalizing the standard.

Set forth in the Attachment to this letter are comments on specific matters included in the proposed auditing standard and accompanying release.

We appreciate the opportunity to comment on the Proposal. If you have any questions regarding our comments or other information included in this letter, please do not hesitate to contact Sam Ranzilla, (212) 909-5837, sranzilla@kpmg.com or Glen L. Davison, (212) 909-5839, gdavison@kpmg.com.

Very truly yours,

KPMG LLP

cc: PCAOB Members and SEC Chief Accountant

PCAOB

Daniel L. Goelzer, Acting Chairman
Willis D. Gradison, Member
Steven B. Harris, Member
Charles D. Niemeier, Member
Martin Baumann, Chief Auditor and Director of Professional Standards

SEC

James Kroeker, Chief Accountant



ATTACHMENT

(References to specific paragraph numbers refer to Appendix 1 of the Proposal)

#	COMMENT
<i>Relationship of Confirmation to the Auditor’s Assessment of Audit Risk</i>	
1	Paragraph 4 reiterates a portion of the guidance provided in the Board’s recently adopted Auditing Standard No. 13, <i>The Auditor’s Responses to the Risks of Material Misstatement</i> and Auditing Standard No. 15, <i>Audit Evidence</i> . We recommend that the proposed auditing standard instead refer back to these standards to 1) reduce redundancy and 2) encourage auditors to consider these standards in their entirety when considering the relationship of confirmations to the auditor’s assessment of audit risk.
<i>Cash with Financial Institutions</i>	
2	Paragraph 9 states that “[the] auditor should perform confirmation procedures for cash with financial institutions” and other relationships, such as lines of credit, as well as whether any additional information about other deposit or loan accounts that have come to the attention of the financial institution. We recommend the Board expand the description of cash to include both cash and cash equivalents.
<i>Other Risks</i>	
3	Paragraph 11 states that the performance of confirmation procedures might be an appropriate response to obtain audit evidence for certain items even when a significant risk does not exist. This does not appear to be an incremental requirement and therefore we recommend the Board delete the paragraph. Further, determination of the appropriate audit procedures to be performed to address a specific assertion is already part of the auditor’s responsibility when planning and performing the audit.
<i>Designing the Confirmation Requests</i>	
4	Paragraphs 16 and 31 require the auditor to consider the “[l]ocal customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information” when designing and assessing the reliability of confirmations. We do not believe that an auditor would reasonably be expected to have this knowledge. In addition, if the PCAOB is aware of such situations, we encourage the PCAOB to make that information known to all registered accountants in order to enhance the effectiveness of the confirmation procedures.
<i>Determining the Type of Confirmation Requests to Send</i>	
5	The second sentence of paragraph 17 states that “a positive confirmation request provides audit evidence only when a response is received directly by the auditor from the confirming party.” However, in assessing the reliability of confirmation responses, the first two factors in paragraph 31 refer to indirectly received responses. We recommend the Board modify paragraph 17 to indicate that, based on an auditor’s risk assessment, obtaining indirectly received responses provides a form of audit evidence with the acknowledgement that the auditor will need to consider the persuasiveness of the evidence obtained and determine if additional procedures should be performed.



<p>6</p>	<p>The fourth bullet of paragraph 17 states that the auditor “reasonably believes that recipients of negative confirmation requests will give such requests consideration.” We note that the extant AU 330 utilizes the term “the auditor has no reason to believe.” As such, we recommend the PCAOB clarify whether or not they intend for a change in an auditor’s evaluation based on the change included in the proposed auditing standard. We believe that any such clarification should consider that the auditor will not have a direct relationship with the confirming party.</p>
<p><i>Determining That Confirmation Requests Are Properly Addressed</i></p>	
<p>7</p>	<p>Paragraph 18 states “[t]he auditor should design confirmation requests to establish direct communication between the confirming party and the auditor to minimize the possibility that the audit evidence resulting from the confirmation procedures might not be reliable as a result of interception, alteration, or fraud.” We acknowledge that the auditor should control the confirmation process and send confirmation requests and receive responses directly (in accordance with guidance in paragraph 28 of extant AU 330). We request the PCAOB clarify and/or provide examples to illustrate what additional procedures the PCAOB envisions in “designing” confirmation requests to facilitate this process given this proposed change to the existing requirement.</p>
<p>8</p>	<p>Paragraph 19 includes the use of post office boxes as a factor in determining the nature and extent of procedures to perform to validate addresses on confirmation requests. We request the Board clarify its views on the level of risk associated with a post office box. Given the prevalence of their use, particularly in areas such as trade receivables, this may be the only address on file with the company. Without further guidance, we are concerned that auditors may perform significant verification procedures related to post office box addresses without a significant increase in the quality of audit evidence obtained.</p>
<p>9</p>	<p>We request the PCAOB clarify what is meant in paragraph 19, which states that “the auditor should perform procedures to determine the validity of the addresses on the confirmation requests, including substantive procedures or tests of controls.” Specifically, since an auditor is simply verifying the address, what constitutes “tests of controls” versus “substantive procedures?” For example, with regard to trade accounts receivable confirmations, would tests of controls represent, for instance, procedures an auditor may perform on a company’s controls regarding establishing and maintaining customer information as part of its revenue billing and collection process? Would these procedures be adequate to address the risk of invalid addresses for significant risks? What other types of substantive verification procedures does the board believe would be appropriate? The PCAOB should provide additional guidance in this area in order to clarify the Board’s expectations.</p>
<p><i>Directly Sending the Confirmation Requests</i></p>	
<p>10</p>	<p>In a footnote to paragraph 21, the term “Intended Intermediary” is defined. We recommend the Board include this term in Appendix A, <i>Definitions</i>, to maintain consistency with the rest of the proposed auditing standard.</p>
<p><i>Management Requests Not to Confirm</i></p>	
<p>11</p>	<p>Paragraph 23b states “[i]f management requests the auditor not to confirm certain accounts, balances, or other items, the auditor should obtain audit evidence as to the appropriateness of management’s reasons for the request.” It is unclear as to what would constitute sufficient audit evidence to conclude on the reasonableness of management’s reasons. We</p>



	recommend the PCAOB provide an example in order to clarify the Board's expectations.
12	<p>The Note accompanying paragraph 24b states that in the situation where management requests the auditor not confirm certain accounts, balances, or other items, "[t]he auditor should perform procedures to obtain more persuasive audit evidence than he or she would have obtained had there been no responses to a confirmation request or had the auditor made a decision not to perform confirmation procedures." We are unclear as to the Board's rationale in requiring the auditor to obtain "more persuasive" evidence in this situation rather than a situation where there was no response to a confirmation request or had the auditor chosen not to confirm. Perhaps the concern is that where management requests the auditor not confirm a certain item, the auditor should consider an increased fraud risk and exercise a heightened level of skepticism in performing alternative procedures. We recommend that the Board clarify its rationale.</p> <p>In addition, we recommend the Board provide further clarification as to what an auditor should do if "more persuasive" evidence is not available. For example, if alternative procedures for a non-response on an installment loan confirmation are to audit subsequent cash receipts and read/agree the balance back to the loan agreement, the Board should clarify what procedures could be performed that would be "more persuasive."</p>
13	<p>Paragraph 24c requires that the auditor communicate all management requests not to confirm to the audit committee. It is unclear whether the Board intends to require notification of each individual account to the audit committee. If so, we are concerned that such a requirement could be unmanageable and will not result in the most useful information being provided to the audit committee. For example, many financial institutions maintain no-mail accounts as a regular business practice. We believe that an appropriate requirement in such circumstances would be for the auditor to consider whether communication with the audit committee is appropriate in these situations. This consideration could be based upon a number of factors such as if there is a significant impact on the audit or the financial statements and if this is a benign business practice common in the industry. Furthermore, this consideration would be appropriately tempered by paragraph 25, which states: "[i]f the auditor does not agree to management's request and management refuses to authorize the confirmation request the auditor should communicate management's refusal to the audit committee, or equivalent, and evaluate the implications for the audit report." The Board should clarify its intention as to whether it would require notification of each individual account to the audit committee.</p> <p>In addition, we question the Board's rationale underlying this new requirement. Is the purpose of the requirement simply to inform the audit committee of management's request not to confirm? Does the Board intend for the audit committee to provide some additional assurance to the auditor as to the appropriateness of management's request not to confirm? We recommend the Board discuss these issues with audit committee representatives or organizations (i.e. Association of Audit Committee Members, Inc.) to gain their perspective before finalizing this guidance.</p>
<i>Non-Responses</i>	
14	<p>Paragraph 27 states, "[w]hen using positive confirmation requests and a response from a confirming party has not been received, the auditor should follow up with a second request and should consider following up with a third request." We are concerned that the mandate of a second request and consideration of a third request for positive confirmations may not</p>



	<p>be appropriate requirements for all situations where confirmation procedures are being performed and may not result in a commensurate increase in audit quality. For example, if the auditor has a low expectation of receiving responses to specific confirmation requests, it would seem more appropriate to plan and perform alternative audit procedures rather than sending out second or third requests. We recommend that the Board consider allowing the auditor to exercise professional judgment when determining whether it is appropriate to send follow-up confirmation requests, rather than including a requirement.</p>
15	<p>Paragraph 27 is not clear as to the Board’s position with regard to an oral response received in follow-up to a non-response of a positive confirmation request. As such, we recommend the Board modify paragraph 27 to indicate that, based on an auditor’s risk assessment, obtaining an oral response in follow-up to a non-response provides a form of audit evidence with the acknowledgement that the auditor will need to consider whether and the extent of supplemental procedures required.</p>
<p><i>Reliability of Confirmation Responses</i></p>	
16	<p>When assessing the reliability of confirmation responses, we agree there is a need for auditors to exercise the appropriate level of skepticism. However, we believe that the prescriptive requirements in paragraph 31 would be more appropriate as factors the auditor should consider if they have identified concerns as to the reliability of the confirmation response. We recommend the guidance in this paragraph be conformed with paragraph 10 of ISA 505, <i>External Confirmations</i>, which includes a requirement for the auditor to obtain further audit evidence only “if the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request.”</p>
17	<p>Paragraph 32 requires the auditor to assess any indication that the confirming party is not competent or objective, has questionable motives, or is not free from bias with respect to the company, when evaluating the reliability of the response received. We question how an auditor would be able to sufficiently assess these qualities given the limited interaction between the auditor and the confirming party, and recommend that the Board provide guidance to help auditors make that assessment, if the Board intends to keep this requirement. In addition, in situations where an auditor determines that there is a higher risk that a confirming party’s response may not be reliable, we recommend the PCAOB consider whether requiring confirmations in such circumstances would be appropriate.</p>
18	<p>Extant AU 330.33 states that an auditor should consider the combined evidence provided by the confirmations and the alternative procedures to determine whether sufficient audit evidence has been obtained. The extant standard states that in performing the evaluation the auditor should consider the reliability of a confirmation response and alternative procedures, nature of any exceptions, evidence provided by other procedures and whether additional evidence is required. If the combined evidence is not sufficient, the auditor is required to obtain additional evidence. Paragraph 33 of the proposed auditing standard requires an auditor to obtain additional audit evidence if a confirmation response is deemed not to be reliable, regardless of whether the combined evidence provided by the audit procedures provides sufficiently persuasive audit evidence. In accordance with extant AU 330, when a confirmation response is deemed not to be reliable, we believe an auditor should be required to use his/her professional judgment to determine whether the auditor has obtained sufficiently persuasive audit evidence or whether additional audit evidence is necessary. Therefore, we believe this paragraph should be modified to require the auditor to focus on the impact of the reliability of the confirmation on the combined audit evidence</p>



	obtained and the assessed level of risk to determine whether additional evidence is necessary.
<i>Effective Date</i>	
19	The accompanying release to the Proposal states that “[t]he Board anticipates that the proposed standard would be effective, subject to approval by the SEC, for audits for fiscal years ending on or after December 15, 2011.” Unless the final standard is issued on or before March 31, 2011, we believe that the effective date be revised to a later date to accommodate effective implementation. Many calendar year-end audit engagements are planned during the second quarter of the year. Practitioners will need sufficient time to incorporate a final standard into firm training, methodology, tools and industry guidance prior to the commencement of audit planning and interim audit procedures, which may include confirmation at an interim date.



September 13, 2010

Hunter College Graduate Program
Economics Department
695 Park Ave.
New York, NY 10065

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803
By email: comments@pcaobus.org

**Re: Comment Letter Proposed Rule - PCAOB Rulemaking Docket Matter No. 028.
Proposed Auditing Standard Related to Confirmation and Related Amendments to
PCAOB Standards**

Dear Board members and staff:

The Advanced Auditing class (Eco 775) at the Hunter College Graduate program in New York City appreciates the opportunity to comment on this proposed rule.

The class discussed the above proposed rule and has attached our comments.

If you would like additional discussion with us, contact Professor Joseph A. Maffia, at 212-792-0404.

Sincerely,

A handwritten signature in black ink that reads "Joseph A. Maffia". The signature is written in a cursive, flowing style.

Professor Joseph A. Maffia, CPA

**Hunter College Graduate Program
Economics Department
Advanced Auditing Class
Eco 775**

**COMMENTS TO PCAOB DOCKET #28:
*Proposed Auditing Standard Related to Confirmation and Related Amendments to
PCAOB Standards***

September 13, 2010

Principal Drafters

Siwka, Agnieszka
Kenny, John
Malik, Mahvash
Su, Mao
Lee, Sun Jeong

Hunter College Advanced Auditing Class

Acosta, Jenny	Padilla, Wendy
Amanat, Uzma	Pande, Mangala Gaur
Borrero, Cindy	Peng, Weining
Ercetin, Secil	Puchala, Jolanta
Grueniger, Christine	Rafickrullah, Calvin
Hoshino, Kozue	Redhead, Maurice
Johnson, Tiffany	Rezk, Monika
Kekic, Eldar	Sanderson, Timothy
Kitahata, Akina	Seo, Hyunseok
Li, Ji	Shafiq, Shahrin
Liang, Li	Spikes, Hasea
Liu, Ying Ying	Tamimu, Ali
Naringesingh, Arielle	Tan, Kwon
Navarrete, Daisy	Tonge, Emily
Newcombe, Johnathan	Tune, Henry
Noorani, Ashraf	Waxman, Michael

Professor Joseph A. Maffia, CPA

General Comments

The Advanced Auditing Class has reviewed the above proposed rule and offers the following comments for consideration by the Public Company Accounting Oversight Board (PCAOB). We answered the questions set forth in the proposed draft and also incorporated our comments and suggestions into our responses.

Questions for Respondents

- 1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?**

The definitions provided in the new proposed standard are clear and broad in the scope of confirmation procedures the auditor should perform. Also by broadening the methods and technology an auditor can use to obtain the confirmation from the outside third party, the auditors would be able to perform more efficiently and effectively with a reduced risk of fraud and tampering.

- 2. Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?**

The objective of the proposed standard does not clearly and effectively address the final purpose of the confirmation process. We suggest the Board to use this phrase; “obtain relevant and reliable evidence that is sufficient for the auditor to properly confirm the accounts.”

- 3. What other matters, if any, should the objective include?**

In our opinion, the objective should serve as a reminder to the auditor of their overarching goal of obtaining relevant and reliable audit evidence. Therefore, the general wording of the proposed objective is suitable because it does not include too many specific details which may lead to overreliance by the auditor on mechanically adhering to those rules and underutilization of their professional judgment in obtaining relevant and reliable audit evidence.

- 6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?**
- 7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?**

We are supportive of the other commenter's recommendations that the auditor should use their professional judgment to determine if more extensive confirmation is needed to help understand any unusual and complex transactions. However, if the Board decides to mandate a new requirement on these types of confirmations they should provide a detailed application guidance of what would be deemed unusual and complex transactions.

- 9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?**

The Board should consider adding this requirement:

- Confirmation received through a third party is only viable in situations when risks are insignificant.

- 15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?**

In our opinion the procedures that the Board has set forth require more elaboration. We feel that the Board should provide additional application guidance to the auditor about the proper chain of events and communication they should follow when faced with a management imposed scope limitation than AU 508 provides. We feel the auditor should properly document any scope limitations regardless of whether they deem the limitation material or immaterial.

- 16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?**

Yes. If the circumstances involved with the non-responses to positive confirmation are deemed relatively low-risk and immaterial by the auditor then the performance of alternative procedures for non-responses to positive confirmation requests should be considered by the auditor but not required. If in the auditor's opinion, the circumstances involved are high risk

or material, then the auditor should increase the scope of conformation testing by performing alternative procedures to obtain confirmation responses.

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not what changes should the board make to the requirement?

We recommend that the proposal should include application guidance about the kind of procedures the auditor should perform to investigate exceptions.

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

The Board should elaborate more on the requirements for addressing the reliability of confirmation responses. They should consider adding more guidance about the auditor ensuring that their confirmation requests reach the authorized personnel within the confirming party.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

The auditor should pick the most secure means of communicating electronically. Additionally, if the electronic confirmation contains information of a sensitive nature then the auditor should ensure not only the secure transmission but also receipt between the auditor and the confirming party (ideally, we recommend data encryption for all transmitted information, however, we realize that may not be possible in all circumstances).

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

In our opinion, direct access should be permitted as a confirmation response only if such response is received from a financial institution. Financial institutions allow their customers with direct access to their accounts, resulting in a high level of transparency and data integrity. Therefore, direct access in such institutions serves as a reliable confirmation method. Other companies do not allow the same level of access to their customer, suppliers, and vendors, so at any given point in time, their records may not be as reliable as that of financial institutions.

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

We support the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses because it provides additional transparency on audit evidence.

Additional Comments

The new definition provided in the proposed statement of receivables that arise from credit sales, loans, or other transactions is clear and easily understood. We also strongly support the Board's decision to retain the requirement to perform third-party confirmation procedures for receivables. We are cognizant of the fact that this may lead to the auditor's over-reliance on confirmation procedures. However, we believe that the benefits of doing so outweigh the potential harm arising from supplanting the auditor's judgment with an over-reliance on confirmation procedures. Not only will the third-party confirmation of accounts receivable be more relevant and reliable than information generated by the client, it will also be extremely useful to the auditor in designing and performing an audit plan to help gather audit evidence, and for potentially finding any material misstatements and fraud within the financial statements.

During our analysis we reached the conclusion that the Board should consider the following 2 suggestions; first, the Board should take initiative to collaborate with COSO to include the requirement for companies to respond to confirmation requests. This can greatly enhance collective financial reporting. Secondly, we should mandate a requirement for confirming parties to respond to positive confirmations and to make it available to the public where all confirmation requests should be sent. The inclusion of this new requirement would reduce the risk of sending the confirmation request to the wrong address or to the wrong person within the confirming party. This new requirement would also increase the overall number of responses received as well as increasing the amount of sufficient and appropriate audit evidence. We are aware that we can only mandate such requirement by amending the Sarbanes Oxley Act of 2002. If the Board and other governing bodies work together, such amendment will not only reduce the unnecessary workload for the auditor but it will also simultaneously facilitate the timely and efficient collection of sufficient and appropriate audit evidence.

Enhancing the effectiveness of Audit Confirmations

Confirmations have been widely used and is a valuable tool for auditor's primarily because it can provide persuasive information. If properly designed, confirmations can provide strong audit evidence when received directly from a third party and that corroborates relevant assertions about account balances, transactions, and disclosures.

Confirmations are typically used for cash, investments, accounts receivable, inventory on consignment, accounts payable, loans, capital transactions, and revenue. Other types of audits might include different information such as, employee benefit plans participant data. Use of confirmations are only limited by the Auditor's imagination.

Did you know that some of the largest corporations in the world, such as Amazon and Verizon have established a policy not to respond to audit confirmations? Ironically, they respond in writing that they don't respond to confirmations in writing. Corporate America has a vested interest – no obligation to respond to audit confirmations and that obligation should be formalized as outlined in this proposal.

In the era of looming disruptive technological change, this proposal is a simple, low tech high-quality initiative to improve audit confirmation efficiency. This article proposes changes to the audit confirmation process, standards, and related regulations to improve audit quality by addressing some of the risks to confirmation effectiveness. Adoption will require the consideration of new concepts for the audit confirmation process.

Limitations impeding the confirmation process exist preventing maximizing effectiveness of confirmations. Use of electronic confirmation has helped with faster turnaround times, improved response rates, reduced financial fraud, and minimizing human error, however this has been mainly limited to cash confirmations.

Risks to confirmation effectiveness

While many benefits are derived by its usage, confirmations are still fraught with risks that hamper its effectiveness. Some of the risk associated with utilizing confirmations include:

- Auditor cost to implement may be great
 - Staff time to design
 - Associated fees
 - Follow-up staff time
 - Authentication of respondent
 - Long turnaround times
 - Performance of alternative procedures, if necessary
- Low response rates
- Reliability of confirmation affected by possible respondent bias

- Errors unfavorable to the respondent are more likely to be responded to
- Errors favorable to the respondent are less likely to be responded to
- Larger errors are more likely to be identified by respondent
- Small errors are less likely to be identified by respondent
- Respondent unauthorized to respond
- Authentication of respondent
 - Identity of respondent
 - Verification of contact information
 - Signature verification of respondent
- Respondent error
- Fraud risks
 - Forgeries
 - Collusion

Overview of the confirmation process

No significant change to the audit confirmation process is planned, however some steps will not be necessary depending on the type of response and the information requested. Here is an overview of the more significant steps in the audit confirmation process:

- Auditor determines the appropriateness of confirmation
 - If no confirmation will be used for accounts receivable, then auditor documents the decision that confirms are not appropriate.
- Selection of items to be confirmed
- Design confirmation request
- Send signed confirmation to the appropriate third party
 - Maintain control over the request
 - Pay special attention to related parties
- If the third-party fails to respond
 - Second requests are sent
 - If no response, then alternative procedures are considered.
 - Auditor will evaluate reliability of evidence
 - Conclude whether the objectives have been met.
- When the third party responds
 - Auditor review confirmation response
 - Auditor should consider authenticating the identity
 - Auditor determines if this evidence matches the records
 - Differences are investigated and auditor may perform alternative procedures
 - Auditor will evaluate the reliability of evidence
 - Auditor will conclude whether the objectives have been met.

Overview of the initiative to improve the effectiveness of audit confirmations

The principal concepts of this initiative can be simply summarized as requiring all companies to publish where and how confirmations can be submitted, as well as, requiring all companies to

respond to a confirmation request. Recognizing the significant regulatory and operating differences between public and private companies the specifics of the initiative are as follows:

Required regulatory changes to improve audit confirmation effectiveness

All entities registered with the SEC would be required to do the following:

- All companies must publicly publish either a mailing address, website, or instructions to submit confirmations and publish information on both the Public Company Accounting Oversight Board (PCAOB) website and their own website.
- All companies must publish how the different kinds of information confirmations are to be submitted.
- All Public companies will establish guidelines for sending confirmations to streamline the process and minimize the burden of their response.
 - Require minimum information to facilitate response
- Applies to all confirmations submitted by auditors on behalf of their clients to a public company.
- All companies must send an email acknowledgement of receipt of the confirm with 24 hours.
- All companies must respond to automated confirmation requests received within 2 business days.
- All companies must respond to confirmation requests that require input from the respondent within 5 business days.
- Not responding to confirmations requests would carry a penalty.

Required Standard setting changes

Both the PCAOB and the American Institute of Certified Public Accountants Auditing Standards Board (ASB) should adopt the following:

- Require the use of cash confirmations like the accounts receivable confirmation requirement.
- Eliminate the use of negative confirmations
- Identification that the failure to respond to an audit confirmation received is a material weakness in internal control.
- Broaden the PCAOB audit standards to incorporate or require greater use of confirmations.
- Encourage the use of electronic confirmations when possible.
- Encourage the auditor to submit spreadsheets and other information necessary to assist the respondent to reconcile and respond to the audit confirmations.

Private companies

Accounting for the Common Good

The Committee of Sponsoring Organizations (COSO) framework uses a one-dimensional viewpoint of the objectives for internal control over financial reporting which does not address the prevailing business mindset. Its narrow focus is on the interest of the individual entity and does not address the interests of the broader collective group of all entities. Several events in

society have recently reflected the broadening obligation of the objectives of a corporation. From the growing importance of Environmental, Social, and Governance reporting, to the Business Roundtable, recently redefining the purpose of a corporation to a commitment to all stakeholders such as shareholders, customers, employees, suppliers, and communities.

The COSO reporting objectives pertaining to external financial/nonfinancial reporting should have a new objective relating specifically to responding or complying with all confirmation requests received. If policies and procedures are not in place to provide reasonable assurance that an entity has complied with this objective, then it should be considered a material weakness. Both private and public companies should seek to adopt the characteristics of a good system of internal control.

New considerations required

New factors will need to be considered for this confirmation initiative.

Nature of the respondent

Confirmations sent to a public company will need to be differentiated from a private company. Public companies will be penalized if they don't respond to a confirmation both financially as well as having a material weakness. Private companies that do not publish and respond to confirmations will have a material weakness.

Type of information requested

Information that can be corroborated automatically and directly from the books and records of the respondent via electronic means should be differentiated by information that requires research or input on the part of the respondent. Therefore, automated versus those confirmations requiring research will have to be identified. I.e., a blank positive confirmation versus a filled in positive confirmation. Example would include a cash balance only confirmation versus cash confirmation requiring authorized signatory.

In with the new out with the old

Negative confirmation will not have a place under this new initiative. A combination of a positive confirmation and alternative procedures will have to be performed to replace this technique.

Protecting confidential information

Respondent's will need to adopt protocols to protect personal identifiable information and privacy by implementing protections that address possible fraudulent requests (i.e., the news agency seeking confidential information).

Cost to Business respondents

The ongoing cost to the business respondent will be a function of their internal controls over accounts receivable and accounts payable, the accounting system they use, transaction volume and cost of personnel. These new costs will be partially offset by the cost of current resources allocated to responding to confirmations. There will also be initial start-up costs such as, website and software development. The respondent should be able to recoup the cost which should be

paid by the auditor. A fee should be paid for each auditor request with pricing for automated versus requiring input reflecting the difference in respondent time and effort.

This initiative will significantly improve overall audit quality by increasing confirmation response rates, reducing fraud, and address many of the respondent's risks associated with confirmations by publishing where to submit the request and identification of who is authorized to respond.

**Mayer Hoffman McCann P.C.****An Independent CPA Firm**

175 South West Temple, Suite 650
Salt Lake City, Utah 84101
801-364-9300 ph
801-364-9301 fx
www.mhm-pc.com

September 13, 2010

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

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

Dear Board Members and Staff:

Mayer Hoffman McCann P.C. (“MHM”) welcomes the opportunity to comment on the *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (the “Proposed Auditing Standard”).

In summary, MHM agrees with The Public Company Accounting Oversight Board’s (“PCAOB” or the “Board”) conclusion regarding the need to update and expand certain aspects of the existing auditing guidance on audit confirmations due to changes in the auditing environment and the increased use of technology in the audit confirmation process. However, MHM is concerned with the unilateral approach the Board has taken in certain areas of the Proposed Auditing Standard which seems to be in conflict with a principles based approach to auditing and potentially other current or proposed auditing guidance. For example, the Board’s proposed standard *Audit Evidence* already requires an auditor to design and perform audit procedures to obtain sufficient appropriate audit evidence. Requesting external confirmations is one of the procedures but not the only procedure an auditor may use in obtaining audit evidence. Therefore, MHM is concerned with certain aspects of the Proposed Auditing Standard as currently written and questions, in some cases, the auditor’s ability to comply with the Proposed Auditing Standard due to factors dictated by the confirming parties which are outside the control of the auditor.

Overly Broad Terminology

In certain areas of the Proposed Auditing Standard, the Board has used what MHM considers to be overly broad terminology. MHM believes the terminology should be revised to be either more specific or explained in greater detail through the addition of more terms being added to the definitions section in Appendix A of the Proposed

Auditing Standard. MHM is concerned that without these refinements consistency in the application of this guidance among practitioners will suffer. For example, MHM believes the use of the term “other transactions” in Paragraph 8 is overly broad and is open to a wide variety of interpretation which will result in inconsistent application of the Proposed Auditing Standard.

Requirement to Confirm Receivables

MHM agrees with the Board that a confirmation response from a third party can provide relevant and reliable audit evidence of the existence of receivables and that audit evidence from a third party is generally more reliable than audit evidence generated internally by a company or provided directly by a company. However, MHM believes that a unilateral requirement to confirm receivables in all cases is a one size fits all audit approach that discounts the professional judgment of the auditor and completely ignores factors which may exist that would historically have had an impact on the auditor’s judgment regarding the testing of receivables such as:

- The nature of the receivables and the frequency with which they are collected
- The effectiveness of confirmations. This may be due to a lack of response or incorrect responses being received historically despite utilization of many, if not all, of the steps suggested by the Proposed Auditing Standard to improve the response rate
- The fact that other auditing procedures in certain circumstances may be more effective and provide more persuasive audit evidence than a confirmation
- A history of restrictive or qualified language being included on the returned confirmations which renders them potentially ineffective as audit evidence
- The amount of time elapsed between the balance sheet date and the date of the audit procedures (i.e., in certain circumstances with respect to Initial Public Offerings)

As a result, MHM believes the presumptive requirement to confirm receivables and the exceptions for overcoming this presumption under the existing auditing guidance in AU Section 330, *The Confirmation Process* should continue to be provided to the auditor in the Proposed Auditing Standard.

Requirements Confirming Cash with Financial Institutions

The confirmation process requires the cooperation of not only management but also of the confirming party. Consequently, as the Board seeks to impose expanded requirements for the auditor to seek confirmations from third parties and to prescribe with whom at the third party the auditor should confirm, MHM reminds the Board that these third parties are not obligated to respond or cooperate in the confirmation process and often they do not. In addition, the ability of the auditor to dictate to third parties certain aspects of the confirmation process is, in some cases, beyond the control of the auditor.

For example, Paragraph 15 of the Proposed Auditing Standard states, “The auditor should direct the confirmation request to an appropriate confirming party.” Paragraph 15 continues, “Even if the company provides the auditor with the name of an appropriate confirming party, the auditor should select the confirming party.” MHM is concerned with the auditor's ability to comply with this requirement because the confirming party at a financial institution and their knowledge of the arrangements or transactions is quite often out of the control of the auditor or the client as more and more financial institutions have policies that require all confirmation requests be sent to a central location. As a result, it is the financial institution selecting the confirming party, not the auditor or the client.

When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

Paragraph 29 of the Proposed Auditing Standard states “When a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence that the auditor requires.” The Proposed Auditing Standard then goes on to provide two examples of situations when alternative procedures would not be acceptable audit evidence and thus require that audit evidence be obtained only through a positive confirmation. However, due to the seriousness of the implications of this guidance on the audit and auditors’ report and the broad nature of the two examples presented, MHM believes additional guidance is needed to further clarify when a positive confirmation is the only acceptable form of audit evidence.

We appreciate the opportunity to provide comments on the Exposure Draft. Please contact Mark Nichols (801-364-9300 ext. 180) if you have any questions.

Respectfully Submitted.

Mayer Hoffmann McCann P.C.



Paris La Defense, September 13, 2010

Public Company Accounting Oversight Board

Office of the Secretary

1666 K Street, N.W.

Washington, DC 20006, USA

Attention: J. Gordon Seymour, Secretary, and the Members of the Board

Re: PCAOB Release No. 2010-003 July 13, 2010 - PCAOB Rulemaking Docket Matter No. 028 - Proposed Auditing Standard Related to Confirmation and Related Amendment to PCAOB Standards

Dear Sirs,

Mazars is a unique integrated partnership with a global reach. It operates as one integrated international partnership in 56 countries with more than 12,500 professionals, led by more than 600 partners, with 16 additional countries where Mazars is present through correspondents and joint ventures (see Mazars 2009 annual report together with its more recent updates, its 2009 IFRS joint-audited consolidated financial statements, and all the annual reports published since 2005 on <http://www.annualreport.mazars.com/eng/>).

Mazars is one of the founding members of 'Praxity', an alliance of 109 firms operating in 72 countries with more than 24,500 professional, the world's largest alliance of independent accounting firms.

Mazars provides a complete range of audit, accountancy, tax, legal and advisory services, designed to create added-value. Mazars was founded with certain core values: Independence, Competence; Intellectual and Ethical Rigour and Integrity; Sense of Service and Responsibility; Continuity; Respect for Individuals and Diversity.

We are pleased to submit this comment letter in response to the invitation from the PCAOB to comment on its proposed auditing standard related to confirmation. Mazars is very supportive of the PCAOB's efforts to update its auditing standards related to confirmation.

Since the 1939 McKesson & Robbins case, audit confirmation has continued to play a pivotal role in the audit process as one of the means of gathering evidence. At the same time, the means of communication (fax, email, txt msg, etc) have dramatically changed due to technological advances. Thus, the need to dust off the auditing standard related to confirmation..

We respectfully submit our detailed comments below. We commend the Board for the transparency of its rule deliberation process and for considering the work of the IFAC IAASB.



2

1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions? – Page 9

Mazars believes that the definitions provided in the proposed standard are sufficiently clear and appropriate.

2. Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective? – Page 9

Mazars believes that the objective of the proposed standard as presently stated is sufficient and appropriate.

3. What other matters, if any, should the objective include? – Page 9

Mazars proposes that the objective include a rationale for “*obtaining relevant and reliable audit evidence*”.

4. Is the description of "receivables that arise from credit sales, loans, or other transactions" sufficiently clear and appropriate? If not, what changes should the Board make? – Page 14

Mazars believes that the description of "*receivables that arise from credit sales, loans, or other transactions*" as provided in this proposed standard, is sufficiently clear and appropriate.

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make? – Page 15

The requirement in the proposed standard to confirm cash and other relationships with financial institutions is sufficiently clear and appropriate.

6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make? – Page 18

Mazars believes that the proposed standard appropriately addresses the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures.

7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include? - Page 18

The proposed standard appropriately addresses the requirement for sending confirmation requests in response to significant risks.



3

8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make? – Page 19

The description in the proposed standard of other risks is sufficiently clear and appropriate.

9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make? – Page 22

The requirements in the proposed standard for maintaining control over the confirmation process appear sufficiently clear and appropriate.

10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make? – Page 22

The description with respect to the use of internal auditors in the confirmation process appears sufficiently clear and appropriate.

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make? – Page 23

The factors to be considered by auditors when designing confirmation requests in the proposed standard appear clear and appropriate.

However, Mazars would like to propose that in addition to the company's authorization to the confirming parties to respond to the auditor, the issue of which party bears the costs of processing the confirmation (the confirming party or its intermediary) be agreed upon upfront in order to avoid any misunderstandings.

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements? – Page 26

Per Mazars, the requirements in the proposed standard regarding the use of negative confirmation requests are sufficiently clear and appropriate.

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures? – Page 27

Per Mazars, the procedures the auditor should perform to determine the validity of the addresses on confirmation requests appear sufficiently clear and appropriate.



4

14. Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures? – Page 27

Per Mazars, the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address appear sufficiently clear and appropriate.

15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements? – Page 29

Per Mazars, the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items appear sufficiently clear and appropriate. However, Mazars proposes additionally that:

- a) The auditor also communicates the matter to the corporate legal counsel,
- b) This situation be considered and assessed during the immediate subsequent interim reviews or annual audits.

16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances? – Page 32

Mazars believes that there are no circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests.

17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make? – Page 32

Per Mazars, the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement are appropriate.

18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances? – Page 33

The two circumstances described on pages 32 and 33 that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence are the most pertinent and relevant ones.

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement? – Page 34

Per Mazars, the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses appears sufficiently clear and appropriate.



5

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements? – Page 36

Per Mazars, the requirements in the proposed standard related to addressing the reliability of confirmation responses are sufficiently clear and appropriate.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include? – Page 40

Per Mazars, the proposed standard includes adequate requirements regarding electronic confirmation procedures.

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them? – Page 40

Per Mazars, the proposed standard has adequately addressed the most relevant risks related to the use of an intermediary.

23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party – Page 40

Per Mazars, this issue of intermediary relates for example to services organizations (AU sec 324) and to the use of specialists (AU sec 336). Both are service providers to confirming party and intermediaries between confirming party and auditors. The confirming party has delegated or outsourced to them the performance of certain of its activities. They have certain responsibilities and obligations vis-à-vis the confirming party. In the eyes of auditors, they must for sure be competent, independent, and objective.

24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them? – Page 40

Per Mazars, there are potential risks related to the auditor's use of direct access that the proposed standard has not adequately address, such as IT security and reliability of such a direct access to client's data in the system of the confirming party.

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not? – Page 40

Per Mazars, the Board should not limit the use of direct access as a confirmation response to responses received from financial institutions only for the following reasons:

- a) It should be a matter of professional judgment,



6

- b) It is not appropriate to limit and cater to one industry (financial industry) whereas direct access may be applicable across the spectrum,
- c) Technology can evolve and change landscape rapidly.

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make? – Page 42

The requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses are not sufficiently clear.

The Board should provide a clear guidance with examples on how an auditor can assess the effect of disclaimers and restrictive language on the reliability of a confirmation response. The objective is clearly to ban any ‘toxic language’ from the response of the confirming party.

Thus the auditor will be equipped to determine when a disclaimer or restrictive language becomes a barrier, leading to considering a confirmation response as a non-response and performing appropriate alternative audit procedures.

27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make? – Page 43

Per Mazars, the requirements in the proposed standard related to evaluating the results of confirmation procedures appear sufficiently clear and appropriate. However, the risk-based principle of AS 5 should be added as a tenet of this proposed auditing standard.

We hope that our comments above will be useful and we remain available for further considerations. Please feel free to contact us again if you deem it necessary to discuss our submission further.

Yours sincerely,

Wendy Stevens
WeiserMazars Quality Assurance

Denis Usher
Mazars US Desk

Jean-Luc Barlet
Mazars Chief Compliance Officer



September 9, 2010

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

Re: PCAOB Rulemaking Docket Matter No. 028

Dear Office of the Secretary:

McGladrey & Pullen, LLP appreciates the opportunity to offer our comments on the PCAOB's *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*. Our comments are organized by those that are general in nature, followed by those that relate to specific paragraphs.

General Comments

Differences between the Board's Standards and Other Standards

The requirements of this proposed standard are significantly different from the corresponding standards of the International Auditing and Assurance Standards Board (IAASB) and AICPA Auditing Standards Board (ASB). If differences between the PCAOB's standards and the IAASB and ASB standards become more significant and pervasive, audit firms may be required to develop and maintain separate audit methodologies, policies and training. Under such circumstances, some firms may elect not to perform issuer audits, ultimately resulting in reduced competition. Before embarking on further revisions of the interim standards, we urge the PCAOB to consider whether its planned revisions to the interim standards will create unnecessary differences between its auditing standards and those standard setters for non-issuers.

Risk-based Audit Approach

In our comments below, we note instances where the proposed standard is prescriptive and at times contradicts the concept of risk-based auditing. An effective risk-based audit approach is dependent on the auditor's use of professional judgment in identifying and assessing risks of material misstatement and in designing and performing further audit procedures in response to those risks. Prescriptive procedures inhibit the auditor's use of professional judgment, based on the facts and circumstances of the entity and its environment. In many instances, we believe the Board can achieve its objectives by providing additional guidance regarding the auditor's use of professional judgment, rather than requiring adherence to rigid, prescriptive requirements.

Requirements of the Auditor Included in Notes

We are concerned that auditors will not readily identify requirements contained in "Notes" to the proposed standard, and that auditors may fail to identify and implement those requirements. We urge the Board to place all requirements of the auditor in the body of the standard and use "Notes" to describe how auditors might implement the requirements.

Comments on Specific Paragraphs

1. **Confirmation of Receivables That Arise from Credit Sales, Loans, or Other Transactions**

Paragraph 8 of the proposed standard requires the auditor to perform confirmation procedures for receivables that arise from credit sales, loans, or other transactions. We recommend that the Board retain the exception in extant AU Section 330 that allows auditors to not send confirmation requests when the confirmation process is expected to be ineffective. We believe there are valid situations where confirmation procedures are ineffective, such as when customers have a stated policy of not responding to any auditor confirmation requests and when confirmations are sent to individuals in connection with an audit of a healthcare provider. In such situations, the design of the confirmation has little or no impact on the effectiveness of the confirmation procedures. We believe the removal of this exception precludes the auditor's use of professional judgment and will lead to inefficiencies in the audit without improving audit effectiveness. To improve auditor performance in this area, we suggest the Board retain this exception, but provide guidance on and examples of the appropriate use of the exception and the alternative procedures to be performed in such circumstances.

We also recommend revising the last sentence of paragraph 8 as follows: The auditor should consider ~~assess~~ the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which receivables to confirm.

2. **Confirmation Procedures in Response to Significant Risks**

Paragraph 10 requires the auditor to perform confirmation procedures in response to significant risks that can be adequately addressed by confirmation procedures, regardless of whether the risk of material misstatement can be adequately addressed by the performance of other substantive procedures. We believe this is unnecessarily prescriptive and that paragraph 10 should be revised to apply only to those situations where the significant risk is a fraud risk, such as undisclosed oral or written modifications to agreements. For example, paragraph 10 would appear to require an auditor to confirm the terms of a business acquisition with the selling party when other substantive procedures would also be effective. We recommend the Board eliminate or modify this requirement and, instead, provide guidance regarding when confirmation procedures would be the only effective response to significant risks.

3. **Use of Internal Auditors and Others**

Page 20 of the Release accompanying the proposed standard states: "internal auditors may assist in testing that confirmation requests are properly addressed and in assembling information necessary for the auditor to resolve exceptions in confirmation responses." We suggest the Board include this guidance in the proposed standard. Without this language in the standard, we believe auditors will interpret the standard as precluding the use of internal auditors to assist with confirmation procedures in any manner.

4. **Determining the Type of Confirmation Requests to Send**

In paragraph 17, we suggest removing the phrase "as the only form of confirmation request" from the sentence preceding the bullets as we believe all of these conditions should be present when the auditor uses negative confirmation requests to obtain audit evidence.

5. **Requesting Responses Directly from the Confirming Parties**

The last sentence of paragraph 22 requires the auditor to request that the confirming party re-send a confirmation response that was initially sent to a party other than the auditor. We believe an oral verification of the confirmation response from the confirming party would reduce audit risk to an acceptable level and should also be permitted.

6. **Management Requests Not to Confirm**

The Note in paragraph 24 requires the auditor to “obtain more persuasive audit evidence than he or she would have obtained had there been no response to a confirmation request or had the auditor made a decision not to perform confirmation procedures.” While we understand the rationale for this requirement, we do not understand what audit evidence the auditor would obtain that is more persuasive than that obtained under paragraphs 27 and 28 for non-responses. We suggest the Board revise this Note to more clearly explain the types of evidence the auditor would obtain in these situations.

Also, we believe the requirement in paragraph 24.c. to communicate to the audit committee management’s request to not confirm certain accounts, balances or other items is unnecessary when the auditor has agreed to management’s request. However, we do support the requirement in paragraph 25 for the auditor to communicate any disagreements with management’s request to not confirm certain accounts, balances and other items. We suggest the Board also incorporate this requirement in its *Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards*.

7. **Non-responses**

The fourth sentence of paragraph 28 requires the auditor, in addition to performing alternative procedures, to include the terms of significant transactions or agreements in the management representation letter and to communicate the terms of the transactions or agreements to the audit committee, or equivalent. We believe these requirements are unnecessary as they do not provide the auditor with additional audit evidence. However, if the Board retains the requirement to include the terms in the management representation letter, since a copy of that letter must be provided to the audit committee prior to the filing of the audit report with the SEC, it would be redundant to ask the auditor to also include the terms of significant transactions or agreements in the audit committee communication.

8. **Reliability of Confirmation Responses**

Paragraph 31 requires the auditor to explicitly assess the reliability of all confirmation responses, and provides factors the auditor would consider in making this assessment. We believe this requirement is overly prescriptive, and suggest it be revised to conform with International Standard on Auditing 505 and the Auditing Standard Board’s proposed Statement on Auditing Standards, *External Confirmations*, which require the auditor to obtain further audit evidence when he or she identifies factors that give rise to doubts about the reliability of a response.

In the Note to paragraph 32, the list of circumstances where the auditor should obtain additional audit evidence includes a response from a confirming party that is the custodian and servicer of a material amount of the company’s assets. We suggest the Board clarify that this circumstance would not apply to non-related-party financial institutions, insurance companies, broker-dealers, and other entities whose custodial and servicing activities are subject to regulatory oversight.

9. **Additional Procedures for Electronic Confirmation Responses**

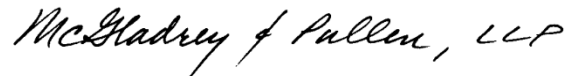
The Note to paragraph 35 requires confirming parties to provide a written acknowledgment that “(a) it is aware of the auditor’s request for and intended use of the information, and (b) the files to be accessed contain information responsive to the auditor’s request”. We are concerned that third parties will refuse to provide such an acknowledgement thereby causing the auditor to be required to perform additional audit procedures, and that the cost of performing such procedures will outweigh the benefits. We recommend this requirement be removed or, at a minimum, that the Board allow confirming parties to provide a general acknowledgement to the auditor’s firm, rather than an acknowledgment for each individual issuer.

10. Disclaimers and Restrictive Language

Paragraph 37 requires the auditor to evaluate the effect of a disclaimer or restrictive language on the reliability of a confirmation response. While we agree with this requirement, we urge the Board to collaborate with representatives of key confirming parties to reduce the use of disclaimers and restrictive language.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to either Bob Dohrer (919.645.6819) or Susan Menelaides (602.760.2827).

Sincerely,

A handwritten signature in cursive script that reads "McGladrey & Pullen, LLP".

McGladrey & Pullen, LLP



Home of the Trusted Professional
3 park avenue, at 34th street, new york, ny 10016-5991
212.719.8300 • fax 212.719.3364
www.nysscpa.org

September 13, 2010

Ms. Jennifer Rand, Deputy Chief Auditor
Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

By e-mail: comments@pcaobus.org

**Re: PCAOB Release No. 2010-003 – Proposed Auditing Standard, *Confirmation*,
and Related Amendments to PCAOB Standards
(PCAOB Rulemaking Docket Matter No. 028)**

Dear Ms. Rand:

The New York State Society of Certified Public Accountants, representing more than 27,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned release.

The NYSSCPA's Auditing Standards Committee deliberated the release and prepared the attached comments. If you would like additional discussion with us, please contact Jan C. Heringer, Chair of the Auditing Standards Committee at (212) 885-8133, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

A handwritten signature in cursive script that reads "Margaret Ann Wood". The signature is written in black ink and is positioned above the printed name and title.

Margaret A. Wood
President

Attachment



Home of the Trusted Professional

3 park avenue, at 34th street, new york, ny 10016-5991

212.719.8300 • fax 212.719.3364

www.nyssepa.org

**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

COMMENTS ON

**PCAOB RELEASE NO. 2010-003 – PROPOSED AUDITING STANDARD,
CONFIRMATION, AND RELATED AMENDMENTS TO PCAOB STANDARDS**

(PCAOB RULEMAKING DOCKET MATTER NO. 028)

September 13, 2010

Principal Drafters

Jan C. Herring

Mark Mycio

John M. Sacco

NYSSCPA 2010 – 2011 Board of Directors

Margaret A. Wood, <i>President</i>	John Barone	Mark G. Leeds
Richard E. Piluso, <i>President-elect</i>	Cynthia D. Barry	Pei-Cen Lin
Joseph M. Falbo Jr., <i>Secretary/Treasurer</i>	S. David Belsky	Heather Losi
Scott M. Adair, <i>Vice President</i>	Ian J. Benjamin	Anthony J. Maltese
David R. Herman, <i>Vice President</i>	Robert W. Berliner	Barbara A. Marino
Martha A. Jaeckle, <i>Vice President</i>	Anthony Cassella	David J. Moynihan
Gail M. Kinsella, <i>Vice President</i>	Sherry L. DelleBovi	Avery E. Neumark
Joanne S. Barry, <i>ex officio</i>	Adrian P. Fitzsimons	Joel C. Quall
	Stephen E. Franciosa	Robert R. Ritz
	Jennifer R. George	Erin Scanlon
	Rosemarie A. Giovinazzo-	Robert E. Sohr
	Barnickel	George I. Victor
	Mitchell L. Gusler	Charles J. Weintraub
	John B. Huttlinger Jr.	Jesse J. Wheeler
	Nancy A. Kirby	F. Michael Zovistoski
	J. Michael Kirkland	

NYSSCPA 2010 – 2011 Accounting & Auditing Oversight Committee

Rita M. Piazza, <i>Chair</i>	Jay H. Goldberg	Mark Mycio
Anthony S. Chan	Jan C. Herringer	Michael A. Pinna
Sharon S. Fierstein	Edward P. Ichart	William M. Stocker III
	Elliot A. Lesser	

NYSSCPA 2010 – 2011 Auditing Standards Committee

Jan C. Herringer, <i>Chair</i>	Manish Gera	Bernard H. Newman
Kamel W. Abouchacra	Fred R. Goldstein	Muhammad F. Padela
John E. Barron	Menachem M. Halpert	John C. Parcell IV
Robert W. Berliner	Neal B. Hitzig	William J. Prue
Roberto Bolanos	Julian E. Jacoby	Michael A. Sabatini
Sharon M. Campbell	Michael E. Kayser	John M. Sacco
Santo Chiarelli	Elliot A. Lesser	Mark Springer
Steven A. Connors	Moshe S. Levitin	Stephen P. Tuffy
Robert J. Cordero	Ralph Lucarello	Richard T. Van Osten
Vincent Gaudioso	Mark Mycio	Paul D. Warner
John F. Georger, Jr.	Lawrence E. Nalitt	Robert N. Waxman
	Wayne Nast	

NYSSCPA Staff

Ernest J. Markezin
William R. Lalli

New York State Society of Certified Public Accountants
Auditing Standards Committee

Comments on

**PCAOB Release No. 2010-003 – Proposed Auditing Standard, *Confirmation*, and
Related Amendments to PCAOB Standards**

(PCAOB Rulemaking Docket Matter No. 028)

The New York State Society of Certified Public Accountants (NYSSCPA) is pleased to submit the following comments in response to the Public Company Accounting Oversight Board’s (PCAOB or the Board) request for comments on the *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (the Proposal or the Proposed Standard).

We support the PCAOB’s standard-setting project to amend the interim standard, AU Section 330, *The Confirmation Process*, because advances in technology from the time the confirmation standard was initially written have changed the way in which confirmation procedures are performed; however, we are concerned that the Proposal does not seem to incorporate the foundational concepts included within the risk assessment standards. As such we are concerned that such a prescriptive approach may stifle the auditor’s risk assessment procedures and result in a “check the box” approach rather than the approach we believe is set out in the recently issued risk assessment standards.

Our comments to the questions posed in the release are presented below.

A. Definitions

1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

Yes, we believe the definitions included within Appendix A of the proposed standard are generally clear and appropriate.

B. Objective

2. Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?

No. We note that this objective is similar to the objective of the corresponding confirmation standard of the International Auditing and Assurance Standards Board (IAASB) and the proposed standard of the Auditing Standards Board (ASB); however, the structure of this proposed standard differs from those standards in that the Board's standard addresses only the design and performance of confirmations whereas the ASB's and IAASB's approach addresses the auditor's response to assessed risks of material misstatement in addition to the design and performance of confirmations when the auditor has determined that confirmation procedures will likely provide relevant audit evidence. For this reason, we do not believe the objective is appropriate and recommend revising as follows:

The objective of the auditor is to—

1. Consider whether to obtain sufficient appropriate audit evidence through the use of confirmation procedures; and
2. Design and perform confirmation procedures to obtain relevant audit evidence.

3. What other matters, if any, should the objective include?

(See our response to question 2 above.)

C. Confirmation of Specific Accounts

4. Is the description of “receivables that arise from credit sales, loans, or other transactions” sufficiently clear and appropriate? If not, what changes should the Board make?

We do not believe the description of “receivables that arise from credit sales, loans, or other transactions” is sufficiently clear as it relates to the term “other transactions.” We believe that the proposed standard should clarify what is meant by the term “other transactions,” as it is not clear what “other transactions” are incorporated within that term. Such additional guidance is necessary to ensure auditors are able to comply with the requirement to perform confirmation procedures for these “other transactions.”

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

While we agree that, ordinarily, confirmation of cash and other relationships with financial institutions should be performed to address the assessed risks of material misstatement, we do not believe that it is appropriate to prescribe the confirmation of cash and other relationships in all instances. Generally, we do not believe that the risks associated with cash are significant, especially in situations in which internal controls are effective. The appropriate response to the assessed risk should be based on the auditor's professional judgment and that the decision about whether to use confirmation procedures should be based on the most effective and efficient means of obtaining

sufficient appropriate audit evidence. Many times confirmation procedures will be the appropriate method, but there are other circumstances in which confirmation procedures may not be the most appropriate means of addressing the assessed risk.

For example, there may be circumstances in which an entity has numerous cash accounts at multiple locations, each with various financial institutions, but the balances are small and the controls over the cash accounts are effective enough that to require confirmation of all cash accounts would not be the most effective or efficient approach. As such, we believe that a risk-based approach would address the risk of material misstatement more appropriately.

6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

No, it does not. We believe that the requirement is unclear, and recommend that the Board clarify the meaning of it. For example, if an auditor is able to perform confirmation procedures, is he or she required to do so, regardless of whether such an approach is the most effective and efficient approach? Further, we believe that a risk-based approach that focuses the auditor on the assessed risks of material misstatement and provides for the use of professional judgment in deciding the most appropriate response to those assessed risks, as set out in the foundational suite of risk assessment standards, provides the best approach.

7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

We do not believe the proposed standard should include any additional requirements with respect to sending confirmation requests. As stated above, we believe a risk-based approach, based on the principles set out in the risk assessment standards, provides for the most effective and efficient audit.

8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

The description in paragraph 11 of “other risks” does not seem to provide any incremental guidance. Further, the identification of risks and the determination of the appropriate response to such risks is already part of the auditor’s responsibility as set out in the risk standards.

D. Confirmation Procedures

9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements for maintaining control could be enhanced. For example, paragraph 16 requires the auditor to consider “local customs that might influence confirmation requests without verifying the information.” It is not clear how the auditor might obtain this information and whether such “local customs” are meant to relate to a country, a specific jurisdiction of a country, or other such geographic location. We suggest clarifying this guidance and providing examples of how to assess such a condition.

We note that the proposed ASB standard has addressed this risk in another way. While acknowledging that a risk exists that a confirming party may reply to the confirmation request without verifying that the information is correct, the clarified ASB standard suggests that the auditor may reduce this risk by using positive confirmation requests that ask the confirming party to fill in the amount or furnish other information. We recommend that the Board consider including such guidance to address the risk that the confirming party will not verify the information being confirmed.

10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The Proposed Standard does not permit the auditor to use internal auditors or others within the company to send confirmation requests, receive confirmation responses, or evaluate the evidence obtained from performing confirmation procedures. We do not believe that such a complete restriction on the use of internal auditors, without regard to (1) risk, (2) the competence and objectivity of internal auditors, and (3) the degree of supervision provided by the auditor, is appropriate. In areas of low risk for which confirmations may be an effective and efficient source of evidence, we believe that the use of internal auditors should be permitted, subject to an assessment of their competence and objectivity. While we agree that the responsibility to maintain control over the confirmation process is solely that of the external auditor, we believe that the use of internal auditors, properly supervised, should be permitted in those areas considered to be low risk.

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

(See our response to question 9 above.) Additionally, we are unclear as to whether each of the factors listed in paragraph 16 are “required” to be considered, and would require the auditor to document his or her consideration of each factor. We do not believe that such a documentation requirement would be appropriate, and suggest moving the second sentence to a separate paragraph so that it is clear that the list is intended to reflect the factors that may be considered when designing confirmation requests.

Further, we are concerned that although the Proposed Standard has provided considerable guidance regarding the design of confirmation requests to increase the reliability of the confirmation process, limitations will continue to exist. For example, respondents may not respond, be unwilling to respond, cannot respond because their systems may not be able to verify what is requested, or do not understand what is being requested and respond incorrectly. We do not believe that these concerns can be adequately resolved solely by improvements in design of the confirmation.

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

We suggest that the Board clarify certain of the factors the auditor should consider in determining whether to use negative confirmation requests as the only form of confirmation requests to address the risk of material misstatement at the assertion level. One factor the proposed standard requires the auditor to consider is whether the auditor reasonably expects a low exception rate; however, the proposed standard does not provide any guidance about how to support such an expectation. We recommend including additional guidance regarding this evaluation.

Further, the fourth bullet point states that the auditor should reasonably believe that recipients of negative confirmation requests will give such requests consideration. We note that extant guidance AU Section 330.20 provides similar guidance; however, that standard states that the “auditor has reason to believe that the recipients of the request are likely to give them consideration.” We suggest that the PCAOB clarify whether the revised language in the proposed standard is intended to result in a different auditor consideration than under the extant guidance, and if not, we recommend retaining the extant guidance.

Additionally, we note the Proposal lacks any guidance on the extent of procedures when negative confirmations are used. We believe that guidance regarding the determination of sample sizes in this regard is needed to promote consistent implementation.

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

We agree that it is important to design confirmation requests in such a way as to enhance the reliability of the audit evidence obtained from such responses and that determining the validity of the addresses on confirmation requests is necessary to ensure the validity of confirmation responses. We note that this requirement is consistent with the IAASB standard, ISA 505, *External Confirmations*, and the ASB proposed clarified standard on confirmations.

However, we recommend expanding the guidance in the proposed standard to include a discussion about how the risks associated with a particular type of confirmation or address may impact the auditor's procedures. For example, electronic confirmations may necessitate different or more extensive procedures to determine a request has been directed appropriately than a written confirmation request to an entity that is well known to the entity and the auditor.

14. Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

Yes, the procedures the auditor should perform when determining that a confirmation request does not include a valid address are sufficiently clear and appropriate.

15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

Yes, the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items are sufficiently clear and appropriate.

E. Evaluation

16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?

We agree that in the case of each non-response, the auditor should perform alternative audit procedures to obtain relevant and reliable audit evidence; however, we do not believe that it is appropriate in all cases to send second and third requests (especially when the auditor may have sent confirmation requests solely in response to the requirement set out in the proposed standard) rather than based on the assessed risk of

material misstatement or whether sending confirmation requests was the most effective and efficient procedure to obtain sufficient appropriate audit evidence.

In addition, the note to paragraph 28, describes the alternative procedures the auditor should perform in relation to the completeness assertion for accounts payable, however, we believe this example is inappropriate, because confirmation procedures primarily address the existence assertion rather than completeness. For this reason, we recommend deleting this example.

17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

Yes, the additional procedures seem appropriate.

18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

No, we are not aware of any additional circumstances.

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

No, we do not believe the requirement in the proposed standard to investigate all exceptions is clear, and suggest clarifying the guidance. We agree that the auditor should evaluate the results of confirmation procedures to determine whether exceptions represent misstatements or potential misstatements, but we believe that the decision about whether an exception represents a risk of material misstatement which requires the performance of additional procedures should be left to the auditor's judgment. For example, some exceptions do not represent misstatements, but instead represent timing differences, or measurement or clerical errors in external confirmation procedures, and, for this reason, we recommend adding this clarifying language to the Proposed Standard.

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

For the most part, we believe the requirements related to addressing the reliability of confirmation responses are sufficiently clear and appropriate; however, we believe that signatures from the confirming party, other than for direct access, for which other controls ensure the validity of the responding party, should be required.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

Yes, we believe the proposed standard provides adequate requirements regarding electronic confirmation procedures.

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

We note that paragraph 35 of the Proposed Standard provides guidance to the auditor when an intermediary is used to facilitate the confirmation process. We believe that additional guidance is necessary to ensure that the system or process that facilitates the electronic confirmation process between the auditor and the respondent is in place and operating effectively. For this reason, we recommend adding guidance that directs the auditor to obtain an assurance trust services report or other assurance report on that process to assist the auditor in assessing the design and the operating effectiveness of the controls with respect to that process. If such a report is not available, additional procedures should be described which could assist the auditor in addressing these risks.

23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.

We have no comments relating to this question.

24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

There are no risks related to the auditor's use of direct access that the proposed standard has not adequately addressed of which we are aware.

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

We have no comments relating to this question.

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

We believe additional clarification is required with respect to disclaimers and restrictive language that is used in confirmation responses. Confirmation responses with such language pose difficulties to auditors in assessing the appropriateness and reliability of such responses, and they have become increasingly prevalent. We recognize that a response that contains restrictions may not invalidate the reliability of the audit evidence derived from the confirmation response; however, we believe additional guidance would assist auditors in evaluating such matters.

27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements are sufficiently clear and appropriate.



October 4, 2010

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

Transmitted by e-mail to: comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 028
 Release No. 2010-003 — Proposed Auditing Standard Related to Confirmation and Related
 Amendments to PCAOB Standards

Ladies and Gentlemen:

We are pleased to have this opportunity to respond to the Board's proposed auditing standard (the Proposed Standard) related to confirmation contained in Release No. 2010-003 (the Release) of July 13, 2010, in which it resides as Appendix 1. Although we have not commented directly on Appendix 2 to the Proposed Standard, many of our comments will likewise apply in some respect to the related proposed amendments to other standards. We support the Board's apparent objective to enhance our professional standards by providing improved guidance to auditors about when and how to use confirmations as a source of audit evidence; however, we have serious overriding concerns about perceived inconsistencies and other flaws in the content of these documents. Therefore, we are presenting our overriding concerns in Part 1 of this letter of comment, which is followed by Part 2 containing our responses to the specific questions posed by the Board in the Release. Since many of our comments in Parts 1 and 2, are interrelated, we are numbering our paragraphs to facilitate internal cross-referencing wherever deemed useful. Although except as otherwise noted, most of our comments below directly address language in the Proposed Standard, itself, responsive actions should likewise result in conforming changes in the final version of the Release. Lastly, in Part 3, we provide some editorial suggestions of somewhat lesser significance.

Part 1 — Overriding Concerns

1.1. In our opinion, the overly prescriptive Release and Proposed Standard both contain many significant inconsistencies within and between them as well as with fundamental principles of modern auditing and professionalism. The nature of such apparent inconsistencies is summarized as follows:

- Inconsistencies with an auditor's basic, general responsibility to exercise professional judgment,
- Inconsistencies with an auditor's specific responsibilities to apply the principles of risk-based auditing, and



- Inconsistencies with the increasingly popular trend in favor of principles-based auditing standards as opposed to rules-based (or “cookbook”) standards, and there appears to be no compelling reason to increase the number of “required” (or even presumptively mandatory) audit procedures at this time.
- Inconsistencies with an auditor’s professional responsibility to perform efficient audits, which inefficiencies tend also to impair timely financial reporting by clients to the inherent detriment of their investors.
- Particularly with regard to the use of intermediaries, inconsistencies with an auditor’s professional responsibilities to determine the nature of auditing procedures to be applied and to supervise the work, as set forth in AU 543 of the PCAOB’s Interim Auditing Standards.

1.2. The most pervasive and significant inconsistencies result from the apparent overly prescriptive nature of the Proposed Standard and Release which, in our view, tend to preclude auditors from meeting their obligation to exercise professional judgment, as is set forth in Rule 102 (ET 102.01) of the AICPA’s *Code of Professional Conduct*, which requires CPAs to maintain their objectivity with regard to professional services and not subordinate their judgment to that of others. Although the judgment-based principles of risk-based auditing (as are set forth in the eight new auditing standards recently adopted by the Board) are cited in several places within these documents, they appear to be given only lip service in the context of the excessively prescriptive provisions of the Proposed Standard and the interpretive language of the Release.

1.3. Significant and pervasive inconsistencies between the Release and Proposed Standard result from, the repeated unqualified use of the terms “requires” and “required,” which denote an *unconditional responsibility* of auditors pursuant to PCAOB Rule 3101(a)(1), as compared to the term “should,” which indicates auditor responsibilities that are *presumptively mandatory* pursuant to Rule 3101(a)(2). This subtle difference, we believe, would pose substantial unnecessary risk to auditors who comply with the final standard but are forced to defend themselves in adversarial proceedings against asserted claims that are based on the more prescriptive language in the Release. It is unlikely that adversaries and adjudicators would understand or appreciate such a fine distinction. We believe the Board should take greater care to assure that the final standard and accompanying release are consistent with one another and with its intended meaning in relation to the definitions in Rule 3101(a).

1.4. A glaring example of the excessively prescriptive language of the Proposed Standard (which also appears in the Release) is the unsupported (and unsupportable, in our opinion) notion (in paragraph 9) that an auditor might obtain audit evidence of some significance or value by confirming immaterial cash on deposit with financial institutions based on the level of pre-balance sheet date activity in the account. It is a fundamental principle of risk-based auditing that when the risk of material misstatement is low, such as with regard to existence of an immaterial asset balance, the need for highly reliable, substantive tests of details should be significantly reduced or eliminated. See our response to **Q5** in paragraphs 2.6-2.7, below.

1.5. The Proposed Standard and Release repeatedly make an ineffective argument to justify its excessively prescriptive language as to when one “should” (or “is required to”) use confirmations by using a variation of language asserting merely that confirmations *can or may provide adequate audit evidence*, without regard to whether the probability of it providing adequate evidence or the probability of adequate (in relation to perceived risks) or even better evidence being provided by other means. We believe these assertions fail to justify the prescriptive language used.

1.6. Based on our views as set forth above in paragraphs 1.1-1.5, above, we believe that a great deal more of the provisions in the Proposed Standard and the discussions thereof in the Release should be revised in the final documents to align clearly with an auditor’s *responsibility to consider*, as set forth in Rule 3101(a)(3). It is our view that allowing for auditor judgment based on thoughtful risk assessment is not

likely to adversely affect the quality of financial audits or diminish the value of a new standard with regard to its ability to achieve its stated objective. On the contrary, as compared to the likely effect of adopting the Proposed Standard, it would have the likely effect of allowing audits to be more effective by eliminating unnecessary work, related costs and possible completion delays thus improving the timeliness of financial reporting.

1.7. We previously responded on September 2, 2009, to the Board's Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations issued April 14, 2009, most particularly about the use of third party service providers (called *intermediaries* in the Proposed Standard and Release) to process electronic confirmations. We believe the Proposed Standard and Release fall far short of addressing several significant issues identified in our previous communication, which are, therefore repeated in paragraphs 2.28-2.32 of our response to **Q22** in Part 2, below. We believe these are serious issues that should be addressed in the final standard.

Part 2 – Responses to Questions Presented in the Release

Q1. *Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?*

2.1 Yes. However, we believe the definition of *intermediary* should be moved from footnote 39 (on p. 20 of the Release) to Appendix A in the final standard.

Q2. *Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?*

2.2 No. The objective of the Proposed Standard is set forth in its paragraph 1 (as opposed to paragraph 3, which is captioned "Objective" and sets forth the auditor's objective). For reasons set forth primarily in paragraphs 1.1-1.5, above, we firmly believe that the prescriptive language of paragraph 1 does not give any credence to the principles of risk-based auditing and the relevance of auditors' professional judgment. It is the first example within the body of the Proposed Standard, itself, of the contradiction described in our paragraph 1.3, above, between an *unconditional responsibility* pursuant to Rule 3101(a)(1), as compared to a *presumptively mandatory* responsibility pursuant to Rule 3101(a)(2).

2.3 We believe both paragraphs 1 and 3 should be revised to make it clear that the decision when to use confirmation as a means of obtaining audit evidence is an auditor judgment to be based on risk considerations, and the primary objective if the standard (among others) is to provide guidance to assist auditors in making such judgments.

Q3. *What other matters, if any, should the objective include?*

2.4 We believe both paragraphs 1 and 3 of the Proposed Standard should be revised to state clearly that decisions as to when to use confirmations as a means of obtaining audit evidence are auditor judgments to be based on risk considerations, and that the primary objective of the (final) standard, among others, is to provide guidance to assist auditors in making such judgments.

Q4. *Is the description of "receivables that arise from credit sales, loans, or other transactions" sufficiently clear and appropriate? If not, what changes should the Board make?*

2.5 No. We believe additional language is necessary to limit the applicability of the term *other transactions* in this context.

Q5. *Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?*

2.6 No. As discussed above in paragraph 1.4, we believe the Board's underlying premise for its overly prescriptive language of the Proposed Standard (which also appears in the Release) regarding confirmation of cash on deposit in financial institutions is unsupportable. We have neither heard nor read any persuasive arguments for the elevation of cash confirmation procedures even to that of presumptively mandatory at this time. In addition, the growing proliferation of insistence by financial institution on the use of intermediaries and their use of disclaimers and restrictions respondents discussed below in our responses to **Q22** and **Q26** in paragraphs 2.28-2.32 and 2.36, below, have greatly diminished the probable cost/benefit value of this procedure with regard to cash on deposit with such institutions and, thus, is inconsistent with making it either mandatory or presumptively mandatory.

2.7 Even when cash balances are material, there is little or no opportunity for incremental audit comfort from confirming a bank balance (in the absence of other banking relationships that might warrant confirmation) as compared to merely examining a bank statement obtained from the client unless one has reason to suspect the client might have altered the statement. Such suspicions go beyond the level of a healthy professional skepticism normally associated with common fraud risk factors but go to the heart of a client retention decision. Generally post-balance sheet activity (such as the bank paying outstanding checks timely provides sufficient evidence of existence of the asset, consistent with the risk. Once again, we believe the final standard should be clear that confirmation of cash balances should be a risk driven auditor judgment with the standard providing useful guidance to assist in such judgments.

Q6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

2.8. No. Once again, as explained above in paragraph 1.3, we believe what is "required" unconditionally vs. what is presumptively mandatory is quite unclear in the Proposed Standard, muddled by the imprecise use of terminology defined in Rule 3101(a). The Board should revisit all so-called "requirements" of the Proposed Standard and revise it throughout to be consistent (among other things) with its risk assessment standards, with its intent pursuant to Rule 3101(a) and with Rule 102 of the *Code of Professional Conduct*.

Q7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

2.9. No. We do not believe the proposed standard should include any additional requirements with respect to sending confirmation requests. We believe a reference to appropriate portions of the risk assessment standards for further guidance should be sufficient, however, to guide auditors as to the consideration of other risks in making scope decisions.

Q8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

2.10. No. Paragraph 11 of the Proposed Standard does not provide any useful guidance and appear entirely gratuitous and of no value as presently drafted. In view of this and our response to **Q7** in paragraph 2.9, above, we believe paragraph 11 should be deleted.

Q9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

2.11. With the exception of matters relating to the use of intermediaries discussed below in response to **Q22** (paragraphs 2.28-2.32), and their characterization as "requirements," we believe the guidance for maintaining control over the confirmation process is sufficiently clear and appropriate.

Q10. *Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?*

2.12. No. The Board's views on the use of internal auditors, whether for direct assistance or otherwise, are not articulated in the Proposed Standard, *per se*, but appear only in the accompanying Release, making them difficult to find and, thus easily overlooked. Subject to our comments in paragraph 2.13, below, we believe the Board's views should be articulated clearly in the final standard.

2.13. In addition to our views about the inconsistent use of Rule 3101(a) language, we believe the language in the Release regarding using the work of internal auditors is inappropriate in several important respects. This is primarily because we believe an absolute proscription from using direct assistance of internal auditors to process confirmations is neither warranted nor even logical. Such a decision, once again, should be an auditor's judgment based on a risk assessment consistent with the principles set forth in AU 322 and AU 316 of the Interim Auditing Standards. Moreover, we believe such a position is inconsistent with the suggestion in the first full paragraph on page 21 of the Release that would enable an auditor to reduce the scope of confirmation work based on the internal auditors' work and inconsistent with the proposed uses of intermediaries that are likely to be even less under the supervision and control of the auditor than internal auditors would be.

Q11. *Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?*

2.14. No. We fundamentally disagree with the change from the extant standard as reflected in pages 12-13 of the Release (but not articulated in the Proposed Standard, *per se*) that would strip an auditor of the ability to choose alternative procedures for receivables when the perceived likelihood of obtaining a timely and otherwise satisfactory response is low. The Release (but not the Proposed Standard) would effectively "require" the auditor to make changes in the design of the confirmation request or the process intended to elevate such probability without regard to the practicality of such an approach based on deadlines and/or perceived likelihood of success in the circumstances, but paragraphs 28 and 38 of the Proposed Standard the use of alternative procedures only if such additional attempts to obtain satisfactory responses fail. Such an inflexible "requirement" to use confirmations invariably without regard to the probability of a satisfactory response is inconsistent such language that would enable an auditor to rely on alternative procedures after nonresponses or after receiving an inadequate response that is accompanied by a disclaimer or restriction. Accordingly, we believe that auditors should be clearly permitted and encouraged to use their best professional judgment as to how to deal with such circumstances, subject to some flexible guidance to aid such judgment as may be provided in the final standard.

2.15. In addition, paragraph 16, among other things, effectively states that an auditor should consider certain factors in designing confirmation requests. (The paragraph is internally contradictory and, therefore, confusing as to its use of language denoting both *presumptively mandatory responsibility* and *responsibility to consider* as per Rule 3101(a) and (c).) Among the factors is the "nature of the information to be confirmed." However, no further guidance is given as to what that is intended to mean. At a minimum, we think that in addition to balances or transaction values and major transaction terms, examples should be given that include requests for information from third parties as to vague or otherwise questionable business purposes such and others mentioned in paragraph 71 of PCAOB Auditing Standard No. 12 (AS 12, pending SEC approval), *Assessing Risks of Material Misstatement*. We think examples should be provided. See our response to **Q18** in paragraph 2.23, below.

Q12. *Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?*

2.16. No. The first bullet in paragraph 17, inappropriately, in our opinion, would make it presumptively mandatory for an auditor to have supported a low assessment of the risk of material misstatement satisfactorily by testing the operating effectiveness of controls as a condition for the use of negative

confirmations. We point out that this criterion in apparent direct conflict with the clear implication in AU 329.09 of the Interim Auditing Standards (as revised by PCAOB Release 2004-008) that substantive analytical procedures alone (*i.e.*, without tests of controls or substantive tests of details) may afford sufficient audit evidence when the risk of material misstatement is low (not significant). Accordingly, we believe the guidance in the final standard should be revised to acknowledge that an assessment of a low risk of material misstatement may be adequately supported by a low inherent risk assessment without regard to controls, therefore, without testing them, and that in such circumstances, although the use of negative confirmations may provide additional evidence to support substantive analytical procedures or to reduce the necessary scope of positive confirmation work, such use may be entirely unnecessary in many cases.

2.17. In addition, we recommend that the Proposed Standard provide useful (but non-prescriptive) guidance about how to support the presumptively mandatory expectations of a low exception rate and adequate consideration by recipients. With regard to the latter, even though this idea is expressed in general elsewhere in the Proposed Standard, we believe the final standard should point out that such an expectation of adequate consideration would be reasonable in this specific instance only for the existence assertion for assets, such as receivables, and the completeness assertion for liabilities, such as bank deposits.

***Q13.** Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?*

2.18. Yes.

***Q14.** Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?*

2.19. Yes.

***Q15.** Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?*

2.20.No. We believe the final standard should contain some useful examples of possibly acceptable and unacceptable reasons for such requests together with guidance for assessing their credibility. In addition, we believe that Paragraph 23a should state that an auditor should obtain management's representation (even though that is contained in a proposed revision to another standard) and supporting evidence. Examples of the types of evidence that might be sought, depending on the circumstances, should also be provided.

***Q16.** Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?*

2.21. Yes, but only if the initial request for confirmation was made solely as a result of a perceived need to comply a prescriptive standard and not judged by the auditor to be necessary to meeting an objective deemed relevant or necessary to support an audit opinion.

***Q17.** Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?*

2.22. Substantially; however, it should be pointed out in the second bullet of paragraph 29 that such alternative procedures as described in paragraph 28 may not be sufficient to address other fraud risks, for example, concerning the presence or absence of side agreements or when seeking information from third parties as to a vague or otherwise questionable business purpose of a significant, unusual transaction or arrangement and others mentioned in paragraph 71 of AS 12 (pending SEC approval).

***Q18.** Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?*

2.23. Yes. We think that paragraph 29 should be revised to suggest that responses to positive confirmation requests should be deemed necessary by auditors (to avoid reporting a scope restriction) when an auditor's judgment requires information from third parties to address concerns about the presence of side agreements or assure an adequate understanding of an apparently vague or otherwise questionable business purpose of a material transaction or arrangement as well as certain other circumstances mentioned in paragraph 71 of PCAOB Auditing Standard No. 12 (AS 12, pending SEC approval), *Assessing Risks of Material Misstatement*. We also believe reference should be made in the final standard to f/n 6 to AU 334.09b of the Interim Auditing Standards, which states, "Until the auditor understands the business sense of material transactions, he cannot complete his audit. If he lacks sufficient specialized knowledge to understand a particular transaction, he should consult with persons who do have the requisite knowledge." (Although this language is contained in a standard about related party transactions, we believe its applicability should not be so limited, and that the standards should clarify that.)

2.24 We also believe paragraph 29 should be revised to clarify the term "is necessary" by adding "in the auditor's judgment" so that it is not misinterpreted by auditors or adversaries as an unconditional responsibility.

***Q19.** Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?*

2.25. Yes. We believe the language in paragraph 30 adequately describes an appropriate (presumptively mandatory) auditor responsibility with respect to all reported exceptions and allows for the application of professional judgment.

***Q20.** Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?*

2.26. Yes.

***Q21.** Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?*

2.27. Yes. This response, however, is without regard to the use of intermediaries, which is discussed in our response to Q22 in paragraphs 2.28-2.32, below.

***Q22.** Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?*

2.28. The only guidance offered by the Proposed Standard appears in paragraph 35 (third bullet). Paragraph 35 rather succinctly states (in presumptively mandatory language) that an auditor (a) "should obtain an understanding of the controls over the procedures used by the intermediary to process the

confirmation requests and responses,” (b) “should perform procedures to determine whether the auditor can use the intermediary's process,” and (c) “should determine whether the intermediary is authorized to respond on behalf of the intended confirming party.” It also sets forth examples of risks to be considered in addressing item (b). However, the Proposed Standard affords auditors no guidance as to how or against what criteria to assess “controls over the procedures used by the intermediary” nor does it suggest any need or provide any guidance as to how to test the operating effectiveness of such controls despite an implied and *de facto* reliance to be placed thereon. Nor does it provide any guidance suggesting how an auditor might otherwise address the identified risks. Significant risks not specifically identified in the Proposed Standard include:

- That the controls over the procedures used by the intermediary are not adequately complied with or otherwise ineffective, for example, due to inadequate training and supervision of the assigned personnel, and
- That the client has the ability to influence to performance of the procedures or the reporting of the results.

2.29. The AICPA attempted to address questions from practitioners on the use of intermediaries raised through its Audit and Attest Hotline in an informal “Communication to AICPA Members Regarding Electronic Confirmations” posted on its website February 10, 2009. Besides being virtually irretrievable and anonymous as to its source and certainly not authoritative, this communication is extremely superficial; it fails to address the principal issues we have identified and with which we are concerned about in connection with this growing practice. Like AU9330-.03 and .06* and PITF Practice Alert 03-1, to which it refers, this AICPA communication speaks primarily to the security of electronic data transmission but does not address any of the critical issues listed in paragraphs 2.30-2.32, below.

2.30. The aforementioned February 10, 2009, member communication from the AICPA indicates that it was precipitated by the position taken by a major bank (and probably others) that it will not process requests for confirmations unless made electronically through a specified intermediary with which it has contracted. However, if an intermediary is to be used to service the auditor, it should be the auditor’s sole judgment that dictates what organization is to be selected and to what extent it is to be relied upon. This is an audit scope decision that should not be made by a bank. In our opinion, allowing a bank to make such a decision without allowing the auditor the opportunity to evaluate the service organizations qualification or make scope adjustments based on the results of such evaluations, may likely constitute a significant scope restriction that should be dealt with as such pursuant to other appropriate auditing literature.

2.31. In our view, an auditor’s use of an intermediary, which we understand is generally to control, mail, receive and process electronic confirmations, often including verification of names and addresses of intended recipients, is, in fact and substance, the delegation of audit procedures to a third party (like another auditor) that are to be performed on the auditors’ behalf, which is the subject of AU 543 (of the Interim Auditing Standards). However, there is no literature, authoritative or not, that makes an analogy to or discusses the applicability or inapplicability of AU 543 to such circumstances. Nevertheless, auditors need to be told that they have a responsibility to assess the competence of assigned service organization personnel, the quality of supervision that they receive, and their independence from the audit client, and to make audit scope judgments based on such assessments. We believe the final standard

* In fact, it is only AU 9930.07 of the Interim Auditing Standards that is somewhat relevant to the use of intermediaries, but it falls far short of dealing with the principal issues regarding the use of intermediaries identified herein. It does recommend consideration of a report based on an assurance service called SysTrust for assessing the reliability of a system for processing confirmations. Few auditors, however, are familiar with SysTrust or are able to distinguish a SysTrust or similar report or the related assurance service from those that are associated with an AU 324 audit engagement discussed herein. Such a distinction is made in another virtually irretrievable (except by internet search engine) and anonymous AICPA online document available at <http://www.sas70.com/systrust.html>. Moreover, there is no guidance in the auditing literature that dictates scope of the work that underlies such a non-AU 324 report, its structure or content or that enables auditors to evaluate its reliability or usefulness consistently.

should contain cautionary language to this effect that clearly informs auditors, with reference to AU 543, of their responsibilities in this regard.

2.32. Many auditors seem to be of the clearly mistaken notion that under the Interim Auditing Standards, an AU 324 audit report (commonly referred to as a SAS 70 report) from an auditor engaged by one of these service organization serves as useful evidence as to reliability of the service provided. These auditors do not seem to understand that AU 324 is intended to deal solely with the objective of obtaining an understanding or establishing the reliability (depending on whether one gets a type 1 or type 2 report) of controls exercised by the third party service organization on a *client's* (not the auditor's) behalf in the execution or processing of the client's (not the auditor's) transactions. An AU 324 report is clearly not intended to afford a basis for relying on *audit work performed by others* in support of one's audit opinion, as AU 543 is. We believe the final standard should also contain cautionary language to this effect.

Q23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.

2.33. Reference is made to paragraph 2.31 in our response to Q22, above.

Q24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

2.34. No.

Q25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

2.35. We do not understand the question.

Q26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

2.36. No. We have observed the use of such disclaimers or restrictions increasing as financial institutions have gotten more automated and cost conscious over the last 40 years when they first appeared. Most tend to render the confirmations virtually unreliable while others may have little or no adverse consequence as to reliability. We believe the prevalence and variety of such practices warrants more guidance (albeit non-prescriptive) in the standard to enable sound professional judgment by auditors.

Q27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

2.37. Yes.

Part 3 – Minor Editorial Suggestions

3.1. Although defined in Appendix A to the Proposed Standard, the term *direct access* appears in the paragraph beginning on p. 36 and ending on p. 37 of the Release, but is not explained until five paragraphs later in the second paragraph on p. 39. We recommend that this paragraph be moved to p. 36 or 37 in closer proximity to the first usage of the term.

3.2. A presumptively mandatory provision to perform confirmation procedures when the presence of side agreements is suspected appears in the Proposed Standard only in paragraph 10, which, as per f/n 11, states that it is not applicable to receivables. Similar language should be placed in paragraph 8 or the final standard should be otherwise revised to clarify that such provision applies equally to receivables.

3.3. Paragraph 14 contains a presumptively mandatory provision to perform sales cutoff testing. We believe the quality of the guidance would be improved if the final standard were to also state that the scope of such testing should be determined based on the auditor's judgment of the level of risk of material misstatement, supported as necessary with tests of controls.

3.4. The second sentence in paragraph 17 is a false statement about positive confirmation since some audit evidence is obtained as to the existence of a valid addressee merely by the absence of a postal return. The same is true for negative confirmations (as is clearly acknowledged in the last paragraph on p. 24 of the Release) thus requiring a correction to the second sentence to eliminate such inconsistency.

3.5. F/n 13 to paragraph 24 should make reference to the guidance provided elsewhere (as recommended above) in the final standard for the use of intermediaries.

3.6 Paragraph 27 should refer also to responses received from an intermediary as well as directly from the confirming party.

3.7 Paragraph 28 should note the unusual nature of confirming accounts payable so as to make it clear that such a procedure is neither mandated nor presumptively mandated by the standard.

* * * * *

Questions about these comments should be directed to the undersigned at 702/382-1120 or hlevy@pbtck.com.

Thank you for this opportunity to comment. We hope the Board finds our comments useful in its deliberations on this important matter.

Very truly yours,

A handwritten signature in black ink, appearing to read "Howard B. Levy, Sr.", with a stylized flourish underneath.

Howard B. Levy, Sr. Principal and Director of Technical Services
Piercy Bowler Taylor & Kern, Certified Public Accountants



PricewaterhouseCoopers LLP
400 Campus Dr.
Florham Park NJ 07932
Telephone (973) 236 4000
Facsimile (973) 236 5000
www.pwc.com

September 13, 2010

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

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

Dear Sir:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (the "standard," "proposed standard" or "proposal").

We are supportive of the Board updating interim standard AU 330, *The Confirmation Process* (AU 330), to address developments in the confirmation process, including advances in information technology and the increasing use of disclaimers and other limiting language, since AU 330 was issued nearly 20 years ago. We commend the Board for seeking public comment on issues related to the confirmation process through its April, 2009, *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*. We also support the view expressed by Acting Chairman Goelzer at the adoption of the risk assessment standards that the Board will consider seeking more opportunities for public participation in the standard setting process, including continuing to experiment with concept releases, multiple proposal periods, SAG discussions, and other opportunities for feedback, such as roundtables and working groups. Finally, as we have commented previously, we support the PCAOB's efforts to compare its standards with those of the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB) to facilitate the identification of differences among the various standards. We encourage the Board to extend these comparisons to include the IAASB's and ASB's application guidance and, in particular, to clarify the Board's rationale for elevating guidance in other standards to requirements in the Board's standards. A more robust comparison would help auditors to better understand the Board's intent and, thereby, promote consistency in conducting audits in accordance with PCAOB standards.

Summary Comments

We agree with longstanding guidance in the auditing standards that audit evidence in the form of a confirmation response generally is more reliable than audit evidence generated internally by a company or provided directly by a company. Although we acknowledge the importance of confirmations as an audit procedure, we are concerned that the proposed standard's expansion of the requirement to request confirmations, coupled with removing the exception not to confirm when the use of confirmations would be ineffective, may significantly increase audit effort without enhancing audit quality. We also believe that some of the new requirements related to performing confirmation procedures are either unclear or are outside the control of the auditor and therefore will be difficult to implement in practice. Moreover, we have concerns about certain of the



requirements in the proposed standard because they apply regardless of the auditor's assessment of risk and by removing the auditor's ability to determine what is the most effective response to the assessed risk, the standard encourages a "checklist" approach that is inconsistent with the framework of the Board's recently adopted risk assessment standards.

In the remainder of our letter, we have organized our observations and concerns about the proposal into the following topical areas:

- Extension of confirmation to new accounts
- Difficulty in implementing certain requirements
- Use of internal auditors in the confirmation process
- Considerations prior to issuance of a final standard

Finally, we have included other specific comments on the proposed standard and the conforming amendments in the Appendix to this letter.

Extension of Confirmation to New Accounts

Use of Confirmations Would Be Ineffective

We encourage the Board to incorporate from AU 330.34 the exception to overcome the presumption to confirm receivables when confirmation can be demonstrated to have been an ineffective audit procedure in the recent past. We acknowledge the Board's statement in the Release that "auditors should determine why they [confirmations] are ineffective and look for ways to improve the effectiveness of confirmation procedures;" however, confirmation is a reciprocal process and inadequate response rates are not always within the auditor's control (for example, low response rates are typical in the health care industry). In addition, since the Board has broadened the AU 330 definition of receivables to include receivables that arise from credit sales, loans, or other transactions, and also has extended the requirement to obtain confirmations to other areas, for example, significant risks, practice may prove that confirmation is ineffective in some unknown areas of this extended population, further exacerbating the problem.

Significant Risks

The proposed standard expands the requirement to perform confirmation procedures to "significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures." The requirement thus recognizes that there are significant risks that will not be subject to confirmation, but it would appear the auditor nonetheless will need to evaluate every relevant assertion of every significant risk identified in an audit to determine when confirmation is appropriate or, alternatively, to document why it is not. We believe the Board should allow the auditor to determine what audit procedures would be effective and would provide sufficient appropriate audit evidence to address the significant risks in the circumstances. At a minimum, we encourage the Board to clarify its intent with respect to this requirement, for example, whether the objective is to obtain confirmations for any third-party evidence that is part of the assertion being tested for a significant risk or whether to do so only when that third-party evidence is significant to the overall assertion.

Difficulty in Implementing Certain Requirements

We believe the requirements in the proposed standard that are discussed below will be difficult for auditors to implement as currently drafted.



Selecting the Confirming Party

The proposed standard requires in paragraph 15 that "even if the company provides the auditor with the name of an appropriate confirming party, the auditor should select the confirming party." We believe that the application of this requirement should depend on the circumstances and the auditor's assessment of risk. We encourage the Board to limit the application of this requirement to areas of higher risk or situations in which the information being confirmed is non-routine, for example, when the auditor is confirming whether there are side agreements to a contract or when the auditor has assessed fraud risk as high.

Furthermore, this requirement will be difficult to implement as currently drafted. In many situations, for example the confirmation of accounts receivable, the auditor has no or limited interaction with the confirming party and, therefore, insufficient knowledge to evaluate personnel as the basis for determining which one is the appropriate one to "select." In addition, in some circumstances confirmations are sent to a department rather than an individual.

Designing the Confirmation Requests

Paragraph 16 of the proposed standard identifies factors that auditors should consider in designing confirmation requests, including whether there are "local customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information." Similarly, paragraph 31 discusses factors the auditor should take into account in assessing the reliability of confirmation responses, including "local customs that may affect the confirmation responses, such as customs that create an environment in which confirmation responses are inherently unreliable." We encourage the Board to clarify how auditors would become aware of such customs, and also to identify any local customs of which the Board has knowledge, through its inspection process or otherwise, that would help auditors implement this guidance.

Also, the examples on pages 22-23 of the Release provide further clarification about each of the factors identified in paragraph 16 that the auditor should consider in designing confirmation requests. We encourage the Board to include these examples in paragraph 16.

Determining the Type of Confirmation Requests to Send

One of the factors that should be present when the auditor is using negative confirmations, as discussed in paragraph 17 of the proposed standard, is that "the auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration." Since the auditor is unlikely to have personal knowledge of the recipients, demonstrating and documenting the basis on which the auditor has met the "reasonably believes" threshold will be difficult and may prevent auditors from using negative confirmations. We recommend that the Board conform this factor to that in the IAASB's International Standard on Auditing 505 (ISA 505) and the ASB's proposed Statement on Auditing Standards (the ASB's proposed SAS), both titled *External Confirmations*, which states, "the auditor is not aware of circumstances or conditions" that would cause recipients to disregard such requests, or to that in AU 330.20, which states, "the auditor has no reason to believe" that recipients are unlikely to give such requests consideration, either of which is more operational than the factor as it is drafted in the proposed standard.

Procedures to Test Validity of Addresses

Paragraph 19 of the proposed standard requires the auditor to perform procedures to determine the validity of the addresses on confirmation requests, "including substantive procedures or tests of controls." We do not believe the characterization of procedures as "substantive procedures" or



"tests of controls" is clear in the context of verifying addresses. We encourage the Board to provide examples that clarify the distinction between substantive procedures and tests of controls in the context of verifying addresses, particularly since auditors are further required by paragraph 19 to "perform substantive procedures to determine the validity of addresses on the confirmation requests for transactions or accounts that involve significant risks or are material to the financial statements."

In addition, among the factors to consider in determining the nature and extent of procedures to perform to validate addresses on confirmation requests is whether "an address is a post office box." Confirmation requests often are sent to post office boxes. We believe the Board should clarify what the auditor should consider with respect to the use of a post office box address in determining the nature and extent of procedures to perform to validate addresses, and also identify procedures the auditor might perform to verify them.

Management Requests Not to Confirm

When management requests the auditor not to confirm certain accounts, balances, or other items, paragraph 23(b) requires that the auditor "obtain audit evidence as to the appropriateness of management's reasons for the request." Auditors may not always be able to obtain such audit evidence. Accordingly, we encourage the Board to conform this requirement to the wording in ISA 505 and the ASB's proposed SAS, that is, to require the auditor to "seek audit evidence" (italics added) about the validity and reasonableness of management's request.

Paragraph 24 of the proposed standard sets forth certain requirements for circumstances in which the auditor agrees to management's request not to confirm. The note to paragraph 24(b) requires that the auditor "perform procedures to obtain more persuasive audit evidence than he or she would have obtained had there been no response to a confirmation request or had the auditor made a decision not to perform confirmation procedures." We encourage the Board to clarify the rationale for this requirement given that the auditor has determined that management's request is appropriate. Furthermore, in certain circumstances it may not be possible to obtain "more persuasive" audit evidence than would be provided by performing alternative procedures (for example, what procedures would the auditor perform to obtain more persuasive audit evidence than the alternative procedures required in paragraph 28 of the proposed standard). We encourage the Board to eliminate the note or modify it to state that the procedures to obtain relevant and reliable audit evidence as required by paragraph 24(b) would be "similar to those appropriate for a non-response," consistent with the guidance in ISA 505 and the ASB's proposed SAS.

We also question why the audit committee needs to be informed of management's request, as required by paragraph 24(c), when the auditor agrees that management's request is appropriate. Is the purpose of the requirement simply to inform the audit committee of management's request not to confirm, or does the Board intend for the audit committee to provide some additional assurance to the auditor as to the appropriateness of management's request not to confirm?

Finally, paragraph 24(e) requires the auditor to "evaluate the implications for the audit report" and includes a footnote reference that "management's request might represent a significant client-imposed scope limitation on the audit." We encourage the Board to clarify, perhaps by an example, the circumstances in which the auditor both agrees with management's request but also concludes that management's request would constitute a significant client-imposed scope limitation. We believe when the auditor has agreed to management's request this requirement would only be appropriate when the auditor has not obtained sufficient appropriate audit evidence; therefore, it should be included as part of the note to paragraph 24(b).



When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

We encourage the Board to conform the first sentence of paragraph 29 of the proposed standard to that in the ASB's proposed SAS, which states "If the auditor has determined that a written response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires." We believe that the decision about whether a written response is necessary to obtain sufficient appropriate audit evidence rests with the auditor and is based on the auditor's assessment of risk in the circumstances.

Reliability of Confirmation Responses

AU 330.27 imposes certain requirements on the auditor "if information about the respondent's competence, knowledge, motivation, ability, or willingness to respond, or about the respondent's objectivity and freedom from bias with respect to the audited entity *comes to the auditor's attention* (italics added)."

When evaluating the reliability of the response received from a confirming party, paragraph 32 of the proposed standard requires the auditor to "assess any indication that the confirming party" is not competent or knowledgeable, has questionable motives, or is not objective or free from bias with respect to the company. Given the limited interaction between the auditor and the confirming party, we do not believe the auditor will have a basis for making this assessment and therefore will not be able to implement this requirement. Accordingly, we believe it is appropriate to retain the conditional "comes to the auditor's attention" language from AU 330.27. Alternatively, the Board should clarify in the Release that it is not the Board's intent that auditors perform additional procedures to perform a separate assessment but rather that the auditor's assessment of these matters would be based on information identified as the result of performing other auditing procedures, including confirmation procedures.

Use of Internal Auditors in the Confirmation Process

The Release text states that "the auditor cannot use internal auditors to send confirmation requests, receive confirmation responses, or evaluate the audit evidence obtained from performing confirmation procedures." We believe that when internal audit is providing direct assistance as discussed in paragraph 27 of interim standard AU 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AU 322), the auditor should not be prohibited from using internal audit throughout the confirmation process. AU 322.27 allows internal audit to perform tests of controls or substantive tests and requires the auditor to supervise, review, evaluate, and test the work performed by internal audit. Although confirmation procedures provide important audit evidence, in many instances the degree of judgment required in the confirmation process is limited; therefore, allowing internal audit to assist the auditor in such circumstances enables the auditor to focus on higher risk areas, which is beneficial to audit quality. Accordingly, we recommend that the Board restore to the proposed standard guidance from footnote 3 in AU 330 which provides that the auditor's need to maintain control over the confirmation process "does not preclude the use of internal auditors in the confirmation process" pursuant to AU 322.

Considerations Prior to Issuance of a Final Standard

Impact Assessment and Outreach to Others

We encourage the Board to undertake appropriate assessments and field tests to ensure that the requirements can be effectively implemented. The assessment should encompass the effort



involved from all parties that are part of the confirmation process, not just auditors. Accordingly, as part of this assessment, we recommend the Board meet with other organizations, such as the American Bankers Association and Financial Executives International, to understand the impact of the proposal on these organizations' members. The Board should discuss with these parties whether they will be willing and able to accommodate the increase in confirmation requests and the potential increase in coordinated efforts to ensure confirmations are effective and meet the requirements of the proposed standard.

In addition, we are concerned that the standard imposes a unilateral requirement on the auditor to request confirmations when confirming parties increasingly use disclaimers and other restrictive language in their responses. We believe the Board should work with organizations that represent issuers, banking regulators, the SEC and others to address respondents' obligations and to explore mechanisms that might reinforce their responsibility to respond to confirmation requests. This issue must be addressed at its root cause as an approach that only places additional requirements on auditors when confirmations are received with disclaimers and restrictive language would not be in the public interest. We encourage the Board to work with others, as discussed above, and also with global constituents since we understand that disclaimers may be even more prevalent in jurisdictions outside the U.S., to identify the cause of such restrictive language (i.e., liability concerns) and work to clarify and / or minimize its use in order to enhance the evidence provided.

Effective Date

We believe the proposed effective date (for audits for fiscal years ending on or after December 15, 2011) may be aggressive in light of the need to consider public comment, revise and adopt a final standard, and allow sufficient time for the SEC to expose and approve the standard. We recommend that the Board consider changing the effective date to audits for fiscal years *beginning* on or after December 15, 2011, if a final standard is unlikely to be approved by the Board and the SEC by the end of March, 2011, so that audit firms have sufficient time, particularly given that some firms perform confirmations at an interim date, to incorporate the new requirements into their audit methodology, complete related training programs, and coordinate with other parties involved in the confirmation process.

* * * * *

We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Michael J. Gallagher (973-236-4328), Brian R. Richson (973-236-5615) or Marc A. Panucci (973-236-4885) regarding our submission.

Sincerely,

A handwritten signature in black ink that reads "Price Waterhouse Coopers LLP". The signature is written in a cursive, flowing style.

Attachment



APPENDIX

Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards

This appendix provides additional comments on specific requirements in the proposed standard and the related amendments to PCAOB standards for the Board's consideration.

Definitions

The definitions of "confirmation," "confirmation request," and "confirmation response" in Appendix A of the proposed standard all include the phrase "either in paper form or by electronic or other medium." We believe the Board should clarify what "other medium" encompasses.

We also suggest the Board move the definition of "intermediary" from footnote 13 in the proposed standard to Appendix A which contains other defined terms.

Paragraphs 6 and 7

Since confirmation *requests* do not *per se* address financial statement assertions, we suggest editing paragraphs 6 and 7 of the proposed standard as shown below to align more closely with language in AU 330.12-.13 which is clearer:

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

7. Confirmation ~~s requests~~ do not address all assertions equally well. For example, properly designed confirmation requests can ***elicit provide*** audit evidence to aid in assessing the existence and completeness of accounts and transactions included in the financial statements. The effectiveness of confirmation ~~s requests~~ in addressing the existence and completeness assertions depends, in part, on whether the auditor selects from an appropriate population for testing. Receivable confirmation ~~s requests~~ would likely be more effective for the existence assertion than for the completeness and valuation assertions. Confirmation of goods held on consignment with a consignee would likely be more effective for the existence and the rights and obligations assertions than for the valuation assertion. Thus, when obtaining audit evidence for assertions that are not adequately addressed by confirmation ~~s requests~~, auditors should perform other audit procedures instead of, or to complement, confirmation procedures.

Use of "Should" in Examples

We appreciate the Board's inclusion of a number of examples to illustrate requirements in the standard as the examples are helpful guidance to the auditor in considering how to meet the requirements. However, paragraphs 10, 14, 19, and 28 of the proposed standard include examples that identify procedures the auditor "should" perform. We believe that the inclusion of presumptively mandatory requirements in examples is confusing because the words "for example" create an expectation that application guidance is being communicated and that audit procedures, if identified, would be illustrative rather than required. Accordingly, we recommend that the Board remove presumptively mandatory requirements from examples.

In addition, we believe that the requirement in paragraph 14 of the proposed standard to perform sales cut-off testing at the balance sheet date when confirmation procedures for receivables were



APPENDIX

performed at an interim date is inappropriately placed. If retained, this requirement should be moved to the section of Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, that discusses the timing of substantive procedures (and which supersedes guidance in the Board's interim standard AU 313, *Substantive Tests Prior to the Balance Sheet Date*), since this guidance does not relate specifically to the use of confirms, or to alternative procedures to perform for non-responses to confirms, but rather provides guidance regarding an auditor's consideration of obtaining evidence at an interim date. Furthermore, the guidance could be misleading because there may be other procedures, in addition to sales cutoff procedures, that would be necessary to reduce audit risk to an appropriately low level for the existence and completeness assertions, but by including the example as a requirement, some auditors may interpret this as the only procedure that is required.

Other Risks

Page 18 of the Release identifies accounts payable as an example of the other risks for which confirmation procedures might be an appropriate response as provided in paragraph 11 of the proposed standard. We encourage the Board to provide a more suitable example given that accounts payable generally is a low-risk audit area in which the key assertions are typically tested with procedures other than confirmations.

Determining the Type of Confirmation Requests to Send

The second sentence of paragraph 17 of the proposed standard states "A positive confirmation request provides audit evidence only when a response is received directly by the auditor from the confirming party." We believe this statement is incorrect because a response that is received indirectly, although it does not meet the definition of a confirmation response, may provide some audit evidence.

Use of Negative Confirmations

We believe the guidance in paragraph 17 of the proposed standard on the use of negative confirmations is unnecessarily complicated by the requirement to use positive confirmation requests to supplement negative confirmation requests unless the identified factors are present. Auditors ordinarily do not use both positive and negative confirmation requests together. We encourage the Board to clarify this requirement, perhaps through some examples. Given that negative confirmations provide some audit evidence, we believe the auditor should consider the amount of evidence necessary to support his or her conclusions on the basis of risk, which may or may not include the use of positive confirmations.

Furthermore, when the identified factors are present, we believe that negative confirmation requests may be used, based on the auditor's judgment, as the sole substantive audit procedure, which is consistent with ISA 505 and the ASB's proposed SAS. We encourage the Board to eliminate the presumptively mandatory requirement to perform other substantive procedures to supplement the use of negative confirmation requests, or alternatively to replace it with the last sentence of AU 330.20, which states that "the auditor should consider performing other substantive procedures to supplement the use of negative confirmations."

Management Requests Not to Confirm

If management requests the auditor not to confirm certain accounts, balances, or other items, and the auditor agrees to management's request, the auditor is required by paragraph 24(a) of the



APPENDIX

proposed standard to "evaluate the implication of management's request on the auditor's assessment of the relevant risks of material misstatement, including fraud risk, and on the nature, timing, and extent of other audit procedures." We believe that the proposed standard would be strengthened by also including this requirement in paragraph 25, which provides guidance on circumstances in which the auditor disagrees with management's request and management refuses to authorize the confirmation request.

Exceptions

The auditor is required in paragraph 30 of the proposed standard to investigate *all* exceptions in confirmation responses. We do not believe it is the Board's intent that auditors investigate immaterial differences, even though they would be considered to be exceptions. We encourage the Board to provide guidance to clarify this matter.

Also, we believe the discussion on page 33 of the Release that the auditor consider the impact of exceptions on any potential deficiencies in the company's internal control over financial reporting should be included in paragraph 30 of the proposed standard.

Direct Access

One of the conditions for direct access to information held by a confirming party to meet the definition of a confirmation response is for the confirming party to make certain representations, described in the note to paragraph 35 of the proposed standard, to the auditor *in writing*. We encourage the Board to clarify that "in writing" includes e-mail or other electronic responses.

In addition, question 25 in the Release asks whether direct access should be permitted as a confirmation response only if such response is received from a financial institution. We do not believe that direct access as a response should be restricted to financial institutions because practices may evolve in which the requirements for direct access would be met in other industries.

APPENDIX 2: Proposed Amendments to PCAOB Standards

We recommend that the Board modify a proposed conforming amendment to interim standard AU 331, *Inventories*, as shown below to allow for consideration of the auditor's risk assessment in determining whether a confirmation should be sent, consistent with the requirements in the proposed standard for selecting which receivables and cash accounts to confirm.

14. If inventories are in the hands of public warehouses or other outside custodians, the auditor should confirm such inventories with the custodians. ***The auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting which inventories with custodians to confirm.***



September 13, 2010

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

RE: PCAOB Rulemaking Docket Matter No. 028
Proposed Auditing Standards Related to Confirmation and Related Amendments to PCAOB Standards

To Whom It May Concern:

One of the expressed goals of the Texas Society of Certified Public Accountants (TSCPA) is to speak on behalf of its members when such action is in the best interest of its members and serves the cause of Certified Public Accountants in Texas, as well as the public interest. The views expressed herein are written on behalf of the Professional Standards Committee (PSC) of the TSCPA. The PSC has been authorized by the TSCPA Board of Directors to submit comments on matters of interest to the committee's membership. The views expressed in this letter have not been approved by the TSCPA Board of Directors or Executive Board and, therefore, should not be construed as representing the views or policy of the TSCPA. We appreciate the opportunity to provide input into your deliberations on the above-referenced Exposure Draft (ED).

Our committee has met and discussed the guidance presented in the above-referenced ED. Prior to relating our responses to the 27 questions posed by the Board, we would like to provide an overall reaction to the ED. We believe much of the guidance presented in this ED is counterproductive to a true risk-based approach to the audit process. While confirmations can provide useful evidence in an audit engagement, they are often given more credibility than they deserve.

There are numerous variables that impact the authenticity and relevance of a confirmation received by an auditor. These variables include the knowledge and concern of the person completing the confirmation, the correct interpretation of the data being confirmed, the agenda of the entity providing the confirmation, etc. In most cases, the auditor is ill-prepared to overcome the risk associated with many of these variables with anything other than a healthy dose of professional judgment. Thus, we believe the auditor should be cautioned about these variables and encouraged to always exercise professional judgment when confirmations are a part of the evidence-gathering process. In our opinion, the ED did not include enough focus on the amount of professional judgment that goes into an evaluation of the confirmation process performed in connection with an audit engagement.

Question 1: Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

The definitions are sufficiently clear and appropriate.

Office of the Secretary
PCAOB
September 13, 2010
Page Two

Question 2: Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?

The objective of the ED is clear. However, we believe the objective should include the words "timely" and "accurate" in addition to "relevant" and "reliable" in describing audit evidence.

Question 3: What other matters, if any, should the objective include?

See answer to question 2.

Question 4: Is the description of "receivables that arise from credit sales, loans, or other transactions" sufficiently clear and appropriate? If not, what changes should the Board make?

The description is clear.

Question 5: Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

The requirement is clear and appears to be appropriate.

Question 6: Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

We question the use of confirmations in addressing the risk of material misstatement. We find it hard to believe that an auditee or a third party involved with a material misstatement would admit to that involvement in a confirmation. It is our contention that perpetrators of wrong doing continue to deny the wrong doing until they are caught. We believe confirmations are an inappropriate means to uncover an intentional misstatement whether material or otherwise. If a significant risk exists in an audit client's financial information, then it is our contention that the professional judgment of an auditor should lead the auditor to perform audit procedures other than confirmation. Telling auditors that confirmations can adequately address significant risks of material misstatements is inappropriate guidance. As we stated in our opening remarks, the exercise of professional judgment is the best approach when significant risks and material misstatements are involved. Once an auditor concludes that an issue poses a significant risk that could result in a material misstatement, further investigation of the issue is warranted. Further, it is our belief that the procedures performed in conducting the further investigation would not include confirmations.

Question 7: Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

Office of the Secretary
PCAOB
September 13, 2010
Page Three

As stated in our answer to question 6, we do not believe that confirmations serve a useful purpose in an auditor's investigation of significant risks. Perhaps a confirmation could lead the auditor to believe a significant risk exists due to the manner in which the confirmation was handled by the respondent or the response received. However, once the significant risk is identified, the confirmation process appears to be an inappropriate way to investigate the issue.

Question 8: Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

The discussion of "other risks" is unclear. The concept of other risks is not defined in the ED and no information is provided by the Board regarding how such risks have been handled by the auditor in the past. Must these other risks be assumed to be material for consideration or is the auditor to pursue anything that he or she considers to be a risk? The guidance on this topic is much too vague to be effective. If the Board wants auditors to deal with "other risks" in a particular manner, they must clearly define what this term means and what end result the auditor is required to attain.

Question 9: Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The definitions are sufficiently clear and appropriate.

Question 10: Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements in the proposed standard for maintaining control over the confirmation process and with respect to the use of internal auditors is sufficiently clear and appropriate.

Question 11: Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

The factors for designing the confirmation requests are sufficiently clear and appropriate.

Question 12: Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

The requirements are sufficiently clear and appropriate regarding the use of negative confirmations.

Question 13: Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

We believe the Board should consider requiring that the auditor examine addresses on remittance advices or electronic evidence of payment to confirm the addresses and customer existence.

Office of the Secretary
PCAOB
September 13, 2010
Page Four

Question 14: Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

See answer to No. 13 above.

Question 15: Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

The guidance is sufficiently clear and appropriate.

Question 16: Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-response to positive requests? If so, what are those circumstances?

We believe the auditor should have a responsibility to follow up on positive confirmation requests where no response was received. If the auditor considered it appropriate to send a positive confirmation, then he or she would need some corroborating evidence regarding that confirmation request.

Question 17: Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

The additional procedures appear to be appropriate.

Question 18: Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

We are unaware of any additional circumstances.

Question 19: Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirements?

The requirement is sufficiently clear and appropriate.

Question 20: Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

The requirements appear to be sufficiently clear and appropriate.

Office of the Secretary
PCAOB
September 13, 2010
Page Five

Question 21: Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

We believe the question is **not** whether the proposed standard includes adequate requirements; rather, the question is whether the proposed standard includes **relevant** requirements. We feel a standard dealing with the confirmation process should adhere to the auditor's responsibility to obtain and evaluate evidence that meets both the sufficiency and appropriateness criteria. Specific procedures related to electronic media should not be promulgated. Rather, the guidance in this area should caution the auditor to apply professional judgment in evaluating the risks related to electronic media and its impact on the confirmation process. The primary concern surrounding the confirmation process is to control the outbound and inbound communication, with secondary concern about whether the confirmation is coming from an independent 3rd party. Most often, the "other party" to the confirmation process is considered independent of the attest client (e.g., banks) with little incentive to falsify the reply. Also, the attest entity has a very limited opportunity to intercept such confirmation requests. If, in the auditor's judgment, he or she is confident that the controls over the sending and receipt of the confirmation request are strong, then the need to directly contact the confirming party seems to be a waste of time and effort. If an auditor clearly understands the risks associated with electronic confirmations, then the exercise of professional judgment, along with a healthy dose of professional skepticism, would allow him or her to decide on the specific audit procedures necessary in each circumstance. Such guidance would be consistent with the risk-based approach to an audit engagement, and allow the auditor to achieve a high confidence level regarding the evidence gathered. Dictating a list of required procedures frequently results in a lock-step approach to an audit engagement, often causing the auditor to avoid focusing on the most relevant risks. We believe a competent auditor applying professional judgment is the one who should decide on the specific procedures that need be performed to authenticate evidential matter gathered in an audit engagement. We encourage the Board to spend more time identifying the potential risks that can impact the audit evidence gathered by an auditor, and allow the auditor to design the procedures to assess the significance of such risks in specific audit situations.

Question 22: Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

The risks related to the use of an intermediary appear to be adequately addressed. We believe it is possible that obtaining confirmations from an intermediary would require consideration of its internal control environment and whether the controls are designed and operating effectively. We suggest in such situations that, when the risks are significant, the auditor consider obtaining a SAS 70 report on the intermediary's internal control environment. In situations where a SAS 70 report would be unavailable, we suggest the auditor be encouraged to develop and perform audit procedures which focus on the strength of the intermediary's control environment.

Question 23: The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.

Office of the Secretary
PCAOB
September 13, 2010
Page Six

While we could not identify a question in the verbiage included in "Question 23," we strongly encourage the Board to gather such information and provide it as an appendix to the proposed standard.

Question 24: Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?

We are sure that the area of direct access has a multitude of risks that, as yet, have not been identified. We suggest the Board again focus on the responsibility of the auditor to exercise a large dose of professional skepticism and use his or her judgment in determining whether sufficient appropriate evidential matter has been gathered. If skepticism on the part of the auditor remains, then the auditor must design procedures that delve further into the situation and determine whether it has the potential to impact the auditor's report.

Question 25: Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

We are of the opinion that direct access should not be limited to financial institutions, since other sources may be adequate, and the auditor should make that judgment. We do believe, however, that financial institutions are best equipped to satisfy the auditor's needs, since they are probably the only entities today that have sufficiently sophisticated systems to routinely allow for reliance on direct access.

Question 26: Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses clear and appropriate? If not what changes should the Board make?

The guidance in this area is quite subjective. The Board has listed a number of boiler-plate type disclaimers that reflect very little in terms of the quality of the confirmation or intent of the respondent. When a disclaimer states: "Information is not guaranteed to be accurate nor current and might be a matter of opinion," how should the auditor interpret this? If any one of the three deficiencies identified in the disclaimer is present, the confirmation is useless. Thus, how could an auditor place reliance on any confirmation that includes a disclaimer? Questions such as the following would come to mind when a disclaimer is included in a confirmation response. "Why was the disclaimer included?" "Is the disclaimer merely a legal precaution suggested by legal counsel, or is it due to a legitimate uncertainty about the data?" "Do they have significant reservations about the response?" "Is the disclaimer a way of masking a problem the respondent wishes to keep confidential?" When such uncertainties exist, it seems to us that the confirmation would be unreliable, and the auditor should be encouraged to expand audit procedures to determine whether the risk of the disclaimed confirmation could be overcome. If the risk remains and the issue is significant to the attestation report, then a modified report may be warranted. Also, we believe an auditor should continue to be skeptical of a confirmation with a disclaimer, even if the confirming party orally indicated that the disclaimer was merely a legal requirement and the information was reliable.

Office of the Secretary
PCAOB
September 13, 2010
Page Seven

Question 27: Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not what changes should the Board make?

The requirements appear to be clear and appropriate.

We appreciate the opportunity to provide input to the Board's standard-setting process.

Sincerely,

A handwritten signature in cursive script that reads "Kathryn W. Kapka". The signature is written in black ink and is positioned to the left of the typed name and title.

Kathryn W. Kapka, MBA, CPA, CIA, CGAP
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants



13 September 2010

Our ref: ICAEW Rep 90/10

Your ref:

Office of the Secretary
PCAOB
1666 K Street
N.W.
Washington
D. C. 20006-2803

PCAOB Rulemaking Docket No. 028

Dear Sir

Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards

The ICAEW welcomes the opportunity to comment on the *Proposed Auditing Standard Relating to Confirmation and Related Amendments to PCAOB Standards* published in July 2010.

The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

It is our continued belief that as part of the risk-based approach, auditors should be required to use their judgement in determining whether confirmation requests are an effective and efficient manner of obtaining audit evidence.

Our main comments and answers to the PCAOB's specific questions are set out below. Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

Katharine E Bagshaw FCA
Manager, Auditing Standards
ICAEW Audit and Assurance Faculty
T + 44 (0)20 7920 8708
F + 44 (0)20 7920 8754
E: kbagshaw@icaew.com

Main Comments

1. The PCAOB's standards need to work abroad

The PCAOB is a *de facto* global auditing standard-setter because the effects of its standard-setting activities extend far beyond its shores. We believe that the PCAOB must therefore take account of the likely effect of its actions outside the USA as well as those within, in order to fulfil its mandate to protect US investors. With the best of intentions, the PCAOB's standards may be applied in a way different to that intended when transplanted into different cultural and legal contexts. In order to be effective, the PCAOB must necessarily seek a balance; its standards and requirements must be set at a sufficiently high level so as to be translatable into different contexts but they must also be sufficiently detailed. The proposed standard on confirmations could achieve this balance better. The lack of balance is exemplified by the statement in the Release to the effect that if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures. To an extent, this misses the point and urges auditors to work harder, instead of smarter. We remain of the view that gearing up and fine tuning processes will not compensate for or address:

- human error on the part of auditors
- the carelessness, or worse, of third party respondents
- very low response rates (which are also unlikely to be improved by confirming individual transactions).

In short, we do not believe that it will improve audit quality for auditors to be required to send audit confirmation requests where expected response rates to any sort of request is very low, or where local customs of simply agreeing to requests prevail. The auditor could also waste time if it is known in advance that any responses will include disclaimers that render such responses of limited value as audit evidence. We believe that it is not appropriate to send requests in such circumstances; auditors should instead be required to move directly to alternative audit procedures. It is our continued belief that auditors should be required to use their judgement in determining *whether* confirmation requests are an effective and efficient manner of obtaining audit evidence.

2. How can response rates be improved?

It is clear from this ED that the PCAOB intends to encourage the use of confirmations in the audit, including where they can effectively be used in connection with significant risks. We believe that a more holistic approach needs to be taken if low levels of responses are to be significantly improved because action on the part of auditors is likely to have limited effect. A policy of non-response to confirmation requests on the part of large corporate entities in the UK, and ever-tighter audit deadlines, are two reasons for the declining response rates. If regulatory bodies in the UK, and their equivalents in the US, were to encourage or mandate responses from the entities that they oversee, response rates would rise. If investors want an efficient and effective audit process, then regulators and auditors have a right to ask for wider co-operation. There are some situations where confirmations are demonstrably the most efficient and effective form of audit evidence and their use should not be circumscribed by cost-cutting on the part of large corporate entities.

3. Will confirmation requests be effective?

It seems clear that there will be additional work to be performed when the proposals are finalised, but it is not at all clear that there will be a corresponding improvement to audit quality. We remain unconvinced that the additional work required will result in any significant improvement. This is mostly because of the highly procedural nature of the proposed standard.

We noted in our response to the Concept Release that any new standard should more clearly recognise that each confirmation will give rise to a unique set of risks that the auditor should be required to consider, and respond to appropriately, rather than encouraging auditors to hide behind a codified set of rules that are not tailored to address the risks identified.

We also noted that a:

'...corollary of the risk based approach, and an important aspect of confirmations that the PCAOB has not really addressed, is the combined effect of the decline in use of confirmations, low response rates and respondent errors because an increasing number of entities regard them as a low priority, and the widespread increase in the use of restrictive language and disclaimers. The... comment on Page 4 of the Concept Release to the effect that some auditors believe that confirmation is not a particularly effective audit procedure in many situations, is important. It calls into question the statement on page 5 that expanding the requirements of the standard to other areas may enhance audit quality and investor protection; it may only appear to do so...and that

A greater discussion of high quality alternative evidence would be helpful here, particularly for those assertions such as existence, for which confirmations, when they can be performed, are good.'

4. Risk-based approach and the role of judgement

We remain concerned that the proposed standard which will require auditors to pay more attention to procedural detail will not necessarily result in an overall increase in audit quality and may distract the auditor from focusing on higher risk judgemental areas.

Micromanaging auditor behaviour and improving confirmation requests will not compensate for the low and declining level of response rates and the increased use of disclaimers. Is it better to ask a valet to park one's car carefully, or to require him to put the key in the ignition, release the brake, engage the clutch and so forth, and risk a response to the effect that '...there was no requirement not to hit the kerb...?'

Our response to the PCAOB on its Concept Release noted

...the need for focus on the outcome of confirmations (including their reliability) and alternatives to confirmations rather than their mechanics. Auditors should be encouraged to apply professional skepticism in evaluating confirmation requests.

We note that the word skepticism does not appear in the proposed standard, and the word judgment just once, as a footnote.

5. The PCAOB should effectively challenge the IAASB

We referred in our 28 May 2010 response to the PCAOB on its proposed auditing standard on communications with audit committees and our 2 March 2010 response to the exposure of the risk standards, to the need for the PCAOB to effectively challenge the IAASB in areas in which it believes that ISAs should be improved. We noted that in order for that challenge to be effective, there is a need for the PCAOB to be robust and detailed in its explanations of differences between PCAOB standards and ISAs; this type of challenge is an important part of the convergence process, which is not well-served by many of the small wording differences noted below (in our answers to questions 1, 2, and 11, for example).

We remain particularly concerned that the proposed standard would create further differences between PCAOB standards and the ISAs by mandating procedures that are driven by judgement under ISAs. Examples include:

- the scope of the document (which we note in our answer to question 4, below, will create some problems)
- the requirements for second and possibly third confirmation requests
- requiring sales cut-off testing when confirmations are carried out at an interim date
- assessing a confirming party's competence, motivation and objectivity.

We understand the rationale for removing the pre-existing exemptions and requiring auditors to perform such procedures in all circumstances - auditors who have not in the past applied their judgement appropriately will now be forced to perform procedures - but we do not believe that mandating such procedures in all circumstances will improve audit quality.

A general risk-based approach, as envisaged by the ISAs would mean that such procedures would be applied where appropriate, and not indiscriminately. This would not prevent failures in the audit confirmations process but neither will the PCAOB's approach, and the ISA approach has the added advantage of enabling audit inspectors to require auditors to justify their approach, thereby holding them to a higher standard than that which is required if inspectors can only ask for auditors to show that they have performed a procedure.

While a small element of judgement will still be applied by auditors under the proposals, (in selecting the receivables sample, for example), the emphasis in audit planning will shift toward requirements to carry out confirmation procedures and away from the need to thoughtfully identify, assess and respond appropriately to risks. We noted in our response to the Concept Release that while standardised confirmation procedures facilitate more consistent (and to that extent reliable) responses in the case of requests to, say, banks, the benefit of such standardisation derive from requestees being a homogenous group subject to regulation. This is simply not the case with, say, recipients of requests for confirmation of accounts receivable.

6. Proposals that may be of very limited value

There remain three elements of the document which we believe in practice will be of very limited value at best.

Firstly, requiring confirmation of the amounts and terms of undisclosed oral or undisclosed written modifications to those agreements, such as undisclosed side agreements, is likely to produce little or nothing in terms of additional audit evidence in the vast majority of cases. Such agreements by definition are shielded from the public eye and it seems very unlikely that confirmation requests will draw out details of such agreements. It would be better to require auditors to make such enquiries where their suspicions are aroused rather than devalue the requirement by applying it indiscriminately.

Secondly, the procedures requiring checking of addresses seem to be fixing a non-existent problem. We noted in our response to the Concept Release that checking addresses will not deter those intent on deceiving auditors, that PCAOB reports do not highlight problems in this area and that additional direction should therefore be kept to a minimum.

Finally, while PCAOB reports do highlight problems with disclaimers, in our answer to question 26 below, we note that we remain unconvinced that the proposed solution to the problem of disclaimers is workable. Paragraph 37 states that if a disclaimer or restrictive language cause doubts about the reliability of a confirmation response, the auditor should obtain additional appropriate audit evidence. We note that the language used in disclaimers, almost by definition, always causes doubts about the reliability of a confirmation response. We fear that paragraph 37 and the examples given of problem disclaimers could be extended by implication to a large majority of disclaimers in use in practice, and will result in inconsistent application of the standard. We would prefer see wording closer to that used by the ISA which states that restrictive language does not necessarily invalidate the reliability of the response as audit evidence.

Answers to the PCAOB's Specific Questions

1. Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

We find the differences between the wording of the PCAOB's definitions of positive confirmation requests, external confirmations and exceptions, and the wording of the IAASB's definitions, to be so small as to be trivial. We see no difference whatsoever of substance in these definitions, and we urge the PCAOB to consider the merits of aligning the wording with that of the ISA, and the disadvantages of maintaining such apparently hair-splitting differences. We are pleased to note that the PCAOB's and the IAASB's definition of a negative confirmation request are identical.

2. Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective? and

3. What other matters, if any, should the objective include?

We are pleased to note that the objective now relates to the auditor rather than the standard, although we find the difference between the wording of this objective and the wording of the objective of ISA 505 so small as to be trivial. Once again, we see no difference whatsoever of substance and we urge the PCAOB to consider the merits of aligning the wording with that of the ISA, and the disadvantages of maintaining the difference.

4. Is the description of "receivables that arise from credit sales, loans, or other transactions" sufficiently clear and appropriate? If not, what changes should the Board make?

The description of receivables which includes *other transactions* will potentially catch a large number of complex financial instruments, some parts of which will have characteristics of receivables, albeit within wrappers that result in the instrument not being classified as such. We do not believe that confirmation requests could be easily drafted for such instruments, nor would responses be forthcoming, nor would they be of much value even if they were. We suggest that the standard note that auditors are not expected to deconstruct complex financial instruments for these purposes and that unless a financial instrument is properly classified as a receivable, confirmation requests are not required.

5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?

Yes.

6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

Yes.

7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?

No.

8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

It would be helpful for the standard to make it clear in paragraph 11 that the auditor should use his judgement in determining what might be an appropriate response to obtain audit evidence.

9. Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements for maintaining control over the confirmation process are clear but not appropriate, because they are likely to increase costs without any corresponding improvement in the extent of the response rate, the quality thereof or the quality of the audit evidence thereby obtained. Furthermore, where audit time and costs are circumscribed, it is very likely that such excessive attention to detail will result in auditors taking their eye off the ball and focussing on compliance with detailed requirements of the standard instead of its ultimate objective, which is for auditors to use their judgement to assess whether cash and receivables are overstated and/or payables understated.

10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The severe limitations imposed on the extent to which external auditors can involve internal auditors in the mechanics of confirmations (p20 *Therefore, the auditor cannot use internal auditors to send confirmation requests, receive confirmation responses, or evaluate the audit evidence obtained from performing confirmation procedures...*) sit uncomfortably with the licence for external auditors to take comfort from the confirmations already conducted by internal audit (p21 *...an auditor may consider work performed by internal auditors in determining the timing and extent of the auditor's procedures... For example, if the internal auditors, as part of their work, confirm certain receivables, the auditor may... change the timing of his or her confirmation procedures or the number of receivables to confirm*). Whilst the distinction may be clear, the sub-text appears to be that internal auditors can be trusted not to misrepresent what they have already done, but cannot be trusted to work under the direct supervision of the external auditor. We agree that internal auditors should not send or receive confirmation requests, but we do not see a bar to their assisting external auditors with evaluating the evidence thereby obtained.

11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?

The list of factors for designing confirmation requests in paragraph 16 is very similar to the list in paragraph A4 of the ISA, and, in line with our main comments above, we encourage the PCAOB to consider whether minor wording differences are worth maintaining. We are concerned about references to *local customs...of responding to confirmation requests without verifying the information*. We note in our main comments above our continued belief that auditors should be required to use their judgement in determining whether confirmation requests are an effective and efficient manner of obtaining audit evidence and we believe that such local customs as described above are on a par with very low expected response rates that cannot be improved. There is little value in sending requests in such circumstances; instead auditors should be able to move directly to alternative audit procedures.

12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?

Yes, although we believe it would be fairer to auditors in the last bullet of paragraph 17 to state that the auditor *...has no reason not to believe that recipients of negative confirmation requests will give such*

*requests consideration, rather than ...the auditor reasonably believes that...they will [do so]. This would bring it further into line with paragraph 15 (d) of the ISA. We are curious as to why the PCAOB has not adopted the seemingly higher hurdle of paragraph 15 (c) of the ISA in requiring a *very low exception rate* as a condition for conducting negative confirmations, rather than the *low expectation rate* set out in paragraph 17 on the PCAOB standard.*

13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures? and

14. Are the procedures the auditor should perform when he or she determines that a confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?

We noted in our response to the Concept Release that:

Auditors should not be required to check the authenticity of documents in this area any more than in any others, unless conditions identified during the audit cause the auditor to believe that a document may not be authentic. Professional skepticism does not extend to an assumption that documents lack authenticity.

We refer to our answer to question 9 above and our main comments. We do not believe that the detailed procedures set out in paragraphs 18 to 20 will result in any improvement to the quality of audit evidence obtained by confirmation requests, above and beyond that which would be obtained through a simple requirement for auditors use their judgement to determine the validity of addresses on confirmation requests on a sample basis.

15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?

Yes, although the communication of the request not to confirm to the audit committee and its inclusion in the management letter may be needed on a summary basis in order to avoid overloading the audit committee and representation letter with excessive, immaterial detail. We encourage the PCAOB to consider the merits of communicating these matters only where the auditor concludes that management's request is unreasonable, in line with paragraph 9 of the ISA.

16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?

No.

17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?

Management representations should not be substituted for third party or other audit evidence that should be available. When the auditor does not receive a confirmation response for the terms of a significant transaction or agreement, other procedures are carried out and which include including the terms in the management representation letter (paragraph 28). We think it important that PCAOB clarify that management representations, while necessary, are not sufficient. Firstly, there should be documentary evidence above and beyond management representations for significant transactions or

agreements. Management representations may supplement such evidence but not substitute for it. If the only evidence available for such transactions is the original written contract auditors should be encouraged to examine the contract in further detail and seek alternative audit evidence (other than or in addition to management representations). Furthermore, we do not believe that it is appropriate for auditors to seek individual written representations from company personnel involved with the transaction, even if they are management personnel.

We noted in our response to the Concept Release that:

Alternative procedures might include using the work of specialists, extending testing of revenue recognition surrounding contracts, requesting and examining copies of the contracts and amendments thereto and comparing contractual terms to industry norms.

18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?

No, although it may be worth noting the fact that it will be rare for information to corroborate management's assertion to be available only outside the company, or that there will only be one such source of information (this is also true of paragraph A20 if the ISA).

19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?

Yes.

20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?

Yes, although we refer to our answer to question 11 above regarding *local customs*.

21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?

Yes, however, the proposed standard goes into more detail than the ISA and while it is useful to consider the questions and risks raised, there is limited help with how they should be addressed. There may well be a need for practical guidance outside the proposed standard, which could be tailored for specific situations (such as particular industries) and kept up to date as technology changes. Without such guidance, it may be difficult for auditors to interpret the requirement in the 3rd bullet of paragraph 35 to *obtain an understanding of the controls over the procedures used by the intermediary*, for example. It would be helpful for the standard to note a need for auditors to remain focussed on the high level risks, as failures in these are where failures in the conduct of confirmations often occur. Telephone calls are no longer necessarily an efficient or effective back-up audit procedure.

22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them? and

23. The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.

Intermediaries are not routinely used in the UK but it is certainly possible that the use of them will increase. We believe that the key issue is for auditors to understand the controls in place to ensure that the information the auditor receives is reliable.

24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them? and

25. Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

We noted in our response to the Concept Release that

Direct electronic confirmation may be more efficient and reliable than manual transcription of electronic information which is then posted to the auditor but direct access to databases may equally be vulnerable to greater manipulation and fraud than more traditional methods. The databases themselves may be subject to a heightened risk of fraud or error and ...the information therein is often transient. Given the potentially relatively weak audit evidence provided by such databases, it is essential that the auditor either be satisfied with the controls over information delivered to the third party provider, the controls applied to the data during processing, and the control of information returned to the entity from such third parties.

We note that large corporate entities may well have adequate controls for these purposes and we are not convinced that all financial institutions, particularly smaller institutions, have the necessary controls in place to make direct access feasible. Again, the key issue is for auditors use their judgement to assess whether the process used is reliable.

26. Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?

We remain unconvinced that the proposed solution to the problem of disclaimers is workable. The effect of disclaimers is a genuinely difficult area and a good example of one in which careful judgement is required. We noted on our response to the Concept Release that:

To require auditors to effectively discount the evidence provided by confirmation requests circumscribed by disclaimers and restrictive language is to enter into a downward spiral at the end of which lies an inability to rely on any confirmation response. Such disclaimers and restrictive language are increasingly common in the UK particularly in responses from banks and the view taken is that of themselves, they do not significantly impair the value of such evidence. Furthermore, the practical effect of a disclaimer or restrictive language is likely to require a legal analysis that is not within the auditor's competence

Paragraph 37 states that if a disclaimer or restrictive language cause doubts about the reliability of a confirmation response, the auditor should obtain additional appropriate audit evidence.

The language used in disclaimers, almost by definition, always causes doubts about the reliability of a confirmation response. We fear that paragraph 37 and the examples given of disclaimers that may affect the value of audit evidence¹, which could be extended by implication to a large majority of

¹ Such as

- information is obtained from electronic data sources, which might not contain all information in the bank's possession.
- information is not guaranteed to be accurate nor current and might be a matter of opinion.
- the confirming party does not accept any responsibility for errors or omissions.

disclaimers in use in practice, will result in inconsistent application of the standard. We are loath to call for further guidance, which would inevitably involve legal analysis. We would prefer to see wording closer to that used by the ISA which states that restrictive language does not necessarily invalidate the reliability of the response as audit evidence, with the implication that in some cases it may, and that auditors use their judgement in determining whether additional audit evidence is needed.

27. Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

Yes.

-
- information is furnished as a matter of courtesy without a duty to do so and without responsibility, liability, or warranty, express or implied
 - the confirming party has not sought to verify that the information contained in the attached report is true and complete and hereby expressly disclaims any liability.



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber.com

September 13, 2010

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

Re: Request for Public Comment on Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards (PCAOB Release No. 2010-003, July 13, 2010, Rulemaking Docket Matter No. 028)

Dear Members and Staff of the Public Company Accounting Oversight Board:

The United States Chamber of Commerce (“Chamber”) is the world’s largest business federation representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

The CCMC recognizes the vital role external audits play in capital formation and supports efforts to improve audit effectiveness. We appreciate the opportunity to comment on the Public Company Accounting Oversight Board’s (“PCAOB”) *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (“Proposal”). However, the CCMC is very concerned with the expansion of the confirmation process contemplated by the PCAOB, the lack of adequate input by all financial reporting stakeholders in the development of the proposal, as well as the consequences that may spring forth if the proposal is implemented, including increased costs and a degradation of audit quality. Accordingly, the CCMC urges the PCAOB to withdraw the Proposal, convene public roundtables involving representatives of all financial reporting stakeholders and conduct a cost-benefit assessment before determining whether and on what terms to present a revised proposal.

Office of the Secretary
September 13, 2010
Page 2

The CCMC's specific concerns are listed below.

I. Process Concerns Regarding the Expansion of Confirmations

The PCAOB appears to have conducted limited outreach activity in the development of this Proposal. This is most apparent from the conclusion that investors view third party confirmations as constituting better audit evidence than that which can be obtained by auditors from internal documentation or alternative audit procedures. Apart from that assertion, the PCAOB has failed to demonstrate if primary reliance should be placed on confirmations in all audits.

It is unclear if the greater use of or reliance on third party confirmations by auditors would generate more reliable financial statements. Perception does not constitute a basis for adopting mandatory audit procedures. As a key assumption underlying the Proposal, the perception requires more extensive examination.

The need for further study is magnified by the longstanding difficulty that auditors face in conducting high quality audits arising from the absence of any obligation for third parties to respond to confirmation requests and the absence of any standards of due diligence or inquiry imposed on responding third parties. Whatever requirements are imposed by the PCAOB on auditors with respect to confirmations, they cannot overcome delay, error, or lack of response by third parties. Equally important, third party confirmations may also produce misleading information in cases of collusive fraud, calling into question the expansion of the confirmation process. It also appears that the PCAOB does not have the authority to compel third parties to comply with confirmation requests. Nor does it appear that the costs and burdens of compliance by third parties have been adequately considered.

As such, the CCMC must question the soundness of attempting to overcome flaws in areas that are outside the PCAOB's scope of authority by imposing mandates on auditors and third parties that may be costly and ineffective. The audit profession has long sought legal and regulatory support to make the confirmation process more effective and reliable. However, in the absence of viable solutions to this difficulty, auditors should be encouraged to use their best efforts to determine when

Office of the Secretary
September 13, 2010
Page 3

confirmations are likely to be inferior to alternative audit procedures. Instead, the Proposal overlooks this continuing vulnerability.

Indeed, the CCMC is concerned that the Proposal will cause deterioration in the quality and effectiveness of audits by requiring a cosmetic solution that will address investor perception but reduce the freedom of judgment for auditors to determine, based on the conditions of each audit, when confirmations are unlikely to be as effective as alternative procedures for acquiring audit evidence.

II. Cost Concerns

Adoption of the Proposal will impose significant costs and other burdens on U.S. public companies. First, this Proposal represents a very prescriptive standard, mandating and extending the use of confirmations. The Proposal contains numerous lists of factors that the auditor should consider and things the auditor should do. To illustrate, more than a dozen of the 39 paragraphs in the proposed standard contain such lists, for a total of at least 56 factors for the auditor to consider or things for the auditor to do with respect to the use of confirmations, generally, as well as for each specific application of confirmations on an audit. Thus, not only will this Proposal drive up audit costs, but it will likely promote a “check-the-box” mentality that may contribute to diminishing, rather than enhancing, the efficacy of audits.

Further, the combination of requiring third party confirmations in each audit and requiring broader and more numerous confirmations will significantly increase the number of confirmation requests issued by auditors. One of the matters that appear not to have been studied by the PCAOB is the extent to which this will impose additional compliance costs and resource burdens on U.S. businesses. This impact will not occur in a vacuum. The increased costs caused by the Proposal will combine with the sharply increased compliance costs imposed by the Dodd-Frank Act, compliance compelled by the Patient Protection and Affordable Care Act, as well as the impact of the several accounting convergence projects currently under consideration.

The cumulative effect of these new requirements, as well as those not listed above, will inevitably increase costs and burdens. There does not appear to have been any assessment by the PCAOB of these compliance costs and if they are outweighed

Office of the Secretary
September 13, 2010
Page 4

by the benefits of the Proposal. The transitional burdens and multiple new requirements are likely to cause a decline in either the proportion of responses to confirmation requests or the extent of care taken in providing confirmations to auditors. With multiple new responsibilities, it would not be surprising or irresponsible for companies to decrease the attention to a request for which there is no compulsory response.

The CCMC's concerns are not fanciful or artificially inflated. Congress is currently considering repealing a provision of the Patient Protection and Affordable Care Act that would require businesses to file form 1099s for any purchase with any vendor above \$600 per year (see the attached letter on the 1099 mandate from the Coalition for Tax Fairness). Is it incongruous that Congress is considering revocation of a recently adopted mandate because of the costs and burdens involved, while the PCAOB pursues an audit mandate without regard to measuring or avoiding its costs?

III. Need for Additional Input

The CCMC agrees that improvements to audits are beneficial to all stakeholders in financial reporting. However, in order to fully understand the needs of these stakeholders and the potential unintended consequences that may be avoided, the PCAOB should engage in public outreach and discussion to better understand the issues arising from audits and the solutions that should be pursued.

While the PCAOB has engaged in some outreach on the Proposal, the flawed nature of the solution indicates that this outreach was not comprehensive, as discussed above. Accordingly, the CCMC recommends that the Proposal be withdrawn and that the PCAOB hold a series of roundtables to discuss the problems it seeks to address and the range of solutions that may be implemented. The CCMC also believes that pre-implementation field testing should also be used to identify and correct any adverse unintended consequences that may arise.

The CCMC supports the implementation of rational improvements to enhance the quality of audits. However well intentioned this Proposal may be, in our opinion, the unintended consequences will lead to the opposite result. Auditors will be forced to make information requests that may not be provided; and if provided, auditors may not be in a position to appropriately evaluate such third party information under the

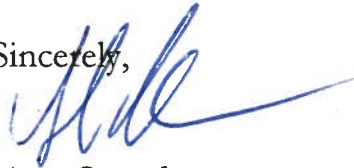
Office of the Secretary
September 13, 2010
Page 5

new requirements being proposed. If such requests are not provided, which could have been anticipated in many cases, auditors will be required to do additional work.

Third parties will be inundated with information requests that they are under no obligation to provide, and in some instances compliance may harm the interests of that party. Failure to comply with confirmation requests will call into question the quality of audits, lessening confidence in financial statements in general and harming investors. Furthermore, costs for all stakeholders will increase at a time when businesses are facing large compliance cost increases with the implementation of potentially hundreds of rule-makings under the Dodd-Frank Act, new health care rules, and the accounting convergence projects.

Simply put, this Proposal will harm investors, increase costs for businesses, and not contribute to improving the quality of financial reporting. Accordingly, the CCMC recommends that the Proposal be withdrawn for more study and input. We stand ready to assist in any such outreach efforts.

Sincerely,



Tom Quaadman

Attachment

THE COALITION FOR FAIRNESS IN TAX COMPLIANCE

September 9, 2010

Dear Senator,

On behalf of the Coalition for Fairness in Tax Compliance (CFTC), we are writing in support of the Johannis Amendment (SA 4596) to the Small Business Jobs and Credit Act of 2010. The Johannis Amendment is the only solution to relieve businesses from the expensive and burdensome new tax paperwork requirement included in Section 9006 of the Patient Protection and Affordable Care Act (PPACA).

As Congress calls on small business to lead the nation out of the recession, now is not the time for government-imposed costs on doing business. The extent of this new paperwork requirement on business owners is astounding, as businesses estimate that they will have to file hundreds and sometimes thousands of new 1099s per year. The IRS National Taxpayer Advocate Nina Olson stated that the administrative costs of small businesses are so high that it “may turn out to be disproportionate as compared with any resulting improvement in tax compliance.” The Johannis Amendment is the only solution that fully protects small business owners from this costly new burden.

The Nelson (FL) Amendment (SA 4595) does not remove the paperwork and administrative burden that is created by this new law. Instead, the Nelson alternative further complicates compliance responsibilities. While the amendment creates exceptions from the “property” information return requirements, those exceptions do not apply to “services” transactions. This lack of clarity will force small business owners to track expenses associated with both “property” and “services,” the amount spent on each, and the method of payment to determine what information must be reported under the new law. Rather than clarify, the Nelson amendment actually creates even greater complexity for those who comply with the law.

The Nelson Amendment gives the IRS the authority to create a list of reportable and non-reportable transactions, but this unleashes a minefield of potential mistakes and unanswered questions. Small businesses lack the book-keeping resources or capabilities to determine whether or not they have to report the transaction – and adding administrative costs takes time and money away from actually running the business. While PPACA created a new and overwhelmingly burdensome paperwork mandate, the Nelson alternative adds an additional layer of confusion to this already complex requirement.

We urge you to pass the Johannis Amendment and oppose the Nelson Amendment. Full repeal of the new 1099 requirement is the only solution that will relieve small businesses of the cost and confusion created by this new burden.

Sincerely,

Air Conditioning Contractors of America
Agricultural Retailers Association
Alabama Nursery & Landscape Association
Alliance for Affordable Services
Alliance of Independent Store Owners and Professionals
AMT- The Association For Manufacturing Technology
American Bakers Association
American Council of Engineering Companies
American Council of Independent Laboratories
American Farm Bureau Federation
American Hotel & Lodging Association
American Institute of Architects
American Nursery & Landscape Association
American Petroleum Institute
American Rental Association
American Road & Transportation Builders Association
American Society of Interior Designers
American Subcontractors Association, Inc.
American Veterinary Distributors Association
American Veterinary Medical Association
Arizona Nursery Association
Associated Builders and Contractors
Association of Free Community Papers
Association of Ship Brokers & Agents
Association of Small Business Development Centers
Automotive Recyclers Association
California Association of Nurseries and Garden Centers
Commercial Photographers International
Community Papers of Florida
Community Papers of Michigan
Community Papers of Ohio and West Virginia
Connecticut Nursery & Landscape Association
Direct Selling Association
Door and Hardware Institute
Electronic Security Association
Free Community Papers of New York
Georgia Green Industry Association
Hearth, Patio & Barbecue Association
Illinois Green Industry Association
Independent Community Bankers of America
Independent Office Products & Furniture Dealers Association
Industry Council for Tangible Assets
International Foodservice Distributors Association
International Franchise Association
International Housewares Association
International Sleep Products Association

Kentucky Nursery and Landscape Association
 Maine Landscape and Nursery Association
 Manufacturers' Agents Association for the Foodservice Industry
 Manufacturers' Agents National Association
 Manufacturing Jewelers and Suppliers of America
 Massachusetts Nursery & Landscape Association, Inc.
 Michigan Nursery and Landscape Association
 Mid-Atlantic Community Papers Association
 Midwest Free Community Papers
 Minnesota Nursery & Landscape Association
 National Association for Printing Leadership
 National Association of Home Builders
 National Association of Manufacturers
 National Association of Mutual Insurance Companies
 National Association of RV Parks & Campgrounds
 National Association of Theatre Owners
 National Association for the Self-Employed
 National Association of Wholesaler-Distributors
 National Christmas Tree Association
 National Club Association
 National Council of Farmer Cooperatives
 National Electrical Manufacturers Representatives Association
 National Federation of Independent Business
 National Home Furnishings Association
 National Lumber and Building Material Dealers Association
 National Newspaper Association
 National Office Products Alliance
 National Restaurant Association
 National Roofing Contractors Association
 National Small Business Association
 National Tooling and Machining Association
 Nebraska Nursery and Landscape Association
 New Mexico Family Business Alliance
 New Mexico Nursery & Landscape Association
 New York State Nursery and Landscape Association
 Northeastern Retail Lumber Association
 NPES The Association for Suppliers of Printing, Publishing and Converting
 OFA-An Association of Floriculture Professionals
 Office Furniture Dealers Alliance
 Oregon Association of Nurseries
 Pet Industry Distributors Association
 Petroleum Marketers Association of America
 Plumbing-Heating-Cooling Contractors Association
 Precision Machined Products Association
 Precision Metalforming Association
 Professional Golfers Association of America

Professional Photographers of America
Promotional Products Association International
S Corp Association
Safety Equipment Distributors Association
Saturation Mailers Coalition
SBE Council
Secondary Materials and Recycled Textiles Association
Service Station Dealers of America and Allied Trades
Small Business Council of America
Small Business Legislative Council
SMC Business Councils
Society of American Florists
Society of Sport & Event Photographers
Southeastern Advertising Publishers Association
Specialty Equipment Market Association
SPI: The Plastics Industry Trade Association
Stock Artists Alliance
TechServe Alliance
Tennessee Nursery & Landscape Association
Texas Community Newspaper Association
Texas Nursery & Landscape Association
Textile Care Allied Trades Association
Textile Rental Services Association of America
The American Council of Engineering Companies
Tire Industry Association
Turfgrass Producers International
U.S. Chamber of Commerce
Utah Nursery & Landscape Association
Virginia Christmas Tree Growers Association
Virginia Green Industry Council
Virginia Nursery & Landscape Association
Washington State Nursery & Landscape Association
Western Growers Association
Wisconsin Community Papers
Window and Door Manufacturers Association
Wood Machinery Manufacturers of America



United States Government Accountability Office
Washington, DC 20548

September 13, 2010

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

Subject: PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2010-003,
Proposed Auditing Standard Related To Confirmation and Related Amendments to PCAOB
Standards

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard on confirmations.

We appreciate the PCAOB's efforts to establish auditing standards on audit confirmations for registered companies and agree that confirmation procedures can be an important means of obtaining audit evidence. However, we have serious concerns about the proposed standard, specifically, (1) the proposed standard could lead to over-reliance on confirmation procedures as the presumptive requirement to perform confirmation procedures would cause auditors to spend time on confirmations when other audit procedures may be more appropriate, (2) the appendix identifies certain significant differences among the analogous standards but does not adequately explain the reasons for all significant differences, and (3) the drafting conventions and wording used in some sections of the proposed standard are unclear and will likely lead to confusion among users and inconsistency of practice. These concerns, along with other comments and suggestions for improving the clarity and other aspects of the standard, are noted below.

The Proposed Standard Could Lead to Over-Reliance on Confirmation Procedures

GAO does not dispute the premise that confirmation procedures can provide adequate and reliable evidence, but we reiterate our position from our previous letter to PCAOB, dated May 29, 2009, that (1) such procedures may not provide the most adequate and reliable evidence in every situation to support management's assertions, and (2) auditors should use professional judgment, based on audit risk and materiality, to determine the most effective procedures for obtaining sufficient appropriate audit evidence, including whether or not to use confirmation procedures in specific circumstances.

The proposed standard could reduce the use of auditor professional judgment when determining the proper combination of procedures that they should use to obtain adequate and reliable evidence to support management's assertions. The presumptively mandatory requirement to perform confirmation procedures supplants auditor judgment by

presuming that confirmation procedures are the most effective audit procedure to address the risk of material misstatement. Rather than requiring auditors to use their professional judgment, based on risk assessment and materiality to inform their decisions to send confirmation requests, the presumptive requirement would have auditors use the same procedures regardless of risk, materiality, or any other relevant facts and circumstances.

We recommend that the PCAOB reconsider the appropriateness of presumptively requiring auditors to use confirmation procedures and the related risk of over-reliance on these procedures. A more effective approach to obtaining evidence to support the entity's assertions is to apply provisions of the audit risk and evidence standards to determine whether audit confirmation procedures would be most effective. These standards and the related guidance provide sufficient principles-based direction for auditors to determine when to use confirmation procedures.

Providing Reasons for Significant Differences Between the Proposed PCAOB Standard and the Analogous Standards of the IAASB and the ASB in Appendix 3: *“Comparison of the Objectives and Requirements of the Proposed Auditing Standard and the Analogous Standards of the IAASB and the ASB”*

We commend the PCAOB for developing a separate appendix to help users recognize differences between the proposed standard and analogous standards of the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB.) However, while Appendix 3 identifies certain significant differences among the various standards, it does not adequately explain the reasons for all significant differences or the changes in practice that are expected to result from these differences.

For example, differences in the requirements for investigating exceptions in confirmation responses are identified on page A3-17 of Appendix 3, but reasons for the differences are not provided. This is also true for the discussion of requirements for evaluating results of confirmation procedures on pages A3-22 and A3-23 of Appendix 3.

To reduce the likelihood of misinterpretation of the standard and improve consistency of application, we recommend that, in addition to identifying the differences, the PCAOB provide reasoned, logical explanations for all significant differences from the IAASB and ASB requirements, along with the objectives of the differences, e.g.: the desired changes in practice.

Our other specific comments and suggestions relating to the drafting conventions and wording used in some sections of the proposed standard are detailed below:

Clarifying the Requirement to Assess the Risk of Material Misstatement When Confirming Receivables That Arise from Credit Sales, Loans, or Other Transactions

Paragraph 8 of the proposed standard states that the auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, when selecting receivables to confirm. While we support PCAOB's effort to incorporate the auditor's risk assessment into the audit confirmation procedures, the auditor should consider the risk of material misstatement when planning and designing procedures for selecting receivables to confirm, rather than in the actual process of selecting receivables

to confirm. Accordingly, we recommend that the PCAOB reword paragraph 8 to state that the auditor should consider the risk of material misstatement when planning and designing procedures to confirm receivables that arise from credit sales, loans, or other transactions, as follows:

8. The auditor should perform confirmation procedures for receivables that arise from credit sales, loans, or other transactions. These receivables may be in the form of loans, notes, and other financial instruments and may be originated by the company or purchased from another entity. The auditor should assess the risk of material misstatement due to error or fraud, including whether the risk is a significant risk, ~~when selecting which receivables to confirm~~ **when planning and designing procedures for selecting receivables to confirm.**

Clarifying the Requirement from another PCAOB Standard in the Discussion of Relationship of Confirmation to the Auditor's Assessment of Audit Risk

The requirement in paragraph 4 of the standard for the auditor to design and perform audit procedures in a manner that addresses the assessed risks of material misstatement is a repetition of paragraph 8 of the PCAOB's Auditing Standard, *The Auditor's Responses to the Risks of Material Misstatement*. Since some readers may not realize the requirement repeats that of another PCAOB standard, it would be more helpful to refer specifically to the other PCAOB standard, as follows:

4. ~~The auditor should~~ **The PCAOB Auditing Standard *The Auditor's Response to the Risks of Material Misstatement* requires auditors to design and perform audit procedures in a manner that addresses the assessed risks of material misstatement due to error or fraud for each relevant assertion of each significant account and disclosure. In designing the audit procedures to be performed, the auditor should obtain more persuasive audit evidence the higher the auditor's assessment of risk.**

Removing Presumptively Mandatory Requirement from Illustrative Example in Discussion of Significant Risks

The second sentence of paragraph 10 of the proposed standard includes a presumptively mandatory requirement presented as an illustrative example. This is not a logical construct, and as written, will likely confuse the reader and result in an inconsistent application of the standard. A more logical construct would be to provide an example to illustrate potential auditor procedures that the auditor may perform in response to significant risks. A clearer construct for the paragraph may be as follows:

10. The auditor should perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures. For example, ~~for one procedure the auditor might use to address~~ significant risks related to agreements or transactions for which confirmation procedures adequately address the relevant assertions, ~~the auditor should confirm~~ **is to confirm the amounts and terms of such agreements or transactions, including whether there are any undisclosed**

oral or undisclosed written modifications to those agreements, such as undisclosed side agreements.

Similarly, the second sentence of paragraph 14, the second sentence of paragraph 15, the third sentence of paragraph 19, and the third sentence of paragraph 28 of the proposed standard also include presumptively mandatory requirements in the illustrative examples. Accordingly, we recommend similarly revising these sentences to remove the presumptively mandatory requirement from the illustrative examples.

Clarifying Threshold for Determining if Disclaimers and Restrictive Language Cause Doubts about the Reliability of Confirmation Responses

The requirement in paragraph 37 of the proposed standard that the auditor should evaluate the effect of a disclaimer or restrictive language on the reliability of a confirmation response further states that if a disclaimer or restrictive language causes doubts about the reliability of a confirmation response, the auditor should obtain additional appropriate audit evidence. However, the term “*causes doubts*” is an ambiguous threshold and should be replaced with a threshold that more appropriately reflects the risk that a disclaimer or restrictive language causes the auditor to believe that it may limit the auditor’s ability to obtain sufficient appropriate evidence necessary to reduce the risk of material misstatement to an acceptable level. A clearer term requiring the auditor to obtain additional appropriate audit evidence may be as follows:

37. The auditor should evaluate the effect of a disclaimer or restrictive language on the reliability of a confirmation response. If a disclaimer or restrictive language ~~causes doubts~~ **causes the auditor to believe that it may limit the auditor’s ability to obtain sufficient appropriate evidence necessary to reduce the risk of material misstatement to an acceptable level**, the auditor should obtain additional appropriate audit evidence.

We thank you for considering our comments on this very important issue.

Sincerely yours,



James R. Dalkin
Director
Financial Management and Assurance

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on April 2, 2009 that relates to *Audit Confirmations*. The other topics discussed during the April 2, 2009 meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: https://pcaobus.org/news-events/events/event-details/standing-advisory-group-meeting_330

1 PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)

2

3 STANDING ADVISORY GROUP MEETING

4

5

6 8:32 a.m.

7 Thursday, April 2, 2009

8

9

10

11 National Association of Home Builders

12 1201 15th Street, N.W.

13 Washington, D.C.

14

15

16

17

18

19

20

21

22

1 [Recessed at 10:17 a.m.]

2 [Reconvened at 10:48 a.m.]

3 JENNIFER RAND: Okay. We're going to get
4 started to our next topic on the agenda, which is
5 audit confirmations. Dee Mirando-Gould, who is an
6 associate chief auditor in the Office of the Chief
7 Auditor, will be leading that discussion. So I will
8 go ahead and turn it over to Dee.

9 DEE MIRANDO-GOULD: Thanks, Jennifer.

10 Before we start our discussion of
11 confirmations, I'd like to introduce Chris David to my
12 left, assistant chief auditor in the office.

13 Confirmation is an important source of the
14 evidence auditors may obtain as part of an audit of a
15 company's financial statements because generally it is
16 presumed that evidence obtained from independent
17 sources outside a company is more reliable than
18 evidence solely from within the company.

19 The auditing standard on confirmation
20 defines confirmation as "a direct communication from a
21 third party in response to a request for information."
22 That definition did not contemplate advances in

1 technology, including electronic forms of
2 communication that are available today, for example,
3 electronic mail.

4 Also, auditors may now obtain direct access,
5 also referred to as direct online access, into the
6 electronic records of an audit client's customer,
7 bank, or other confirming party and check the
8 existence and amount of the audit client's balance
9 without the need for interaction with an employee of
10 the customer bank or party.

11 Direct access refers to an auditor obtaining
12 a direct link into the electronic records on a read-
13 only basis. To provide direct access to an auditor, a
14 third party would provide a temporary password to the
15 auditor to allow him or her to independently confirm
16 the information held by that third party. An auditor
17 using a client's password or sitting with a client to
18 review electronic records would not constitute direct
19 access the way we are contemplating it in this
20 discussion.

21 In addition to advances in technology, other
22 changes have occurred. Some banks and other

1 businesses have decided that they can no longer
2 dedicate the resources required to handle responses to
3 confirmations and, thus, have hired third parties to
4 respond on their behalf.

5 This leads me to our first question. Should
6 the definition of "confirmation" allow for responses
7 other than traditional mailed responses, such as oral
8 confirmation, facsimile, email, responses processed
9 through third-party service providers, and direct
10 access to information held by a third party?

11 Wayne Kolins?

12 WAYNE KOLINS: Yes. I guess I'll add to
13 that. It's certainly in this environment at least
14 Bank of America and I'm sure other financial
15 institutions now are just not responding to
16 confirmations. And that's their process.

17 But they have established another process
18 where an entity, a particular entity that we use
19 called Capital Confirmation, does have access to their
20 records and the issuer's information on their records.
21 Therefore, we have established procedures going to
22 those third parties to get access to it, and that

1 certainly is, in our view, is as strong as the normal
2 paper confirmation process and is the best
3 alternative.

4 DEE MIRANDO-GOULD: Thank you.

5 Joe Carcello?

6 JOSEPH CARCELLO: I would agree with Wayne.
7 Just to second that, I am somewhat familiar with the
8 Capital Confirmation process, and I'm sure there are
9 other competitors as well. And that seems to have a
10 lot of merit. So I would encourage you to continue
11 down that path.

12 But as it relates to some of what you have
13 up there, you have some other specific wording up
14 there beyond what Wayne talked about. To me, the big
15 issue, as it relates to all confirmations, whether
16 it's paper or anything else, is knowing who's
17 responding to the confirmation.

18 And again, I refer to some expert witness
19 work I've done, and you do get colored by your
20 experiences. We all do. And in that particular case,
21 there was a problem, major problem with confirmations,
22 and what was happening is the sales people were

1 confirming rather than people in the accounting area.
2 And so, the confirmations weren't of a lot of value.
3 So, to me, that's a major issue to the auditor is to
4 get comfortable as to who's responding.

5 As it relates to an oral confirmation, I
6 think that can work as long as it's followed up with
7 something written eventually. The problem with
8 relying only on oral is that no written record of the
9 confirmation response exists, could always be denied,
10 could always claim misunderstanding. Phone
11 conversations are prone to a lot of risk, as we all
12 know from our personal life.

13 And then I would suggest that the board
14 think about, as it talks about confirmations, that
15 they think about incentives to respond truthfully. In
16 retailing, often you get vendor rebates. And so,
17 those can be receivables. And when you confirm them,
18 you are confirming from a supplier.

19 And so, in that case, you're their customer.
20 And so, their incentives to not make you unhappy are
21 very different than if you're confirming to somebody
22 who buys from you. What are you going to do? Not

1 sell to them any more?

2 And so, I think the board needs to think
3 carefully about those incentives to respond truthfully
4 because I think it affects the quality of the audit
5 evidence.

6 DEE MIRANDO-GOULD: Thank you.

7 Gaylen Hansen?

8 GAYLEN HANSEN: Our firm also uses an
9 outside vendor, and I think their name has been
10 mentioned. So I won't mention it again the third
11 time. And that seems to be working.

12 But I'm a little bit distressed with the
13 direction that the banking groups are going with this.
14 I won't say anything more than that.

15 As far as oral confirmations, as I think an
16 oral confirmation is essentially no confirmation, is
17 incompatible with AS3 as far as that documentation
18 standard. And until you do follow up, as Joe just
19 said, I don't think it constitutes a confirmation
20 because of that misunderstanding, because of the
21 things that can be misinterpreted.

22 And so, I would kick oral confirmations out

1 of this and basically say that it's no confirmation.

2 DEE MIRANDO-GOULD: Thank you.

3 Any other comments?

4 JENNIFER RAND: I'd just like to jump in and
5 kind of ask a follow-up to Joe's point, and I thought
6 he made a very good point about incentives to respond
7 truthfully. And Joe, just kind of wondering in
8 connection with your comment, is the suggestion that
9 it should be a consideration by the auditor to
10 consider if they're aware of any incentives, or I
11 guess kind of in connection with your point, what are
12 you thinking auditors should do?

13 It may be difficult to kind of understand
14 that, but certainly I think it is a good point. Just
15 wondering if you could expand on that to help us in
16 our thinking?

17 JOSEPH CARCELLO: Well, I think the language
18 -- I could be wrong. But my recollection of when I
19 read this, you did talk about the auditor should
20 consider the ability, the incentive, the willingness
21 of parties to respond and to respond truthfully. So
22 if my memory is right, you have language in here. So

1 I'm not sure you need additional language. That's not
2 obvious to me that you do.

3 And I'm sure most of the firms would
4 normally think that through carefully. And in those
5 cases where they don't think it through carefully,
6 that's an inspection or an enforcement issue.

7 DEE MIRANDO-GOULD: Thank you.

8 Arnold Schilder?

9 ARNOLD SCHILDER: Thank you. And I would
10 offer that the IAASB recently had a new standard on
11 confirmations, and a number of questions that are
12 addressed here are also addressed in the standards
13 that we produced. For example, you mentioned about
14 when there is a refusal to allow a confirmation or
15 deals with oral confirmations, whether or not and not
16 without sufficient corroboration, and other issues.
17 And I will not mention that again by question, just
18 would point to the existence of that standard.

19 Furthermore, in our meeting a couple of
20 weeks ago, decided that it might be helpful if we
21 issue a staff alert just to bring that standard to
22 life also in light of very recent developments that

1 cast some doubt about the reliability of
2 confirmations.

3 So that would focus even more on how it's
4 working in practice and thereby assist people in
5 applying the standard. And if we can cooperate with
6 the PCAOB in that respect, that would be great because
7 we, of course, are serving here similar objective.

8 Thanks.

9 DEE MIRANDO-GOULD: So just let me clarify.
10 You're suggesting we might consider a practice alert
11 to discuss issues related to audit confirmations?

12 ARNOLD SCHILDER: That's what the IAASB
13 decided to do. So the staff will be working on that
14 in cooperation with some experienced practitioners.
15 But if in drafting that alert, we could cooperate with
16 the PCAOB, that, of course, would be quite helpful.

17 DEE MIRANDO-GOULD: Okay. Thank you.

18 Gary Kabureck?

19 GARY KABURECK: Thank you.

20 Two comments. One on oral. I mean, I don't
21 know that oral confirmations never work, but I would
22 certainly -- if you were going to stack, rank these

1 things in priorities, you'd have it sort of
2 minimalist, very low level of evidence and sort of
3 only on an emergency-type basis. You know, last
4 minute or something, followed up. So I wouldn't put
5 too much stock in it.

6 But I'm actually looking at the last item in
7 there, direct access to information held by a third
8 party. And again, I accept technology can probably
9 allow you to do that, but I would be nervous about
10 having that be an allowable audit procedure for
11 something important. You don't necessarily know what
12 you're looking at.

13 If you're the auditor and let's say you do
14 have access into some vendor's records or some
15 outsourcing records, you think of let's say bank
16 accounts. I mean, there might be one concentration
17 account and 60 clearing accounts. So you're taking
18 upon yourself to decide have I identified the right
19 account or accounts, and have I read it correctly?

20 And seems to me you're better off having
21 someone respond on behalf of the institution itself as
22 opposed to you deciding I've interpreted somebody's

1 ledger or trial balance correctly. Again, a lot of
2 these arrangements are very complicated with dozens of
3 accounts and ledgers and stuff. I would be very
4 careful about that.

5 Again, I'm not saying it's an inappropriate
6 procedure, but I have doubts about how good it really
7 will be in the main for most of the time.

8 DEE MIRANDO-GOULD: Gaylen Hansen? Oh, Hal
9 Schroeder?

10 [Laughter.]

11 HAROLD SCHROEDER: A few weeks ago, we were
12 down here for the new members session, and I recall
13 one of the sessions went into audit deficiencies,
14 things that you all have found on inspections. And I
15 was struck by the fact that audit confirmations, I
16 think, was not -- if it wasn't number one, it was
17 number two on the hit list of things most often done
18 wrong.

19 Will this definition or some expanded
20 definition help rectify that? Is this trying to
21 address a specific problem? Could you give a little
22 bit of color in terms of how this matches up with what

1 you all are finding in the field?

2 DEE MIRANDO-GOULD: The type of inspection
3 findings related to confirmations, things like
4 auditors not following up on exceptions on
5 confirmation responses or not following up when there
6 is a nonresponse. There's no response at all.

7 There has also been confirmation where the
8 auditor has relied possibly too much for a particular
9 assertion. So, for example, valuation of investments.
10 Audit confirmations typically are better for existence
11 assertion -- maybe for some other things as well --
12 but to a lesser extent, for valuation. And so, in
13 certain cases, that was a problem.

14 I'm trying to remember some of the others.
15 I think those are some of the biggest issues with
16 confirmations that we've seen in inspections. So the
17 definition itself doesn't address those kinds of
18 exceptions. Possibly some other areas, like how to
19 deal with exceptions, which isn't discussed in this
20 SAG briefing paper, but that would address those kinds
21 of issues.

22 Any other? Joe Carcello?

1 JOSEPH CARCELLO: Yes, just a quick point to
2 follow up on what Arnold said earlier. If memory
3 serves me correctly -- I haven't looked at this
4 recently. But if memory serves me correctly, a few
5 years ago, the Auditing Standards Board issued a -- it
6 wasn't a standard. I forget what they call these
7 things. It was like a practice alert, but I'm not
8 sure they call it that -- on confirmations.

9 And I thought it was pretty good. I thought
10 some of their specific suggestions in there were
11 pretty good. So if you haven't looked at that, you
12 might want to look at that.

13 DEE MIRANDO-GOULD: Thank you.

14 Yes, it's a practice alert, and we
15 definitely have looked at it. And we're definitely
16 keeping it in mind as we're considering this topic.

17 Jim Cox?

18 JAMES COX: One of the other national
19 committees I'm on is the American Bar Association's
20 Corporate Law Committee. And I just thought I'd share
21 an insight with you that something that just caused us
22 fits over the last year. We meet every quarter in

1 half-day meetings, and it relates to this question
2 about oral confirmations.

3 And which I share the same level of
4 skepticism, if not outright cynicism, about it.
5 Except for the following, is that there is pretty
6 well-advanced technology now for taking an oral
7 communication and reducing it to written format. And
8 so, you may want to think about that. There is oral,
9 and then there is oral.

10 What causes us fits about that is the
11 question about notice, which is a big deal for
12 lawyers, okay? And when you get it, and if you get a
13 message on your cell phone, is that notice at that
14 point? Or is it when you reduce it down, and what's
15 it mean to be reduced down? And not everybody has the
16 technology because it's fairly expensive. So it's
17 just adding undoubtedly an insignificant lawyer
18 footnote to this conversation. So --

19 DEE MIRANDO-GOULD: Thank you.

20 JOSEPH CARCELLO: May I have a follow up?

21 DEE MIRANDO-GOULD: Ted White?

22 JOSEPH CARCELLO: I was going to say may I

1 have a follow up?

2 In that -- Professor, in that conversation,
3 did they get into a discussion of whether it was legal
4 to actually record it and how that varies from State
5 to State?

6 JAMES COX: It does. I mean, our committee
7 has a focus on a statute that's supposed to be a model
8 for other States, and there are some variations, of
9 course, across the States.

10 MS. MIRANDO-GOULD: Ted White?

11 TED WHITE: Just a quick comment. I don't
12 really have any concerns over the alternative forms of
13 confirmation except for oral. My take on that is that
14 it just introduces too much potential problem for very
15 little benefit, and I would suggest just a bright line
16 on oral confirmation at this point to prohibit it
17 until such time that maybe there is some clear-cut
18 advance in technology in the future where you can
19 accept it.

20 But in just stepping back and thinking about
21 it, it doesn't seem that if somebody is able to give
22 an oral confirmation, it's that much harder to give a

1 written one along with it. And I just don't see the
2 benefit in it.

3 And I agree with Joe's comments earlier,
4 too, about the importance of the source as probably
5 more important actually than how it's transmitted.
6 But the source is also something that's quite
7 important there.

8 DEE MIRANDO-GOULD: Bob Dacey?

9 ROBERT DACEY: We would just like to
10 reiterate the points that Arnold raised that there are
11 a lot of good materials I think in the IAASB standard
12 that address this, and it's relatively recent and gone
13 through due process. And some of the answers to the
14 questions as we go through today I think are
15 reasonably answered by their draft, and we would
16 encourage consistency to the extent possible,
17 including the definition.

18 Secondly, with respect to the standard, it
19 ought to be clear about some of these points,
20 particularly oral. I don't think we believe that that
21 is a confirmation. It is some form of evidence, and
22 you have to evaluate it in terms of evidence quality.

1 And the other point with direct access. I
2 think some of the language now about direct
3 communication is a better issue because when you do
4 that, there is some risk that who you are connecting
5 to isn't the party you think you're connecting to.
6 And therefore, I think you'd have to employ a lot of
7 procedures to ensure that you're actually getting it
8 from that party to meet the requirements of what I
9 think a confirmation would be.

10 So one of the concerns about the proposed
11 language might make too broadly open the direct access
12 because I do think there are a lot of issues related
13 to verifying that other party.

14 Thanks.

15 DEE MIRANDO-GOULD: Thank you.

16 Joe Carcello?

17 JOSEPH CARCELLO: One other thought that I
18 thought to mention earlier. The proposal doesn't talk
19 at all, unless I missed it, is the importance of
20 evaluating the form that comes back, and here's what I
21 mean by that. My understanding of what most firms do
22 and what we did when I was in practice is the firm had

1 a standard confirmation form that was sent out.

2 And there is at least one prominent case
3 that I'm aware of where what was sent back is what I
4 would call customized letters from each client. It
5 wasn't the firm's confirmation form. And what ended
6 up being confirmed wasn't the balance but the total
7 revenue transactions during the year. And obviously,
8 what needed to have been confirmed was the receivables
9 balance at the end of the year.

10 And again, maybe in some sense, you think do
11 you even need to say things like this in a standard?
12 Because most auditors are going to be, I would hope,
13 very sensitive to that. But you may want to at least
14 consider the issue of what is the implication if the
15 auditor sends out a confirmation form and gets back
16 something that's very different, how he or she should
17 respond to that?

18 DEE MIRANDO-GOULD: Thank you.

19 Warren Malmquist?

20 WARREN MALMQUIST: Just from a preparer's
21 point of view, I would take exception or I do take
22 exception, I guess, to the use of oral confirmations

1 because I think it's a less quality standard to
2 follow, and I think that it makes it more inefficient
3 for both the external auditor and also for the
4 preparer.

5 Other point here on direct access, I think
6 this would go a long ways in increasing the response
7 rate and the quality of confirmations if you do have
8 or give direct access to the auditors to customers, to
9 banks, to other financial institutions with whom you
10 might have debt with. But to Gary's point, I think
11 there is some training that needs to take place so
12 that there is the proper use of that direct access.
13 Otherwise, it will add to the inefficiency of an audit
14 and also to that for the preparer.

15 DEE MIRANDO-GOULD: Thank you.

16 Okay, Gaylen Hansen? Did I get that right?
17 Okay.

18 GAYLEN HANSEN: I just want to follow up on
19 Joe, what you're talking about, the nonstandard
20 replies. I don't really have too much of an issue
21 with that because it's third-party evidence that is
22 coming back. As long as you can reconcile that to the

1 receivable balance, in some ways, I think that's
2 another way of getting to the same thing. I would
3 just consider that a reply with comments that you've
4 reconciled and not necessarily an exception or
5 something that you cannot rely on.

6 But I do agree it's something that should be
7 considered perhaps in the standard when you do get
8 something back that's completely different than what
9 you asked for.

10 DEE MIRANDO-GOULD: Thank you.

11 Let's move to our next discussion topic.

12 Oh, excuse me. I'm sorry.

13 HAROLD SCHROEDER: This was the challenging
14 part. We actually both had our 10 cents in.

15 DEE MIRANDO-GOULD: Hal Schroeder.

16 [Laughter.]

17 HAROLD SCHROEDER: My initial thought was
18 oral confirmations, like most people, it's very
19 problematic. But then I thought back to situations
20 where you're dealing with -- and I had one like this
21 where it was military shipments. You could get oral
22 confirmations, but you could not get written

1 confirmations.

2 I don't know if there's anyone who's got
3 certain security clearances that could address that
4 issue. But I think there are certain circumstances
5 where you're not going to get anything in writing.
6 And would this, by excluding it, preclude that? So if
7 there was a way to work that into the language where
8 it's permissible in certain circumstances, and maybe
9 that's one illustration.

10 DEE MIRANDO-GOULD: Thank you.

11 Wayne Kolins?

12 WAYNE KOLINS: I just wanted to supplement
13 what Gaylen had mentioned, which played off Joe's
14 comment. If you get confirmation back that's
15 different from what you sent out in terms of what
16 information you got back, I just think the standard
17 could be written that to assess whether the objectives
18 of your confirmation request were fulfilled by what
19 you got back. If they were not, then you need to do
20 some more work.

21 DEE MIRANDO-GOULD: Thank you.

22 Any other?

1 [No Response.]

2 DEE MIRANDO-GOULD: Okay. Now let's move to
3 our next discussion topic, the requirement for an
4 auditor to confirm accounts.

5 The current auditing standard includes the
6 presumption that the auditor will request the
7 confirmation of accounts receivable during an audit.
8 The standard further provides that an auditor should
9 consider requesting confirmation of the terms of
10 unusual agreements or transactions, such as bill in
11 wholesales, in addition to the amounts.

12 Other standard setters have differing views
13 on whether auditors should be required to request
14 confirmation of accounts receivable and other items.
15 For example, ISA 505 does not require confirmation of
16 any specific accounts, terms, or transactions, while
17 the Auditing Standards Board of the AICPA has
18 indicated that inclusion of the presumptive
19 requirement to confirm accounts receivable is
20 appropriate.

21 That leads me to my next question. Should
22 the board expand the presumptively mandatory

1 requirement to request confirmation of accounts
2 receivable in AU Section 330 to include confirmation
3 of terms of unusual agreements or transactions and
4 complex or unusual revenue transactions?

5 Tom Tefft?

6 THOMAS TEFFT: My view on this is if we're
7 to expand the mandatory requirement, you would then
8 invariably need to define what the scope of unusual
9 transactions were. And even under the best
10 circumstances, you'd never be able to contemplate
11 every kind of unusual transaction. Even if you were
12 able to define all of those today, there's going to be
13 new ones tomorrow.

14 I think you've got to leave this to the
15 judgment of the auditor to determine when is it
16 appropriate and necessary to use a confirmation as a
17 means of getting appropriate audit evidence.

18 DEE MIRANDO-GOULD: Doug Anderson?

19 DOUGLAS ANDERSON: I've always felt that
20 confirmations are one of many sources of audit
21 evidence. You can get audit evidence through all
22 sorts of different means. And making the presumption

1 that confirmations is one of the very best in every
2 risk scenario is not necessarily true. So I've never
3 been in favor of, what is it, presumptively mandatory
4 requirement because it may have no correlation with
5 the risk of what you're looking at.

6 I think a much better guidance approach
7 would be to talk about the value of confirmations, the
8 weaknesses, the pros and cons of what scenarios it
9 works well in and what scenarios it doesn't. But not
10 to have any presumptive mandatory requirement
11 regarding confirmations of receivables or anything
12 else and leave it up to the judgment of the auditor to
13 decide based on the risk of the engagement, the risk
14 of the specific area whether confirmations is a good
15 part of the audit evidence they have to gather or
16 whether there are other types of audit evidence that
17 might be better or more efficient.

18 DEE MIRANDO-GOULD: Hal Schroeder?

19 HAROLD SCHROEDER: We've actually kicked
20 this one around internally from an investment
21 standpoint. As we were talking about fair value last
22 week, and we actually had a conference call with the

1 FASB on this, one of the ideas that was kicked around
2 was a central clearinghouse of some sort where you
3 could actually confirm credit default swaps or other
4 bilateral transactions where there are really only two
5 parties involved.

6 And as I read this, I thought this is an
7 ideal place to expand confirmations, and I agree with
8 your comment. There are some places where it just
9 doesn't make sense. There's no risk there.

10 But there are other places where
11 confirmation, like a credit default swap, would be a
12 tremendous value. A, does the transaction exist? B,
13 do we have the same terms? And C, I would go as far
14 as saying if it's a zero-sum game -- I lose \$10
15 million, you make \$10 million -- we ought to confirm
16 that that's actually at least within ballpark that
17 we're dealing with the same numbers so that they are
18 the mirror image of us.

19 I know that may be way beyond the scope of
20 this, but I think the board actually ought to very
21 seriously consider the need for this in light of all
22 these types of transactions and the troubles that

1 we've had in the last year or two.

2 DEE MIRANDO-GOULD: Thank you.

3 Gaylen Hansen?

4 GAYLEN HANSEN: I would agree. A lot of
5 this is based on judgment. And as you point out,
6 Harold, I mean, there might be some situations where
7 it might be very straightforward to do the
8 confirmation. On the other hand, you have an
9 agreement. Sometimes I wonder whether why don't we
10 just attach the agreement to the confirmation, mail it
11 to the client or the confirming party, and say, "Do
12 you agree with this?"

13 And you've got a written agreement signed by
14 both parties in the file. So how much are you going
15 to get into this definition of what is unusual and the
16 terms and so forth? And I think you have to go back
17 to judgment. So I don't know that you can standardize
18 that.

19 DEE MIRANDO-GOULD: Thank you.

20 Paul Sobel?

21 PAUL SOBEL: I think I'm just going to add
22 on pretty much to what's been said before. One other

1 thing to consider here, and I like Doug's suggestion
2 about providing guidance on when confirmations are
3 useful versus less so, and also Gaylen's last
4 suggestion. If you think about it, an accounts
5 receivable balance is quite simple to confirm. You
6 can have almost a clerical person -- I suspect this
7 happens frequently. Somebody in the clerical capacity
8 looks up in the system at a point in time what was the
9 balance. Yes, that's right. Confirms back.

10 When you get into more complicated
11 arrangements, I'd be concerned that, again, absent
12 attaching the contract, you may get confirmation that,
13 yes, those terms exist. There may be other terms that
14 have some very significant impact on the accounting
15 that, for whatever reason, you've failed to put in the
16 confirmation and then would not be confirmed as such.

17 So, again, I think there is value to the
18 confirmation, but it's -- I don't think it should be
19 required because you're not always certain who is
20 responding to that. Again, if a clerical person is
21 responding on a very complex, again, even credit
22 default swap, do they understand the underlying

1 economics and the accounting implications of that
2 credit default swap? Or are they just going to go
3 tick, tick, tick, yes, I found those in a contract.
4 Good enough.

5 DEE MIRANDO-GOULD: Thank you.

6 Joe Carcello?

7 JOSEPH CARCELLO: Let me respond to what
8 Doug said earlier because I think you have language in
9 the standard now that allows for that in terms of not
10 sending confirmations.

11 If you look at footnote 7 on page 4,
12 starting with the second paragraph, "The auditor can
13 overcome the presumption to request confirmation if
14 accounts receivable are immaterial or the auditor's
15 combined assessed level of inherent and control risk
16 is low and the assessed level in conjunction with
17 other evidence is sufficient to reduce audit risk to
18 an acceptably low level."

19 So I think the standard that exists already
20 contemplates not needing to send confirmations. I
21 also think it would be dicey to have a PCAOB standard
22 that would at least be viewed in the eyes of outsiders

1 as a lower level of performance than an ASB standard.
2 And as long as the ASB requires confirmation, I think
3 it puts the PCAOB in a tough position.

4 I also would agree with, I think, Harold
5 said earlier, considering expanding the use of
6 confirmations. I don't know if I would require it.
7 Requiring it is always a bit dicey. But encouraging,
8 particularly as it relates to confirming terms of
9 material revenue transactions near year end, the
10 amount, the order date, the receipt date, to get a cut
11 off -- cut off is a big issue with revenue -- and
12 right of return provisions, particularly oral, which
13 are very problematic, as we've seen in many frauds.

14 Again, the focus that I'm coming from here
15 is I think if you talk to most investors, they would
16 say what they care about is fraud, errors that result
17 in material restatements, and clean opinions before a
18 company shortly thereafter goes belly up. We'll talk
19 about growing concern this afternoon.

20 And a lot of these frauds, I don't think
21 typical management wakes up early in the year and says
22 today is a good day to start a fraud. It happens

1 toward the end of the year when it's obvious they're
2 not going to hit the targets that the analysts have
3 set, and some managements give into pressure. And we
4 know that in terms of fraud, revenue recognition is
5 the override -- by far the most common means of
6 committing fraud.

7 So if you look at transactions close to year
8 end that involve material revenue transactions and at
9 least consider confirming them, that would probably be
10 a prudent course of action in many cases.

11 DEE MIRANDO-GOULD: Thanks, Joe. And you're
12 correct. I mean, the standard right now does have the
13 presumption for accounts receivable, and it has the
14 "should consider" language about unusual and complex
15 transactions.

16 Gary Kabureck?

17 GARY KABURECK: This is going to probably be
18 building somewhat on some of the other comments about
19 confirming unusual transactions and arrangements and
20 stuff like that. The way I think it would work in
21 most big companies, I mean, clerical people are going
22 to give the dollars and cents. But they're probably

1 not going to actually having the contract.

2 I mean, that's probably somebody in the
3 legal department or the business development
4 department or the controller's department. So the
5 clerks are not going to be able to confirm these
6 things. They pay bills as they come in, or they
7 collect cash as it comes in, as the case may be.

8 But you're going to be dealing with an
9 entirely different level of management if you want to
10 start getting into confirming the salient terms of
11 deals. And if all of a sudden, if an audit
12 requirement came out where the middle management core,
13 the general counsel's core of the country has all of a
14 sudden got an extra million confirmations coming out a
15 year, that's a workload issue, and it's going to be
16 challenged I would think as far as necessity.

17 I think judgment is the right way to do it.
18 I mean, certainly confirming complex and strange
19 arrangements has its place in auditing. But I think
20 to be required, I think, is going one step beyond
21 where it needs to be.

22 DEE MIRANDO-GOULD: Thank you.

1 Doug Anderson?

2 DOUGLAS ANDERSON: Just to follow up on my
3 conversation, kind of respond to Joe's thoughts. In
4 all consideration of what's in footnote 7, I think
5 it's upside down when the reliance on judgment and
6 focus on risk is buried in footnote 7, and the narrow
7 prescriptive standard is put up in the front. I think
8 the right order of it is focus the auditor on risk,
9 focus the auditor on persuasiveness of audit evidence,
10 and explain how confirmations work.

11 If we want to put in footnote 7 that
12 receivables is a great place to confirm, go ahead.
13 But I would not put in footnote 7 use your judgment
14 and then put in the primary standard we're assuming
15 you're going to confirm receivables. That seems
16 upside down.

17 And if the ASB and the AICPA has a different
18 standard, that's fine. I still think the PCAOB should
19 take the best approach and convince the ASB to change
20 theirs.

21 DEE MIRANDO-GOULD: Thank you.

22 Any other comments?

1 [No Response.]

2 DEE MIRANDO-GOULD: Okay, let's move to the
3 next question in this area. Should there be a
4 requirement that the auditor should consider
5 requesting confirmation of other items? If so, which
6 items should be included in this requirement?

7 Gaylen Hansen?

8 GAYLEN HANSEN: I'll jump in here. I think
9 whenever you can focus in on a KPI, a key performance
10 indicator, that involves nonfinancial measures, and in
11 my part of the world, that might be tons in the mining
12 industry or barrels produced. I like to see those
13 things confirmed, and then it ties back into the
14 financial records.

15 So I mean, I don't know that that's part of
16 the standard, but I think it's just sort of common
17 sense, and a lot of times you can get to a quicker
18 answer and a more logical and practical answer if
19 you're confirming some of those sorts of metrics.

20 DEE MIRANDO-GOULD: So, Gaylen, would you be
21 saying a "should consider" type of requirements
22 appropriate?

1 GAYLEN HANSEN: Yes. Absolutely. Maybe
2 it's patient days. It could be any number of things,
3 and they would be all over the board depending on what
4 industry you're dealing with, but more of an
5 understanding of the business and the industry type of
6 approach.

7 DEE MIRANDO-GOULD: Thank you.

8 Tom Tefft?

9 THOMAS TEFFT: I wouldn't object to this
10 requirement. However, I would think that in most
11 situations today, auditors are already considering
12 using confirmations as part of the audit process and
13 thus would question whether it even needs to be an
14 explicit requirement.

15 DEE MIRANDO-GOULD: Thank you.

16 Hal Schroeder?

17 HAROLD SCHROEDER: More of a question. You
18 use the term here "investments." Why would you not be
19 using more of the "financial instruments" term,
20 terminology from the accounting standards?

21 DEE MIRANDO-GOULD: It's a good question. I
22 mean, we were thinking broadly. "Investments" was a

1 term we picked, but we could say "financial
2 instruments." There is no reason why it couldn't be
3 that.

4 Wayne Kolins?

5 WAYNE KOLINS: I think rather getting into
6 the particulars of which accounts or areas should be
7 considered specifically, I think the auditor needs to
8 address the assertions that he's interested in, he or
9 she is interested in, and what is the persuasive means
10 of obtaining evidence to corroborate the assertions?
11 And if confirmation is the persuasive evidence, then
12 that's what the auditor should use. And certainly
13 areas that are quite often confirmed on audits are
14 certainly cash, marketable securities, accounts
15 payable.

16 And I think maybe firms have gotten away
17 from that, but since there's such an acceleration of
18 the filing deadlines to rely on subsequent
19 disbursements to verify accounts payable, perhaps the
20 actual confirmation is a quicker way of getting to the
21 answer in addition to assessing the quality of the
22 internal control system.

1 DEE MIRANDO-GOULD: Thank you.

2 Bob Dacey?

3 ROBERT DACEY: Yes, I'd just like to offer
4 that I think, in our view, there shouldn't be absolute
5 requirements, even "should considers," because of the
6 variability that we've all talked about here today.

7 One of the discussion points we had, too, is
8 that if confirmation is perceived to be of a
9 particular value, that perhaps it ought to be -- the
10 use of confirmations ought to be discussed in your
11 auditor's response to risk of material misstatement
12 and focus this standard on what the confirmation
13 process is, if you decide to use confirmations.

14 DEE MIRANDO-GOULD: Thank you.

15 Sam Ranzilla?

16 SAM RANZILLA: Excuse me. I agree with Bob.
17 A requirement to "should consider" basically drives
18 the auditor to document all the things they thought
19 about and didn't do. And it seems to me what we ought
20 to be focused on is the risk assessment and what you
21 did do in documenting your risk and how you responded
22 to that risk.

1 So I would not be favor of a requirement to
2 "should consider" because it just, again, leads to
3 documentation around what you decided you didn't need
4 to do.

5 DEE MIRANDO-GOULD: Thank you.

6 Any other comments? Jeff Mahoney?

7 JEFF MAHONEY: Thank you.

8 I think I'd like the requirement in that I
9 think we've had some recent events where the cash that
10 the company had said existed did not exist or the
11 investments the company said they had did not exist.
12 So I think there is some expectation out there that
13 one efficient way to get some audit evidence about the
14 existence of those cash balance and investments is
15 through a confirmation.

16 So I think there is some expectation by some
17 investors that confirmations are being sent out in
18 those areas. So I think I would support the
19 requirement.

20 DEE MIRANDO-GOULD: Thank you.

21 Any other comments?

22 [No Response.]

1 DEE MIRANDO-GOULD: Okay. Now we'll talk
2 about reliability of confirmation responses. The
3 standard requires the auditor to evaluate the
4 reliability of confirmation responses and alternative
5 procedures as part of the auditor's overall evaluation
6 of confirmation procedures.

7 The standard acknowledges that there may be
8 situations in which the confirming party responds to a
9 confirmation request other than in written
10 communication mailed to the auditor. When these
11 responses are received, additional evidence may be
12 required to support the validity. For example, a
13 facsimile response involves risk because of the
14 difficulty of ascertaining the source of the response.

15 As discussed previously, banks and other
16 businesses may hire third parties to respond to
17 confirmation requests on their behalf. If a system or
18 process that facilitates confirmation between the
19 auditor and the confirming party is in place and if
20 the auditor plans to rely on that system or process,
21 another auditor's report on that system or process may
22 assist the auditor in assessing the design and

1 operating effectiveness of the electronic and manual
2 controls that address the reliability of the
3 information being confirmed.

4 This leads me to my next question. What
5 factors should the auditor consider when evaluating
6 the reliability of confirmation responses in paper,
7 electronic, or other form?

8 Joe Carcello?

9 JOSEPH CARCELLO: I think we've hit on a lot
10 of this already in some of our earlier discussion.
11 You know, who's responding would certainly be a
12 factor.

13 One of the things that is not in your
14 discussion paper, and again, I'm not even fully
15 convinced it needs to be in a standard, but I want to
16 at least throw it out. One of the things that I think
17 it's important to think about, I know when I cover
18 confirmations in class, is if you get back the
19 confirmation requests, and they're riddled with
20 exceptions, that probably tells you something, if
21 nothing else, about internal control over financial
22 reporting, at least potentially.

1 But the other extreme I think is maybe just
2 as dangerous, right? The other extreme is you send
3 out a lot of confirmation requests, and they all come
4 back perfect. Yes. And so, again, I don't know how
5 you put that in a standard exactly. I'd have to think
6 that through a lot more than I have -- can quickly do
7 here.

8 But I think that's an issue, and I think
9 sometimes in doing audits there is a lot of time
10 pressure. And again, it gets to the overriding
11 importance that can never be emphasized too much of
12 professional skepticism. It just underlies everything
13 auditors do.

14 DEE MIRANDO-GOULD: Thank you.

15 Any other comments?

16 Okay. Oh, Vin?

17 VINCENT COLMAN: Maybe I'll just -- we
18 already have something. I was just wondering what the
19 objective of this is because there is already
20 something in the standard that addresses this. Not to
21 be too, but AU 9330 talks about this already. So I
22 was just wondering what is it we're trying to

1 accomplish here that we don't already have because
2 there's a standard that we need to go through today on
3 this. So I was just trying to understand that better
4 and what problem we're trying to solve.

5 DEE MIRANDO-GOULD: Well, you're right. The
6 standard does have language about assessing the
7 reliability. The question is does there need to be
8 additional information? What factors should be
9 considered?

10 The other thing is AU 9330 technically isn't
11 a PCAOB standard because it was issued after April
12 2003 when we adopted our standards.

13 VINCENT COLMAN: I'm sorry. I didn't catch
14 that nuance. Because it's actually a very good
15 principles-based standard, to Joe's point. It goes
16 through the principles and the thought process you
17 should go through in this instance. So I'd encourage
18 you to consider it. It's pretty well written.

19 DEE MIRANDO-GOULD: We're definitely
20 considering it as we go through the process. But,
21 yes, that's part of it. It addresses some things that
22 the original standard didn't. We haven't adopted it.

1 Any other -- Sam Ranzilla?

2 SAM RANZILLA: I was just going to help Vin
3 out, and I think what he was telling you --

4 VINCENT COLMAN: Well, thanks, Sam.

5 [Laughter.]

6 SAM RANZILLA: Huh? I'm sorry?

7 VINCENT COLMAN: I was thanking you.

8 SAM RANZILLA: I got you. I think the
9 answer to your question is actually you can find some
10 very good evidence and standard setting both at the
11 ASB level and at the IAASB level with respect to this
12 question.

13 DEE MIRANDO-GOULD: Thanks, Sam.

14 Vin, did you have anything else you wanted
15 to -- No, you're --

16 Any other comments?

17 [No Response.]

18 DEE MIRANDO-GOULD: Okay, now let's talk
19 about situations when management requests that the
20 auditor not confirm certain accounts. The standard
21 does not specifically address such situations or
22 procedures that the auditor might perform when faced

1 with these situations. Therefore, what procedure
2 should the auditor be required to perform to address
3 situations in which management requests that the
4 auditor not confirm accounts?

5 Gaylen Hansen?

6 GAYLEN HANSEN: I think the existing
7 guidance, as was just mentioned. I think there's a
8 lot of information already there that there's
9 heightened -- there should be heightened skepticism in
10 this situation, and you start with discussing with the
11 officers of the company as to the rational reasons and
12 evaluate the legitimacy of those reasons.

13 However, and depending on the significance
14 and the materiality, I would think that this might be
15 one of those instances where consideration of the
16 discussion with an audit committee chair, used
17 sparingly, but this is one of those times when I think
18 you might want to exercise that option.

19 DEE MIRANDO-GOULD: Thank you.

20 Shelley Stein?

21 SHELLEY STEIN: As an auditor, I think this
22 is one of those situations where my first reaction

1 would be to run like the wind. We talk about the
2 quality of audits. We talk about documentation. Now
3 we've got management saying please, please don't
4 confirm this.

5 So my skepticism is going straight up
6 immediately with the request, and there are very
7 limited circumstances that I can imagine where that
8 would happen. And I think that you've got to be very
9 careful about that. It doesn't mean there might not
10 be a legitimate one somewhere, but, boy, that ought to
11 be a rare situation.

12 DEE MIRANDO-GOULD: Thank you.

13 Damon Silvers?

14 DAMON SILVERS: I'm just curious if members
15 of the group who are -- do this more day-to-day than I
16 do could explain any instances they know of where this
17 kind of request would be legitimate? I mean, I can
18 kind of imagine maybe some circumstances. But I'm
19 just curious if anyone has ever actually had one?

20 DEE MIRANDO-GOULD: So there are a couple of
21 people down there. Hal Schroeder?

22 HAROLD SCHROEDER: In my auditing days, I

1 actually did one involving litigation. It was a
2 sensitive issue, and you already knew it was in
3 litigation or about to go into litigation. We were
4 asked not to confirm and to speak with the attorney.
5 So, yes, I could come up with one or two.

6 DEE MIRANDO-GOULD: No, not at all.

7 DAMON SILVERS: What was the -- I mean, a
8 matter was being litigated, and so you were not -- I'm
9 not sure how you connect the notion that there was
10 litigation with what the nature of the matter was.

11 HAROLD SCHROEDER: They just didn't -- the
12 client, as I recall -- and this is a few years ago.
13 The client was very sensitive to any exchange of
14 information between itself and the other party because
15 it may go into litigation.

16 They just didn't want any more
17 documentation. They had what they wanted, and they
18 were going to litigate it, and they just didn't want
19 to -- they were attempting, if I recall, they were
20 attempting to settle it out of court. But it was very
21 likely to go to court, and so they asked for us not to
22 confirm it.

1 DEE MIRANDO-GOULD: Gaylen, did you have a
2 comment?

3 GAYLEN HANSEN: I was going to say basically
4 the same thing. I've had those instances that I've
5 had to deal with.

6 DEE MIRANDO-GOULD: Hal Schroeder?

7 HAROLD SCHROEDER: I'm sorry. I did have
8 another comment. Very much like Gaylen, I sit on a
9 board of an insurance company, and I'm on the audit
10 committee. If we're not confirming something that
11 would normally be confirmed, I would certainly want to
12 know about it. So I would expect it to be a
13 requirement that they actually communicate that.

14 DEE MIRANDO-GOULD: Thank you.

15 Okay, Ted White?

16 TED WHITE: I like the suggestion that this
17 possibly be a communication back to the audit
18 committee chair. The other thing I was wondering was
19 whether your language could either suggest or require
20 that the auditor reopen their risk assessment and
21 address this issue specifically?

22 I suspect if this is something that they

1 knew up front, that the risk assessment would be quite
2 a bit different going into the audit. And this would
3 materially change that, or should, and that in most
4 instances it's probably something that's going to
5 raise some big red flags. Because what I think you
6 need is a mechanism to ensure that it's dealt with,
7 right?

8 DEE MIRANDO-GOULD: Thank you, Ted.

9 Actually, I believe it's ISA 505 has
10 slightly different wording, but they do encourage the
11 auditor to consider the effect of any requests like
12 that on a risk assessment, including risk of fraud.
13 So that's one of the things we've been discussing.

14 I think Bob Dacey was next.

15 ROBERT DACEY: In answer to the question, we
16 thought the procedures outlined in ISA 505, in fact,
17 which were pretty similar to the ones you have in your
18 document, were appropriate procedures in this
19 circumstance.

20 DEE MIRANDO-GOULD: Thank you.

21 Damon Silvers?

22 DAMON SILVERS: It seems to me that

1 particularly based on the responses I got to my
2 earlier question, that my intuition about this, which
3 is that this is a very unusual phenomenon when this is
4 a legitimate matter. And that even as, for example,
5 in the litigation arena, if there is an account that
6 is subject to litigation, it strikes me that the
7 auditor -- that that's obviously an account where
8 somebody disagrees with what the preparer is -- or how
9 the preparer is characterizing that account.

10 I think that the fact that the preparer is
11 uncomfortable with that with getting -- with a third
12 party like the auditor getting into that is kind of
13 too bad in relation to what the auditor's obligations
14 need to be in that circumstance.

15 I mean, I can imagine a circumstance, for
16 example, where law enforcement is involved where it
17 would clearly be inappropriate to, say, tip off
18 someone that law -- you know, you could be in a
19 situation where that kind of extreme thing might make
20 sense. But it seems extraordinarily rare to me.

21 And I very much support the notion that
22 there ought to be kind of a presumption that when that

1 occurs, that the auditor needs to be talking to the
2 audit committee to make sure that there is really a
3 justification for this and that the PCAOB's guidance
4 and standards in this area need to really kind of
5 ensure that this is a very rarely accepted
6 proposition.

7 I want to go from that, though, to a broader
8 comment about the discussion thus far, which is that
9 it's not clear to me how explicit -- you know, the
10 issue I think Joe Carcello talked about, about
11 professional skepticism. The question of how much you
12 wish to specify and guide professional skepticism in
13 the drafting of your standards, this area or others,
14 is one that it's, I think, a subtle judgment.

15 It strikes me, for example, that when you're
16 talking about different forms of confirmation that
17 there are obviously implications to certain -- toward
18 a prevalence of certain types of forms of
19 confirmation. That there are that there is a sliding
20 scale with faxes -- that some faxes are pretty much no
21 different from a letter, and other faxes are a lot
22 different from a letter. How much do you want to get

1 into that?

2 And I think one of the questions that the
3 board might want to consider is the lessons that it
4 has from its inspections as to whether there is kind
5 of -- whether there is pretty well-established and
6 understood practice in this area, such that that type
7 of guidance is not really necessary, or whether there
8 is not? Or whether there seems to be a willingness
9 within the profession, within the firms that do the
10 predominant amount of public company auditing to kind
11 of just accept anything? To not be skeptical in these
12 areas and whether, therefore, some more detailed
13 guidance needs to be had?

14 I don't know the answer, but I assume you
15 all might be able to figure that out.

16 DEE MIRANDO-GOULD: Thank you.

17 Jim Cox?

18 JAMES COX: I was just wondering about
19 somewhat more of maybe a formulaic response here and
20 think about this as being in the category of a
21 limitation on the scope of the audit and material.
22 Then the way you normally deal with that question is

1 to see if there are other ways.

2 For example, the litigation situation -- I'm
3 not asking how you handled it. But it had come to my
4 mind that you may want to think about other ways of
5 getting at that, including having conversations that
6 you can with the counsel for the audit client to get
7 some review about what the exposure is there and then
8 figure out what -- but to figure out some way to
9 overcome it.

10 But if you can't overcome it, then I would
11 think that it's appropriate to see this as a
12 limitation on scope and that the implications of that
13 depends on the materiality of the limitation.

14 DEE MIRANDO-GOULD: Thank you.

15 Randy Fletchall?

16 RANDY FLETCHALL: Yes, I was just going to
17 try to add to Damon's question and Hal's response. I
18 think, Professor Cox, to your point, I mean, we look
19 at confirmation in terms of whether it would be
20 effective at getting evidence. And if you went to
21 management and they said, "Don't confirm that account
22 because they may not agree with the balance," I would

1 agree that's a red flag, and I think you'd probably
2 want to direct your attention there.

3 If they said, "This has been in litigation
4 for three years," I think you'd say, "Well, there's no
5 sense mailing a confirmation to the customer."

6 Instead, I think you'd go to the process of confirming
7 and evaluating responses from outside counsel or in-
8 house counsel to decide what that meant from an
9 accounting standpoint and not a confirmation that you
10 just knew was of no value and, in fact, could affect
11 their legal strategy.

12 So I don't think it's a matter of you just
13 don't want to do it because it's a problem, when it's
14 a matter of there's a more effective way to get the
15 answer for something that's in litigation. If they
16 just said, "Don't mail that one. We think they may
17 not agree." I would think that would certainly draw
18 your attention to it.

19 DEE MIRANDO-GOULD: Thank you.

20 Joe Carcello?

21 JOSEPH CARCELLO: I think just about
22 everybody in this room is onboard that except for the

1 litigation situation, there would be very unusual
2 circumstances where a request by management not to
3 send a confirmation when the auditor feels it's
4 appropriate would be honored without it being viewed
5 at least as a scope limitation.

6 But I think the board runs the risk if they
7 are completely silent in this area because,
8 unfortunately, the people in this room are not the
9 ones who are likely to have been involved with
10 problematic behavior or they wouldn't be in the room.

11 We shouldn't lose sight of the fact that Z
12 Best, which was one of the largest frauds certainly at
13 the time it happened, was essentially this issue. The
14 auditors wanted to send confirmation to the building
15 restoration projects, and they were convinced that
16 that was going to be problematic from a client
17 perspective, and they didn't do it.

18 More recently, I would refer interested
19 readers to the Breeden Report on the WorldCom fraud,
20 where, although this wasn't a confirmation issue, the
21 firm, and it was a large firm -- I won't mention it by
22 name -- wanted to do certain work in the United

1 Kingdom and were told that there were reasons why
2 management did not want that done. And a good bit of
3 the fraud was seated in the accounts in that
4 subsidiary.

5 So I think we should not lose sight of those
6 issues.

7 DEE MIRANDO-GOULD: Thanks, Joe.

8 Vin Colman?

9 VINCENT COLMAN: The specific question --
10 again, I just repeat what other people have said. The
11 ISA 505 is a pretty good outline again. So it sounds
12 to me like we're still -- I think we've got the
13 solution here. And a pretty good, again, principles-
14 based procedures that would solve it.

15 I want to go to -- I was going to take a
16 shot at answering Damon's broader question because I'm
17 struck by a similar type of reaction when you go to
18 audit confirmations and it's as if we're having a
19 conversation a little bit in a vacuum. And you know,
20 there is something called a risk assessment. You've
21 got assertions. And audit confirmations is one
22 element of dealing with the assertions in the risk

1 assessment.

2 And just be too prescriptive, and any one of
3 these actually could have an inverse effect. It could
4 actually be a negative. We really should be up a
5 level, as you were just talking about, of what is the
6 risk assessment? What are the assertions? How do you
7 use confirmations at the right time?

8 And there's a time and a place for them.
9 And quite frankly, there are times where this is not
10 the best solution and to be able to have judgment
11 around that, to make sure that we're very outcome
12 driven against those assertions.

13 Similarly, with the audit committee
14 communications, there is -- it's come up a number of
15 times already today -- there is a standard on audit
16 committee communications of what needs to be given to
17 the audit committee, and you would hope that in
18 certain situations like this, if it really raised to
19 that level, it would fit into that standard.

20 And so, you know, it came up this morning
21 while concurring important reviews. It's come up
22 here. You know, there is a standard there. It's

1 actually a pretty good principle standard of what are
2 the types of things that need to go to an audit
3 committee? And instead of putting individually in a
4 standard, if we think that there is something where
5 that could be -- that communication needs to get
6 better, then I'd encourage you to go back and look at
7 that standard of what those communications are and
8 make sure that it is covering, you know, what we
9 believe broadly needs to get to an audit committee.

10 DEE MIRANDO-GOULD: Thanks, Vin. Hal
11 Schroeder?

12 HAROLD SCHROEDER: I just wanted to follow
13 up, Professor. We did handle it through litigation
14 later, so -- and I think Randy was our independent
15 partner that year, so --

16 [Laughter.]

17 HAROLD SCHROEDER: Actually, he may have
18 been. I'm not certain. But I just don't want to go
19 too far down the path of saying if a client -- if the
20 company says, "I don't want you to confirm this and
21 here are the reasons why," then we immediately -- it
22 just throws up all sorts of red flags and it's the end

1 of the world. Maybe I've had a lot of unusual certain
2 situations, but had a shipping company that sent
3 crates over and they wouldn't allow me to confirm it.
4 It went to a hot spot in the world. We knew where the
5 ship went. We knew what was in the crates, and it
6 happened to be an airstrip.

7 No one was going to accept the -- or sign a
8 piece of paper that said "yes" they received a U.S.-
9 grade military airstrip in that region of the world.
10 They just weren't going to say that, and so we had to
11 come back with alternative procedures. And as I look
12 around the table and know what some of your companies
13 do, I've got to envision that you find yourselves
14 quite often in those situations, and you've got
15 processes and procedures to handle that.

16 So I'm concerned that if we write this too
17 restrictive that, you know, the end of the world has
18 come, this is a scope limitation, there are going to
19 be a lot of companies that can't be audited, which
20 will create a whole new set of problems. So I can
21 think of several in my own situation, and just looking
22 around the table I know that there are a few more

1 ideas out there that I just don't want to go too far
2 down that path.

3 DEE MIRANDO-GOULD: Thank you. Sam
4 Ranzilla.

5 SAM RANZILLA: Well, Hal, I can understand
6 why you left Ernst & Young based on that client
7 portfolio --

8 [Laughter.]

9 SAM RANZILLA: -- and the fact that
10 Fletchall is your independent reviewer, because I was
11 getting ready to say at least in my experience what
12 we're talking about here is a very unusual
13 circumstance where management would come and say, "I
14 don't want you to confirm something." At least, my
15 experience -- and I think that I can speak for my firm
16 -- this is not a burning issue.

17 I would agree, though, that when management
18 does come and request it, the ISA505 factors are the
19 things you can -- and in the most extreme
20 circumstance, after you've plowed your way through all
21 the issue, I think there is a possibility that you
22 could find yourself in a scope limitation. But again,

1 that would be a very extreme circumstance, and
2 honestly this is not a prevalent auditing issue, at
3 least from my experience. Now, maybe your inspection
4 results say different, but I think we're talking
5 about, you know, sort of Haley's Comet here.

6 DEE MIRANDO-GOULD: Yeah, I don't believe
7 it's a major issue in inspections, either. So Damon
8 Silvers?

9 DAMON SILVERS: I mean, in a way, this -- as
10 I said earlier -- I find this more interesting as a
11 window into some larger things than perhaps as
12 something that hopefully doesn't happen every day and
13 in every engagement. I'm particularly interested in
14 responding to the comment -- and I'm afraid I -- I
15 think you're -- I don't -- I know your -- the person
16 that was talking about sending airstrips in unmarked
17 containers.

18 [Laughter.]

19 DAMON SILVERS: Which I think opens up a
20 whole different kind of thing. The -- I like -- I'll
21 reiterate this -- to the extent that Haley's Comet
22 comes along, I like the board's solution best because

1 I think it reemphasizes where really the client
2 relationship ought to run, and I think that, you know,
3 there is a -- there is a way in which these kinds of
4 things weighs, you know, really, really large problems
5 are generally kind of surfaced at first by something
6 like the request not to get a confirmation.

7 It's akin -- I think it's the sort of thing
8 like it's an akin to an ethics waiver, thinking back
9 in the long -- back to the early -- back to the
10 distant past of the Enron matter. Right? It's akin
11 to an ethics waiver. There may be reasons to grant
12 ethics waivers, but boy, you know, they often -- the
13 request often signals something and I think that the
14 guide -- that the standard ought to be written with
15 that sort of thing in mind.

16 And I think it will have a salutary effect,
17 meaning a sort of -- a default of going to the board I
18 think will make management think again before asking.
19 I think that's a good idea, because then there's a --
20 then you don't necessarily put so much weight on the
21 manager/auditor relationship that way.

22 But now, I want to turn this business about

1 airstrips, because I think that raises a much broader
2 issue. Auditing is not simp -- there are issues that
3 -- an examination of the accounts can raise other
4 issues. If, for example, you know, I think there was
5 some obligation on the auditor to do something if in
6 the course of confirmations you discover that your
7 client is bribing foreign officials. All right?
8 Which is a violation -- which is a felony in the
9 United States.

10 And I can easily imagine in the course of
11 enterprises like shipping airstrips to hot zones that
12 someone might not want to get a confirmation because,
13 in fact, that would set off a criminal inquiry. And I
14 think that there needs to be some guidance here to --
15 one of the issues I think that's very present right
16 now, and in a way I think is under discussion with the
17 G20 as we meet, is the sort of interaction of the
18 financial reporting and governance system with some of
19 these larger issues.

20 And whether or not our financial reporting
21 public company disclosure and auditing systems
22 adequately capture the range and risks that are in

1 play in businesses, the -- and I, you know, I
2 apologize for harping on this example, but I think
3 that this is a window into the fact that auditors may
4 often be told answers which at one level may be
5 plausible but at another level open up this -- all
6 these other issues that are in fact properly the
7 subject of the audit.

8 All right? Meaning that the financial --
9 meaning that if it's, for example, if a company is
10 engaged in illegal trade in arms, that that might be
11 something that would have to be dealt with in the
12 financial statement in some form or fashion, and if it
13 wasn't, that financial statement might not be
14 accurate. So I think that sort of puts a -- it raises
15 this largest context that's opened up by this Haley's
16 Comet-type issue.

17 DEE MIRANDO-GOULD: Thank you, Damon. Does
18 anybody else want to comment?

19 [No Response.]

20 DEE MIRANDO-GOULD: Okay. Now, our last
21 topic on confirmations involves disclaimers and
22 restrictive language, including on confirmation

1 responses. Examples of such language include that the
2 information is not guaranteed to be accurate nor
3 current and may be a matter of opinion, and the
4 confirming party doesn't accept any responsibilities
5 for errors and omissions.

6 The standard does not specifically address
7 the use of disclaimers and restrictive language by
8 confirming parties, which leads me to my last
9 question. Should the auditor be required to perform
10 procedures to evaluate the effect of disclaimers and
11 restrictive language on confirmation responses? If
12 so, what procedures should an auditor be required to
13 perform in evaluating such disclaimers and restrictive
14 language? Joe Carcello?

15 JOSEPH CARCELLO: I thought your list on
16 Page 8 was a good list, and it certainly T's up the
17 discussion nicely. I guess from my point of view,
18 disclaimers designed to solely limit legal liability
19 from the perspective of who responds -- not from the
20 auditor's perspective, but from the perspective of who
21 responds they're probably okay. And you can't force
22 these parties to respond to confirmations. This is a

1 voluntary action.

2 However, disclaimers that call into question
3 the accuracy of the response to me weakens the audit
4 evidence provided. So to me, if I looked at what you
5 had on Page 8, there were two types there. One was
6 really more of "we're not going to take legal
7 liability by choosing to voluntarily help you." I'm
8 not sure if that is a big issue. On the other hand,
9 the -- some of the others said, "We're not even sure
10 this information is right." That to me is very
11 different.

12 DEE MIRANDO-GOULD: So, Joe, would you be
13 recommending that the auditor just document that
14 thought process? That this disclaimer really doesn't
15 have much of any effect on the audit evidence versus
16 the other type?

17 JOSEPH CARCELLO: Yeah, I'm sensitive to the
18 people who practice every day. And, you know, there's
19 obviously been a lot of concerns raised this morning
20 about excessive documentation burden, so I think
21 that's fair and I think that's valid, but I think a
22 quick -- I think that's something you could document

1 in one or two sentences.

2 DEE MIRANDO-GOULD: Hal Schroeder?

3 HAROLD SCHROEDER: This is more of a
4 question and it may be more addressed to the SEC
5 observers, but if you're dealing with public companies
6 that you're trying to confirm things with, can there
7 be some type of requirement placed upon any SEC
8 register?

9 PAUL BESWICK: I'm not -- I mean, it's an
10 interesting question. I think we need to talk to the
11 lawyers, because for once the SEC doesn't have lawyers
12 present.

13 [Laughter.]

14 PAUL BESWICK: So you're asking two
15 accountants that question. It's something we could
16 take back. It would only -- the problem is, it would
17 only deal with a certain population of the universe.
18 I mean, confirmations go out to nonpublic companies
19 all the time, and so you would be limiting it in that
20 manner. I mean, I think we'd have to think about
21 whether we could bring action under a securities law
22 violation that you've -- I'd -- we need to think

1 through it, and that's something we can certainly ask.

2 HAROLD SCHROEDER: Yeah, but I'm thinking
3 that, A, it would cover the bulk of the assets that
4 are being audited out there, at least the significant
5 assets, and the second point is, is I read through --
6 and I agree these were very good examples, and they
7 look very similar to what I recall seeing in various
8 confirmations, these would be to the professor's
9 comment earlier.

10 To me, these would be scope limitations
11 which, you know, really presents a real problem from
12 an audit perspective. And so, what you do is you
13 start to get more and more of this type of response in
14 your efficiency of auditing, if not the whole audit
15 process, starts to collapse, which to me is an SEC
16 issue.

17 PAUL BESWICK: Agree. And, I mean, I think
18 one thing we'd need to consider, though, is the
19 repercussions to preparers if we now have securities
20 law -- a security law that says, "If you confirm
21 something and it's not accurate, you're going to be
22 held accountable from a legal standpoint." I can

1 imagine what the disclaimers are now going to appear,
2 and we're going to be back in, "Can I rely on this
3 confirmation, because I received a cash confirmation
4 back that has ten pages of disclaimers?"

5 And so, I mean, I think that's something we
6 need to think about, and it's something we can
7 certainly take back to our people.

8 DEE MIRANDO-GOULD: Thanks, Paul, for
9 answering that. Okay. Randy Fletchall?

10 RANDY FLETCHALL: I was just going to add in
11 a similar vein I think Wayne Kolins said earlier, a
12 long time ago, that we are seeing an increase in
13 responses, say, from banks that are just filled with
14 disclaimers. And I think an auditor does have to look
15 at those from a standpoint of, you know, some you can
16 kind of ignore; others look like they might affect the
17 reliability of the evidence, and you can't ignore
18 those.

19 But I think we find ourselves slugging those
20 out one by one, engagement by engagement, with a
21 particular institution, and I think if there was some
22 collective way to deal with this, so whether it's the

1 PCAOB, or Hal suggested the SEC, some way to deal
2 with, you know, what would be an appropriate, you
3 know, caveat or a limiting language and a confirmation
4 will be inappropriate, and try to get these done right
5 the first time, it really would save a lot of time and
6 effort.

7 DEE MIRANDO-GOULD: Thank you. Wayne
8 Kolins?

9 WAYNE KOLINS: On the suggestion that the
10 SEC consider ways to impose a requirement on issuers,
11 it really goes beyond that, too, because you've got,
12 you know, many of these do come from financial
13 institutions that are not issuers. And so, you look
14 at the bank regulators for possibly doing this kind of
15 a thing, and I thought there was something in Sarbanes
16 Oxley or the outgrowth of that which basically made it
17 unlawful to lie to auditors, and I think that's
18 probably the seeds for a lot of what's happening now.
19 So there is an interplay here.

20 DEE MIRANDO-GOULD: Thanks, Wayne. That's
21 my understanding, too. Gary Kabureck?

22 GARY KABURECK: Actually, Wayne hit my

1 point. I think one of the 59 sections of the SOX act
2 there is about misrepresentation to auditors, and when
3 it first came out five or six years, there was a
4 flurry of, you know, the legal community advising
5 their clients, "Don't answer if you don't have to."

6 DEE MIRANDO-GOULD: Wayne Carnall?

7 WAYNE CARNALL: Thank you. Paul and I were
8 actually just chatting. I can't recall the specifics,
9 but there was actually an enforcement case against a
10 company where they actually did lie on their
11 confirmations. I think it was actually a Jap --
12 involving a Japanese subsidiary where there was
13 massive, massive collusion among all these companies
14 all lying on their confirmations, and the commission
15 did actually take action against that company. Yeah,
16 I'll try and find the specifics.

17 DEE MIRANDO-GOULD: Thank you, Wayne. Ian
18 Dingwall?

19 IAN DINGWALL: Yeah, I was just going to
20 say, the confirmations that I see that typically make
21 me a little crazy is the ones that say, "To the best
22 of my knowledge and belief," and you have no idea who

1 signed that thing.

2 DEE MIRANDO-GOULD: They were drafted by a
3 lawyer.

4 [Laughter.]

5 IAN DINGWALL: Yeah. Actually, you're quite
6 right about that, probably a bank of lawyers, but, you
7 know, I've always wondered what to make out of that,
8 and it seemed to me that if I was an auditor getting
9 something that says, "To the best of my knowledge and
10 belief," I'd wonder who that person was and in what
11 capacity was that person signing.

12 And frankly, the other thing that happens
13 oftentimes with these is there's a stamp. It's not
14 even a signature; it's just a stamp. It was stamped
15 by whoever had the stamp that day.

16 DEE MIRANDO-GOULD: Thank you. Gary?

17 GARY KABURECK: Just building on his last
18 comment, "The best of my knowledge and belief," that's
19 in the rep letters today from Page 1. I mean, so
20 you've got the issue elsewhere, and here is from
21 people who actually are supposed to know what's going
22 on inside the accounts in the company. And it's the

1 first paragraph almost of a standard rep letter.

2 DEE MIRANDO-GOULD: Thank you. Any other
3 comments? Oh, Gail Hanson?

4 GAIL HANSON: I just want to be sure we
5 don't lose sight of the fact that responding to
6 confirmations is voluntary, and so we get them in our
7 office and this gentleman was right, who signs them is
8 a big question. Are they -- they come in, and then
9 our mailroom -- think of the expertise here -- has to
10 figure out who they go to. And so, if you don't --
11 and I think it behooves you to ask your client, "Who
12 is the best?"

13 You know, is it written to the accounting
14 department, the legal department? How to best address
15 those confirmations, because when it gets to our
16 mailroom, it's up for grabs.

17 DEE MIRANDO-GOULD: Doug Anderson?

18 DOUGLAS ANDERSON: I was just add a side
19 point, and maybe now is the right time to do it, and I
20 remember -- I don't have the quotes from the past,
21 some past research, that sometimes auditors can put
22 too much reliance on confirmations and they're not

1 always accurate.

2 And I think the guidance, whatever we have,
3 is just to make sure we understand the limitations,
4 whether it's a stamp, whether it's somebody who's in
5 the mailroom signing them, or whatever else it is,
6 they're not as perfect and as reliable as sometimes I
7 think auditors would hope they were.

8 DEE MIRANDO-GOULD: Thank you. Warren
9 Malmquist?

10 WARREN MALMQUIST: I think we've just about
11 killed this one, but I think that from all the
12 comments that you've heard, is that there's not a lot
13 of confidence in the confirmation process itself. Not
14 only is there a low response rate, but then you have
15 those that have been received, confirmations that have
16 been received, that have disclaimers. So I've always
17 been of the belief that the confirmations that you
18 actually do receive and don't have a disclaimer on
19 them, maybe they should have.

20 In other words, they're -- I -- there's not
21 much that you have that you can rely on if you only
22 use the confirmation process, so I -- going back to a

1 previous question, I think that what should be
2 mandatory is the fact that alternative procedures
3 should be in place, audit procedures should be in
4 place, to give the auditor the confidence.

5 And you'll be back to the due professional
6 care and the evident evidential manner that's required
7 to reach a conclusion on those assets, liabilities,
8 whatever it is that you're trying to confirm.

9 DEE MIRANDO-GOULD: Any other comments?

10 [No Response.]

11 DEE MIRANDO-GOULD: Okay. Thank you very
12 much, and I'll turn it back over to Jennifer.

13 JENNIFER RAND: Okay, thanks, Dee. We're
14 going to go ahead and break for lunch. We have just a
15 couple of logistical issues. One, as I had mentioned
16 this morning, we're provide -- we have copies
17 available of what the FASB issued this morning made
18 publicly available, so those are back at the
19 registration desk, so please pick one of those -- pick
20 that up.

21 Also, for lunch, lunch is provided for SAG
22 members, observers, and PCAOB staff, and that'll be in

1 Rooms A, B, and C, which is out here to your right.
2 For other members of the public, you are on your own,
3 but we will be resuming at 1:15. And at that point,
4 we'll start with the discussion of emerging issues.
5 Okay? Thanks.

6 [Recessed at 12:09 p.m.]

7 [Reconvened at 1:20 p.m.]

8 WAYNE CARNALL: Jennifer, could I just
9 actually make a very quick -- I'll call it a
10 "correction" of what I said previously about this one
11 enforcement case I was referring to?

12 The company I was thinking about was Boston
13 Scientific, and unfortunately I probably thought there
14 was a case against the people with the confirmations,
15 because perhaps I thought there should have been at
16 the time, but it involved a Japanese subsidiary.
17 There was 40 people -- 40 employees at the company
18 that were involved.

19 What was surprising was that there was 143
20 independent distributors that participated in the
21 fraud in terms of sending in false confirmations.
22 Anyway, there was a commission enforcement case

1 several years back involving Boston Scientific, but to
2 the best of my knowledge there was no action taken
3 against the people that submitted the false
4 confirmations.

5 JENNIFER RAND: Okay. Thanks, Wayne. All
6 right.

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on October 14, 2009 that related to the Board's concept release on possible revisions to the PCAOB's standard on audit confirmations. The other topics discussed during the October 14, 2009 meeting are not included in this transcript excerpt.

The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript. The transcript has not been edited and may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at http://www.pcaobus.org/News_and_Events/Webcasts.aspx.

Meeting

Washington, DC

October 14, 2009

Page 1

1

2

3

4

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

5

(PCAOB)

6

7

STANDING ADVISORY GROUP MEETING

8

9

9:03 a.m.

10

Wednesday, October 14, 2009

11

12

National Association of Home Builders

13

1201 15th Street, N.W.

14

Washington, D.C.

15

16

17

18

19

20

21

22

1 input. And Damon, thanks also for the commentary on
2 fraud.

3 Let's move along to the second topic where we
4 have issued a concept release on confirmations, and Dee
5 Mirando-Gould is going to give you a summary of the
6 comments received there.

7 Thanks, Dee.

8 DEE MIRANDO-GOULD: Thank you, Marty.

9 So, as you are aware, we spoke with the SAG
10 last April regarding confirmations, and we released a
11 concept release in the middle of April. The comment
12 period ended May 29th, and we received 24 comments.
13 The majority of those comments again are from firms or
14 associations of accountants, and then there is a
15 smattering of academics, issuers, other standard
16 setters, other organizations, and the like in those
17 comments.

18 And similar to Keith's comments, I just want
19 to go through some discussion of some key themes with
20 those comments. Generally, commenters were supportive
21 of the PCAOB considering revising its standard on
22 confirmations, and that was mostly because of changes

1 in technology that didn't exist at the time the
2 original standard was put in place.

3 A number of commenters, a lot of auditors
4 referred us to the IAASB standard ISA 505, which deals
5 with confirmations, and the ASB's proposed statement on
6 auditing standards, which came out at the end of May of
7 this year, to look to try to align with those standards
8 and also be more principles based in our approach. So
9 not include a lot of additional requirements in the
10 standard is what was recommended to us.

11 We were also recommended to focus on risk,
12 make the standard be based on -- the use of
13 confirmations be based on an auditor's risk assessment.

14 And then, as a general comment, we received a
15 lot of support for revising the definition of
16 confirmation. In the concept release, we asked the
17 question whether or not confirmation should be revised
18 and should include direct access to information held by
19 a third party on behalf of a confirming party? And
20 overwhelmingly, the commenters supported us revising
21 the definition incorporating direct access as a
22 confirmation.

22 MARTIN BAUMANN: Good. Thanks, Joe, for that

Page 142	Page 144
<p>1 The other thing that came out of that, 2 though, surprised us a little, was that the majority of 3 commenters who did comment in this area also suggested 4 that oral confirmation should not be -- oral responses 5 should not be a confirmation. 6 Other areas we asked questions was regarding 7 the requirement to confirm. So we asked whether or not 8 the standard or revised standard should include 9 additional presumptions to confirm certain accounts, 10 transactions, the like. And there were divergent views 11 on this. 12 Auditors generally were not supportive of 13 expanding the presumption beyond confirming accounts 14 receivable, and a number of other groups -- the 15 academics, some of the issuers, some of the individual 16 investors -- supported adding additional requirements, 17 making the requirement to confirm cover additional 18 areas, especially risky areas, was the general comment 19 we got there. 20 We also asked about disclaimers and 21 restrictive language. That is showing up in a lot more 22 confirmation responses. And we asked if that a new</p>	<p>1 think we need to consider. 2 Paul? 3 PAUL BESWICK: And this will be very brief. 4 It seems to me the divergent views on expanding the 5 presumption beyond accounts receivable would be 6 contrary to the previous slide, where you say it should 7 be risk based. If it's risk based, they will determine 8 when they need to do something beyond accounts 9 receivable. 10 So I can't quite understand why the academics 11 would be arguing to do more because of risk if it's 12 already covered on the previous slide? 13 DEE MIRANDO-GOULD: If I can just answer 14 that? I think the issue there was that there are 15 certain areas, like investments and certain revenue 16 transactions and the like, that individual commenters 17 thought were riskier areas in the first place so that 18 the auditor should confirm those types of things 19 because they are higher risk, and that would go along 20 the lines of the risk focus. 21 But I take your point. I understand the 22 confusion there.</p>
Page 143	Page 145
<p>1 standard should include something around that 2 requirements for the auditor to evaluate the language 3 that's there, specific procedures. Generally, the 4 commenters who commented here suggested that we clarify 5 the auditor's responsibility to consider these -- this 6 language and also provide perhaps some more guidance 7 around what language creates a problem, what language 8 doesn't create a problem. 9 One other area we addressed was with regard 10 to negative confirmations. We asked the question of 11 whether or not we should keep negative confirmations as 12 a form of confirmation and allow it in the standard. 13 And the individuals who did respond -- virtually 14 everybody who responded on this question suggested that 15 we do continue to allow negative confirmations, 16 although it was recommended that we limit when they can 17 be used. 18 So those are some general. There were other 19 questions we asked in the concept release, but these 20 were some general ones that we just wanted to highlight 21 for you. And I'd be happy to get any input from anyone 22 on the area of confirmations, any concerns that people</p>	<p>1 Any other comments, thoughts? 2 Yes, Liz? 3 ELIZABETH GANTNIER: It seems that all the 4 themes I'm hearing today are auditors don't understand 5 how to evaluate the risk of fraud. Auditors don't know 6 how to evaluate when the risk is great enough that a 7 third-party independent confirmation is required. 8 Auditors don't understand, and we'll get later to how 9 to evaluate fair value properly or related party 10 transactions properly. 11 And I guess I'm waiting for a conversation 12 about how we're going to train auditors in these 13 processes, and yet all I'm hearing is so let's just 14 default to a standard that requires or presumes certain 15 risk assessments, which goes against pretty much 16 everything that I know about auditing is that you're 17 supposed to be capable of evaluating risk and employing 18 your time and resource properly to these items. 19 And I wish there was a place in all of this 20 where we said we don't have to answer every failure by 21 an auditor with a standard that requires a presumption 22 that something is, therefore, high risk. We had to</p>

Page 146	Page 148
<p>1 redo Audit Standard 2 because it was so prescriptive, 2 and it had so much "If you have this, then it is a 3 material weakness." And we backed off of that and 4 said, for example, these are examples of what might be 5 a material weakness. But we got rid of the "always" 6 and "never" type of language. 7 And so, again, I just wish there was a place 8 in all this where students were better trained in risk 9 assessment and audit technique and theory and less 10 about presumption in the standards about you have to 11 confirm something. That ought to be left to us to 12 decide. 13 And if you're telling us we don't know how to 14 decide that, then there is another failure here. But 15 it's not necessarily always going to be resolved with 16 or by a standard. 17 KEITH WILSON: Can I just react to that a 18 little bit? At least from the standpoint of risk 19 assessment, I take your point about a large number of 20 presumptions. Certainly I think one of the things that 21 we tried to do with the risk assessment standards in 22 making -- in the foundational principles is to set</p>	<p>1 on that. 2 So we'll take those -- we're taking all of 3 those comments into consideration, and we do think that 4 the comments certainly supported amending the standard. 5 But we'll take the other comments into consideration as 6 to how we do that. And again, our target on that, 7 according to our plan, is to get a proposed standard 8 with public comment during the first quarter. 9 DEE MIRANDO-GOULD: Sam, did you want to? 10 SAM RANZILLA: If the chairman will recognize 11 me? 12 MARTIN BAUMANN: Sam Ranzilla. 13 [Laughter.] 14 SAM RANZILLA: Well, Marty -- I thought he 15 was just trying to cut me off. So I at least wanted to 16 give you the chance to do that formally. 17 [Laughter.] 18 MARTIN BAUMANN: Fair enough. 19 SAM RANZILLA: I think Liz brings up some 20 excellent points, and we'll get to that as we go 21 through each of the three projects. And let me say up 22 front, my comment has nothing to do with audit</p>
Page 147	Page 149
<p>1 forth a process that allows the auditor to demonstrate 2 that they have a reasonable basis for those risk 3 assessments, okay, and then they can develop -- and how 4 they can develop responses that are commensurate with 5 the risk. 6 So I think that is an approach that we're 7 trying to follow. But for purposes of standard-setting 8 and discussion, I think sometimes it's helpful to just 9 lay out these points for discussion and say have these 10 risen to the point where they're important enough often 11 enough that there ought to be a presumption here? 12 It's a point of discussion. It doesn't 13 necessarily mean that that's the intention, okay? So 14 -- 15 MARTIN BAUMANN: And the last comment, I'd 16 like to make is that -- 17 DEE MIRANDO-GOULD: Sam? 18 MARTIN BAUMANN: -- of course, Dee was 19 putting up some of the responses we got back and not 20 necessarily how we're going to deal with those 21 responses. But there were some mixed views with 22 respect to the presumptions. She was just commenting</p>	<p>1 confirmations. 2 But I agree with Liz that there is a theme 3 running through the papers later this afternoon and 4 tomorrow to adding requirements and very prescriptive 5 set of standards, and I think you ought to think very 6 long and hard about going down a path that is very 7 prescriptive. And I also warn you about the 8 presumptive nature that to just presume something is a 9 risk factor or is a bad thing and, therefore, you go to 10 an extended audit response to it. 11 But you can avoid that by documenting in some 12 level of detail why you overcame that presumption. 13 Human behavior will just accept that it's whatever it 14 is you presumed it was in the standard because the risk 15 of trying to get second-guessed by either me, as an 16 internal inspector, or the external inspector. And 17 quite frankly, it might be more efficient to actually 18 just go do unnecessary work than it would be to 19 document why you don't need to do unnecessary work. 20 I just think going down a presumptive path is 21 something that is, in my mind, a very significant 22 decision that the Board will be making and one that you</p>

Meeting

Washington, DC

October 14, 2009

Page 150

1 should not take without a great deal of soul searching.

2 MARTIN BAUMANN: Good. Thanks for that
3 input, Sam.

4 Randy Fletchall?

5 RANDY FLETCHALL: Gosh, after that, I hate to
6 go back to confirmations, Sam.

7 [Laughter.]

8 RANDY FLETCHALL: But you mention there about
9 disclaimers and restrictive language, and we've talked
10 about that stuff at the last meeting in terms of seeing
11 more of that and how to evaluate whether that was to
12 such extent that you really couldn't treat it as audit
13 evidence.

14 I guess the other thing is also we've seen
15 increasing is where companies just won't respond. And
16 whether that's kind of a misinterpretation of Section
17 303 of Sarbanes-Oxley or not, I guess I would make
18 sure, as you write your standard, not only deal with
19 disclaimers and restrictions, but where you just
20 recognize you're using confirmations more often and yet
21 maybe respondents are not required to send them back to
22 you.

Page 151

1 And I don't have a solution here because, you
2 know, public companies, nonpublic, individuals -- it's
3 not like there's any one group that can dictate that
4 people have to respond. But I would encourage you in
5 the standard itself or covering releases to recognize
6 that as you talk about it is good evidence, try to use
7 it more often, that you're going to have to deal with
8 situations where you are unable to get a response and
9 have to do alternative work to satisfy the evidential
10 matters.

11 DEE MIRANDO-GOULD: Thank you, Randy.

12 As you may be aware, in the comments we've
13 received, we certainly received a lot of suggestions
14 that we consider response rates and we consider
15 disclaimers and consider whether or not there's
16 anything we can do, as a group, to help improve that.
17 So it's certainly something that we haven't forgotten
18 and we are considering in the whole process as we go
19 down this path.

20 Yes. We appreciate it.

21 MARTIN BAUMANN: Thanks for your comments on
22 that.

39 (Pages 150 to 153)

Meeting of the Standing Advisory Group

October 14, 2009

9:00 a.m. – 2:30 p.m.

Update on Proposed Standards and Concept Release Issued

Keith Wilson, Dee Mirando-Gould, and
Bella Rivshin

*Associate Chief Auditors, Office of the Chief
Auditor*

Update on Proposed Standards and Concept Releases

- Proposed standards on risk assessment
- Audit confirmations concept release
- Signing the auditor's report concept release

Audit Confirmations Concept Release

□ Comment Letters Received

■ Firms and association of accountants	15
■ Academics and associations of academics	1
■ Issuers, business groups, and internal auditors	1
■ Investor representatives	1
■ Other standards-setters	1
■ Other organizations	2
■ Other individuals	<u>3</u>
Total	24

Audit Confirmations Concept Release

- Key Themes of Comment Letters
 - Support for a revised standard
 - Standard should be principles-based
 - Confirmation should be a function of risk assessment
 - Support alignment with ISA 505 and the ASB's Proposed Statement on Auditing Standards
 - Support for revising definition of confirmation to include direct online access and exclude oral responses

Audit Confirmations Concept Release

- Key Themes of Comment Letters (cont'd)
 - Requirement to request confirmation
 - Divergent views on expanding the presumption beyond accounts receivable
 - Disclaimers and restrictive language
 - Clarify auditor's responsibility to evaluate
 - Provide more guidance on how language affects audit evidence
 - Negative confirmations should be permitted as audit evidence

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on October 14, 2010 that relates to the Board's proposed auditing standard relating to confirmations. The other topics discussed during the October 14, 2010 meeting are not included in this transcript excerpt.

The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript. The transcript has not been edited and may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at:

http://pcaobus.org/News/Events/Pages/10132010_SAGMeeting.aspx.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

SAG MEETING

National Association of Home Builders

1201 15th Street, Northwest

Washington, D.C.

October 14, 2010

8:33 a.m.

17 Well, we're coming into our final subject of
18 the day and that is, we proposed a new standard with
19 respect to confirmations, the comment period on that is
20 closed and we've received many comments, and I've asked
21 Dee Mirando-Gould to present a summary of the comments
22 received, as we've been doing on other proposed.

1 standard-setting initiatives.

2 So, Dee, you've got the final position.

3 MS. MIRANDO-GOULD: Thanks, Marty.

4 So, as Marty said, we proposed a standard on
5 confirmation and the comment period ended on September
6 13. And before I talk about some of the key themes in
7 the comment letters that we received, I just wanted to
8 go through some of the key requirements -- remind you
9 of some of the key requirements that are in this
10 proposed standard. So, there's a lot of words on this
11 slide, so it's a little hard to read, but we'll go
12 through a little bit of the background on it.

13 There is a requirement to confirm
14 receivables. We broadened the terminology so it
15 includes receivables that arise from credit sales,
16 loans or other transactions. That terminology is
17 found, actually, in FASB qualification. It also
18 includes a "should confirm" receivables, and that
19 establishes a presumptively mandatory requirement to
20 confirm receivables. And under the Board's Rule 3101,
21 the auditor must comply with requirements of this type,
22 unless the auditor demonstrates that alternative

1 actions he or she followed in the circumstances were
2 sufficient to achieve the objective of the standard.
3 So, thus, this includes -- the proposed standard does
4 not include a discussion of the exceptions to
5 confirming receivables that were in the existing
6 standard.

7 The proposed standard also includes a
8 requirement to confirm cash with financial institutions
9 and it includes a requirement to confirm other
10 relationships with those financial institutions,
11 including lines of credit, compensating balances,
12 contingent liabilities, including guarantees, and the
13 like.

14 It includes a requirement to confirm
15 significant risks, or in response to significant risks,
16 but it discusses the fact that confirmation might not
17 be appropriate for all significant risk, because its
18 confirmation should be performed for those significant
19 risks that relate to relevant assertions that can be
20 adequately addressed by confirmation procedures. So,
21 the release is clear that we understand that not all
22 significant risks will be able to be confirmed.

1 The proposed standard includes requirements
2 around maintaining control consistent with the existing
3 requirement, but there are also some new requirements
4 there. So, for example, it includes a requirement to
5 perform procedures to determine the validity of
6 addresses on confirmation requests. It also includes a
7 requirement around management's requests not to confirm
8 accounts, and actions the auditor should consider to
9 evaluate the implications of those requests.

10 The proposed standard also includes a
11 requirement for the auditor to evaluate the audit
12 evidence. Now, that also is in the existing standard,
13 but this proposed standard goes a little bit further in
14 that it requires the auditor to perform alternative
15 procedures for all non-responses, it includes
16 requirements for the auditor to investigate each
17 exception on a confirmation response, to assess the
18 reliability of all confirmation responses, to evaluate
19 the effective disclaimers or the restricted language on
20 the reliability of the confirmation process. As we've
21 heard, the inclusion of disclaimers and restricted
22 language in confirmation responses has increased over

1 time.

2 We received 27 comments on the proposed
3 standard, and the breakdown of the respondents is shown
4 on this slide, so the -- predominantly from accounting
5 firms and the Association of Accountants. And some of
6 the key themes here, we generally received support for
7 pursuing -- continuing to pursue a new standard to
8 replace the existing standard, and primarily that
9 support came from the fact that there have been
10 advances in electronic communication that weren't dealt
11 with under the existing standard.

12 Some of the other things we heard from
13 respondents are that we should consider modifying the
14 standards to be more principles-based, risk-based, more
15 consistent with the risk-assessment standards. The
16 Board is encouraged to consider additional outreach to
17 learn how the additional confirmation requirements will
18 affect confirming parties, so the standard includes a
19 number of requirements for auditors, but there is no
20 ability to require confirming parties to actually
21 respond to those confirmation requests, so we have been
22 encouraged to consider outreach, to understand that

1 process, to see if we can encourage better responses
2 from confirming parties.

3 A couple of other areas, the -- we've
4 received comments on the presumption to confirm
5 receivables, and the concern that we didn't include a
6 statement about when exceptions are appropriate. And
7 that's why I mentioned rule 3101, because that covers,
8 the "should" covers any possible exceptions, so there
9 is no need to discuss exceptions in the standard.

10 The other area was having the audit -- the
11 standard discuss any limitations on the use of internal
12 audit, or refer to the relevant auditing standard, AU
13 Section 322. So, there was some concern that we were
14 planning to change practice, and limit the use of
15 internal audit, and other commenters mentioned that we
16 should have more clear requirements -- discussion of
17 the intent related to internal audit in the standard.

18 So, I open it up, if anybody has any thoughts
19 or comments about the comment letters we received at
20 this point.

21 MS. RIVSHIN: Doug Anderson?

22 MR. ANDERSON: Okay, I'll jump in first this

1 time, maybe in part because I was part of the group
2 that drafted one of those comment letters.

3 Two things I wanted to say, one was I think I
4 expressed the ergo when SAG talked about this last
5 year. I still believe this is a great example of a
6 rule that's overly prescriptive in how it's structured.

7 I think that, you know, the way paragraphs 8 and 9 are
8 stated brings focus to two elements -- receivables and
9 cash. I love paragraphs 10 and 11 that talks about
10 specific risks and talking about really focusing on the
11 risk. And I know I have seen situations where
12 receivables and cash were not the primary risk areas.
13 And I think we fall into a trap with this, if we start
14 off the discussion saying, "Think about receivables and
15 cash, and oh, by the way, if there's other good risks
16 out there, address those, too," puts it backwards. I
17 think it should be stated, "Look at your risks and look
18 at confirmations as a fabulous way to potentially get
19 audit evidence, base it on the risks of the situation,
20 and two areas you want to give special consideration to
21 are receivables and cash," would be structured more
22 appropriately around the risk of the environment.

1 And then, of course, being an internal
2 auditor, or recently having been one, I'll just echo
3 the comments you made at the end about the use of
4 internal audit. I think again, there, the way that the
5 current wording is interpreted, back in page 20 of the
6 release basically putting severe limitations around
7 internal audit and how it can be used, again, may not
8 be respective of the environment within a specific
9 company. And I'd rather go back and just rely on 322.

10 The way -- I'm worried if it's written now, and
11 especially in the introduction to the standard, it's
12 written now, it will be interpreted to have a different
13 approach than what we have in the standard right now in
14 the use of internal audit.

15 MS. RAND: I'd like to respond to Doug's
16 point about -- well, he had two points -- one about
17 being overly prescriptive and then internal audits,
18 I'll start with overly prescriptive.

19 When we were developing the standard, and I'm
20 kind of thinking about Sam's comments, about
21 principles-based or rules-based, and the reality is,
22 it's a combination of both. And also, Marty's comments

1 yesterday about all our standards, we we're developing,
2 consider the risk of fraud. This standard certainly,
3 as we were developing it was for -- in considering the
4 risk of fraud. Certainly, the requirement to confirm
5 receivables to begin with came from a very significant
6 fraud case, McKesson Robbins. And we even had
7 discussion this morning about the, you know, the
8 concern about overstatement of revenue. So, we had
9 expanded the requirement there.

10 Cash has also been an area where there's been
11 alleged frauds regarding cash, and even confirmation
12 process. And even in the area of significant risk, our
13 current standard today requires the auditor to at
14 least, you know, consider confirming things like
15 significant or unusual complex terms, bill and hold
16 arrangements, other things -- things that, in our view,
17 would fall under the category of significant risk for
18 which it would be appropriate to confirm.

19 So confirmations -- and oftentimes,
20 confirmations are used to get information -- to
21 identify frauds, whether, you know, maybe falsification
22 of revenue. So, for all of those reasons, that was

1 really driving our thinking about what to confirm, plus
2 most of the firms today, if they don't explicitly
3 require, they strongly encourage confirmation of cash.

4 So, that led to our thinking in developing the
5 standard and the procedures around it go to consider
6 fraud-risk factors -- testing the validity of
7 addresses, so there the auditor's just not relying on
8 what the company is giving them for where the companies
9 are located, because it could be, you know, one of
10 their best friends, or -- making sure the auditor sends
11 and receives.

12 And then -- so that was our perspective, and
13 hopefully that helps as far as the standard and how we
14 viewed it.

15 The other thing on internal audit, what Doug
16 is referring to in the release, we indicated that
17 auditors could use internal, you know, internal
18 auditors, however, in our view, and as we've indicated
19 in the standard, when auditors send and receive
20 confirmations, they shouldn't rely on the company or
21 any other party. In our view, that included internal
22 audit, because in our view you're giving up control, if

1 I've given it to someone else, I've lost maintaining
2 control over that process. Or even evaluating
3 responses, we thought that was so important for the
4 auditors.

5 We did get comments saying, "Well, you should
6 just go with 322 and allow that to continue." And I'd
7 be interested if you had any other thoughts on why
8 internal auditors -- why you think it's appropriate for
9 them to send confirmations on behalf of the auditor;
10 how the auditor would still maintain control in that
11 process.

12 MR. ANDERSON: Yeah, just on those two
13 thoughts -- the first one, I'm not saying the
14 confirmation of receivables and cash are not good,
15 don't get me wrong. It comes into looking at this,
16 instead of relying on issues from a, you know, a big
17 issue from a couple of decades ago to drive how this
18 standard is structured, I think the primary focus
19 always needs to be on auditors need to focus on risk.
20 And we need to be -- have a singular focus on risk, and
21 we need to look at confirmations, respond to that, and
22 then see how to apply that thinking. This standard of

1 structure today, number one thought: beat up on
2 receivables. Well, that may not be the number one
3 thought.

4 So, it's not that I think confirmation of
5 receivables is wrong, I think it basically just sends
6 the wrong message that maybe a not-so-smart auditor
7 says, "If I deal with receivables and I deal with cash,
8 I must have the big things covered." Well, they may
9 have missed the entire big risk areas of a company.
10 So, it's a question of emphasis and how it's structured
11 in package is what I take issue with. I think it
12 should be more focused on audit risk and designing
13 confirmations for those high-risk areas, not
14 necessarily presume that those will always be
15 receivables and cash with zero balances, as the
16 standard is basically implying now.

17 And then back to the internal audit, I mean,
18 I've seen a lot of different internal audit functions,
19 and there are some great internal audit functions, and
20 there are some really poor internal audit functions.
21 And I think I'm pretty comfortable allowing the public
22 accountant, the external auditor, assess and evaluate

1 the strength and the weakness of the internal audit
2 functions -- their objectivity, the way that they
3 operate -- as kind of guided by the current standard to
4 decide how best to use internal audit in those
5 circumstances.

6 It may very well be a case that confirmations
7 are dealing with a medium- or lower-risk area. They
8 still think it's an effective method, but in that risk
9 profile, they're willing to take the situation that
10 they think internal audit is objective, will do it
11 objectively and do it professionally and they go with
12 that judgment.

13 Right now, the way the standard and the
14 release seems to be worded, you've said there will
15 never be a situation where an internal audit can
16 competently mail out some envelopes. And I'm not sure
17 in every situation, every risk profile for every
18 company with every internal auditor that's the right
19 answer. So, I would leave it up, more of the judgment
20 of the auditor. That's just how I react to what I
21 read.

22 MS. RAND: Well, and that was in there

1 internal audit is considered by auditors in two ways.
2 One is, internal audit can do their own work, they may
3 go ahead and send their own confirmations and do tests,
4 and auditors may consider that, reduce the nature, time
5 and the extent of their procedures. So, that part of
6 it remains the same.

7 The other thing is, they may decide to reduce
8 the nature, time and extent of their procedures, say,
9 based on the work of internal audit and use internal
10 audit as part of their audit team. So, it's counting
11 as part of the auditor's own work, and that's kind of -
12 - that's the part where we were placing, you know, it's
13 so important, it's really your own work, and we think
14 it's important enough that the auditors send it -- send
15 and receive confirmations and evaluate those responses.

16 MR. BAUMANN: Well, Dee, I guess we -- we've
17 received the comments letters, we're in the process of
18 analyzing them. Doug, thanks for your further comment
19 today.

20 I think, to a large degree your comment
21 actually, I think, supports one aspect -- certainly,
22 one aspect that we added to the standard, which was for

1 the auditor to confirm significant risks. And so you
2 certainly, I think, supported the concept of a risk
3 approach, and I think you're saying, "Think of our
4 packaging."

5 So, I appreciate your comments and I think as
6 was said by Jennifer, we are mindful of investors'
7 concerns on the risk of fraud. And it's forefront on
8 the mind of investors, and a we're writing standards --
9 whether they be the risk assessment standards that have
10 been adopted or other standards that we're proposing,
11 the risk of fraud is high on our list as to the
12 procedures that we require.

13 Dee, thanks for your presentation of the
14 comments. We'll take all of the comments we receive
15 and letters, obviously, into account as we think about
16 a -- our next steps in this regard and make a proposal
17 to the Board.

Meeting of the Standing Advisory Group

October 14, 2010

8:30 a.m. – 12:45 p.m.

Confirmation – Summary of Comments Received

Dee Mirando-Gould

*Associate Chief Auditor, Office of the
Chief Auditor*

Proposed Standard – Confirmation of Specific Accounts

- Requirement to confirm receivables
 - Includes receivables that arise from credit sales, loans, or other transactions
 - Includes presumptively mandatory requirement to confirm receivables
- Requirement to confirm cash with financial institutions
 - Confirmation procedures with these financial institutions includes –
 - Other relationships, such as lines of credit, other indebtedness, compensating balance arrangements, and contingent liabilities, including guarantees, and
 - Whether, during the process of completing the confirmation response, any additional information about other deposit or loan accounts has come to the attention of the financial institution
- Requirement for significant risks
 - Confirmation should be performed for those significant risks that relate to relevant assertions that can be adequately addressed by confirmation procedures

Proposed Standard – Confirmation Procedures

- Auditors should maintain control over the confirmation process, including -
 - Sending the confirmation request and not relying on the company or any other party
 - Performing procedures to determine the validity of addresses
 - Requesting confirming parties to respond directly to the auditor and not to the company or any other party
 - Determining whether management requests not to confirm are appropriate, and evaluating implications of the request

Proposed Standard – Confirmation Procedures

- Requirement for auditors to evaluate the audit evidence obtained from performing confirmation procedures by –
 - Evaluating the audit evidence and not relying on the company or any other party
 - Performing appropriate alternative procedures for each non-response
 - Investigating each exception in confirmation responses
 - Assessing the reliability of confirmation responses, including additional procedures for responses received electronically
 - Evaluating the effect of a disclaimer or restrictive language on the reliability of a confirmation process



Summary of Comments Received

□ Comment Letters Received	
■ Accounting firms and associations of accountants	19
■ Associations of business groups and internal auditors	3
■ Academics and associations of academics	2
■ Confirmation intermediaries	2
■ GAO	<u>1</u>
Total	27



Summary of Comments Received

- General acknowledgement of the need to revise existing standard
- Respondents recommended -
 - Modifying the standard to be more principles-based/risk-based
 - Additional outreach to learn more about how additional confirmation requirements will affect confirming parties



Summary of Comments Received

- Respondents recommended (cont'd) -
 - Including in the standard the statement in AU sec. 330.34 that the presumption the auditor will confirm receivables may be overcome if the use of confirmations would be ineffective
 - Having the standard either discuss any limitations on the use of internal audit or refer to AU sec. 322





The Auditor's Use of Confirmation, and Other Amendments to PCAOB Standards

PCAOB Release No. 2023-008
September 28, 2023

PCAOB Rulemaking
Docket Matter No. 028

Summary: The Public Company Accounting Oversight Board ("PCAOB" or the "Board") is replacing its auditing standard, AS 2310, *The Confirmation Process*, with a new standard, AS 2310, *The Auditor's Use of Confirmation*, and making conforming amendments to certain related PCAOB auditing standards. The new standard and conforming amendments are designed to improve the quality of audits when confirmation is used by the auditor and to reflect changes in the means of communication and in business practice since the issuance of the original standard.

Board

Contacts: Barbara Vanich, Chief Auditor, Office of the Chief Auditor (202/207-9363, vanichb@pcaobus.org);
Dima Andriyenko, Deputy Chief Auditor, Office of the Chief Auditor (202/207-9130, andriyenkod@pcaobus.org);
Lisa Busedu, Associate Chief Auditor, Office of the Chief Auditor (646/437-5126, busedul@pcaobus.org);
David Hardison, Associate Chief Counsel, Office of the Chief Auditor (202/591-4168, hardisond@pcaobus.org).

Staff

Contributors: Heather Jossem, Assistant Chief Auditor, Office of the Chief Auditor;
Dani Verbeck, Assistant Chief Auditor, Office of the Chief Auditor;
Michael Gurbutt, Deputy Director, Office of Economic and Risk Analysis;
Tian Liang, Associate Director, Office of Economic and Risk Analysis;
Tasneem Raihan, Financial Economist, Office of Economic and Risk Analysis.

Amendments:

The Board is adopting amendments to:

- (1) Replace AS 2310, *The Confirmation Process*, and retitle the standard as *The Auditor's Use of Confirmation*; and
- (2) Amend related PCAOB auditing standards.

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY..... 4

II. BACKGROUND 5

A. RULEMAKING HISTORY7

B. EXISTING STANDARD.....8

C. CURRENT PRACTICE9

D. REASONS TO IMPROVE AUDITING STANDARDS13

III. DISCUSSION OF FINAL RULES..... 16

A. OVERVIEW OF NEW STANDARD16

B. INTRODUCTION AND OBJECTIVE18

C. RELATIONSHIP OF THE CONFIRMATION PROCESS TO THE AUDITOR’S IDENTIFICATION AND ASSESSMENT OF AND RESPONSE TO THE RISKS OF MATERIAL MISSTATEMENT19

D. DESIGNING CONFIRMATION REQUESTS.....25

E. MAINTAINING CONTROL OVER THE CONFIRMATION PROCESS.....31

F. EVALUATING CONFIRMATION RESPONSES AND CONFIRMATION EXCEPTIONS, AND ADDRESSING NONRESPONSES AND INCOMPLETE RESPONSES39

G. ADDITIONAL CONSIDERATIONS FOR CASH, ACCOUNTS RECEIVABLE, AND TERMS OF CERTAIN TRANSACTIONS.....44

H. PERFORMING ALTERNATIVE PROCEDURES FOR SELECTED ITEMS60

I. EVALUATING RESULTS63

J. OTHER MATTERS63

IV. ECONOMIC ANALYSIS 70

A. BASELINE.....70

B. NEED.....76

C. ECONOMIC IMPACTS.....79

D. ALTERNATIVES CONSIDERED91

V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES 94

VI. EFFECTIVE DATE..... 96

APPENDICES

APPENDIX 1 – NEW STANDARD

APPENDIX 2 – AMENDMENTS TO RELATED PCAOB AUDITING STANDARDS

I. EXECUTIVE SUMMARY

We are replacing AS 2310, *The Confirmation Process*, in its entirety with a new standard, AS 2310, *The Auditor's Use of Confirmation* ("new standard") to strengthen and modernize the requirements for the confirmation process. As described in the new standard, the confirmation process involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party (e.g., a financial institution), evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions. If properly designed and executed by an auditor, the confirmation process may provide important evidence that the auditor obtains as part of an audit of a company's financial statements.

Why the Board is Adopting These Changes Now

AS 2310 is an important standard for audit quality and investor protection, as the audit confirmation process touches nearly every audit. The standard was initially written over 30 years ago and has had minimal amendments since its adoption by the PCAOB in 2003.

We are adopting the new standard after substantial outreach, including several rounds of public comment. The PCAOB previously considered updating AS 2310 by issuing a concept release in 2009 and a proposal in 2010 for a new auditing standard that would supersede AS 2310. While the PCAOB did not amend or replace AS 2310 at that time, subsequent developments – including the increasing use of electronic communications and third-party intermediaries in the confirmation process – led us to conclude that enhancements to AS 2310 and modifications to the approach proposed in 2010 could improve the quality of audit evidence obtained by auditors. In addition, we have observed continued inspection findings related to auditors' use of confirmation, as well as enforcement actions involving failures to adhere to requirements in the existing auditing standard regarding confirmation, such as the requirement for the auditor to maintain control over the confirmation process.

Accordingly, having considered these developments and input from commenters, we revisited the previously proposed changes and issued a new proposed standard to replace AS 2310, along with conforming amendments to other PCAOB auditing standards, in December 2022. Commenters generally supported our objective of improving the confirmation process, and suggested areas to further improve the new standard, modify proposed requirements that would not likely improve audit quality, and clarify the application of the new standard. In adopting the new standard and related amendments, we have taken into account all of these comments, as well as observations from PCAOB oversight activities.

Key Provisions of the New Standard

The new standard and related amendments are intended to enhance the PCAOB's requirements 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. In addition, the new standard is more expressly integrated with the PCAOB's risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor's responsibilities for obtaining relevant and reliable audit evidence through the confirmation process. Among other things, the new standard:

- Includes a new requirement regarding confirming cash and cash equivalents held by third parties ("cash"), or otherwise obtaining relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source;
- Carries forward the existing requirement regarding confirming accounts receivable, while addressing situations where it would not be feasible for the auditor to perform confirmation procedures or obtain relevant and reliable audit evidence for accounts receivable by directly accessing information maintained by a knowledgeable external source;
- States that the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence (and includes examples of situations where the auditor may use negative confirmation requests to supplement other substantive audit procedures);
- Emphasizes the auditor's responsibility to maintain control over the confirmation process and provides that the auditor is responsible for selecting the items to be confirmed, sending confirmation requests, and receiving confirmation responses; and
- Identifies situations in which alternative procedures should be performed by the auditor (and includes examples of such alternative procedures that may provide relevant and reliable audit evidence for a selected item).

The new standard and related amendments will apply to all audits conducted under PCAOB standards. Subject to approval by the Securities and Exchange Commission ("SEC" or "Commission"), the new standard and related amendments will take effect for audits of financial statements for fiscal years ending on or after June 15, 2025.

This release provides background on the Board's standard-setting project, discusses the new standard and related amendments, and includes an economic analysis that further considers the need for standard setting and the anticipated economic impact of the new standard. This release also includes two appendices. Appendix 1 sets forth the text of the new standard. Appendix 2 includes conforming amendments to related PCAOB auditing standards.

II. BACKGROUND

Information obtained by the auditor directly from knowledgeable external sources, including through confirmation, can be an important source of evidence obtained as part of an

audit of a company's financial statements.¹ Confirmation has long been used by auditors. For example, one early auditing treatise noted the importance of confirmation for cash deposits, accounts receivable, and demand notes.² In addition, confirmation of accounts receivable has been a required audit procedure in the United States since 1939, when the American Institute of Accountants³ adopted Statement on Auditing Procedure No. 1 ("SAP No. 1") as a direct response to the *McKesson & Robbins* fraud case, which involved fraudulently reported inventories and accounts receivable that the independent auditors failed to detect after performing other procedures that did not involve confirmation.⁴

SAP No. 1 required confirmation of accounts receivable by direct communication with customers in all independent audits of financial statements, subject to the auditor's ability to overcome the presumption to confirm accounts receivable for certain reasons. Following the adoption of SAP No. 1, the accounting profession also adopted a requirement in 1942, which remained in effect until the early 1970s, that auditors should disclose in the auditor's report when confirmation of accounts receivable was not performed. The AICPA's subsequent revisions to its auditing standards included the promulgation of AU sec. 330, *The Confirmation Process*, which was adopted in 1991 and took effect in 1992. The PCAOB adopted AU sec. 330 (now AS 2310) as an interim standard in 2003.⁵

The amendments in this release to the standards for the auditor's use of confirmation are intended to improve audit quality through principles-based requirements that apply to all methods of confirmation and are more expressly integrated with the Board's risk assessment standards. These enhancements should also lead to improvements in practice, commensurate with the associated risk, among audit firms of all sizes. The expected increase in audit quality

¹ See, e.g., paragraph .08 of AS 1105, *Audit Evidence* (providing that, in general, "[e]vidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources").

² Robert H. Montgomery, *Auditing Theory and Practice* 91 (confirmation of cash deposits), 263 (confirmation of accounts receivable), and 353 (confirmation of demand notes) (1912).

³ The American Institute of Accountants was the predecessor to the American Institute of CPAs ("AICPA").

⁴ See *In the Matter of McKesson & Robbins, Inc.*, SEC Rel. No. 34-2707 (Dec. 5, 1940).

⁵ Shortly after the Board's inception, the Board adopted the existing standards of the AICPA, as in existence on Apr. 16, 2003, as the Board's interim auditing standards. See *Establishment of Interim Professional Auditing Standards*, PCAOB Rel. No. 2003-006 (Apr. 18, 2003). AU sec. 330 was one of these auditing standards. As of Dec. 31, 2016, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated number system, at which time AU sec. 330 was designated AS 2310. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Rel. No. 2015-002 (Mar. 31, 2015).

should also enhance the credibility of information provided in a company's financial statements.

A. Rulemaking History

The final amendments to the auditing standards reflect public comments on a concept release and two proposals. In April 2009, the PCAOB issued a concept release seeking public comment on the potential direction of a standard-setting project that could result in amendments to the PCAOB's existing standard on the confirmation process or a new auditing standard that would supersede the existing standard.⁶ The 2009 Concept Release discussed existing requirements and posed questions about potential amendments to those requirements.

In July 2010, the PCAOB proposed an auditing standard that, if adopted, would have superseded the existing confirmation standard.⁷ The 2010 Proposal was informed by comments on the 2009 Concept Release and was intended to strengthen the existing standard by, among other things, expanding certain requirements and introducing new requirements. In general, commenters on the 2010 Proposal supported updating the existing standard to address relevant developments in audit practice, including greater use of e-mailed confirmation requests and responses and the involvement of third-party intermediaries. At the same time, some commenters asserted that the proposed requirements in the 2010 Proposal were unduly prescriptive (i.e., included too many presumptively mandatory requirements) and would result in a significant increase in the volume of confirmation requests without a corresponding increase in the quality of audit evidence obtained by the auditor. The PCAOB did not adopt the 2010 Proposal.

In December 2022, we issued a proposed auditing standard to improve the quality of audits when confirmation is used by the auditor and to reflect changes in the means of communication and in business practice since the standard was originally issued.⁸ The 2022 Proposal was informed by comments on the 2009 Concept Release and 2010 Proposal and specified the auditor's responsibilities regarding the confirmation process. We received 46 comment letters on the 2022 Proposal from commenters across a range of affiliations. Those comments are discussed throughout this release. Commenters on the 2022 Proposal generally expressed support for the project's objective and suggested ways to revise or clarify the

⁶ *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations*, PCAOB Rel. No. 2009-002 (Apr. 14, 2009) ("2009 Concept Release").

⁷ *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*, PCAOB Rel. No. 2010-003 (July 13, 2010) ("2010 Proposal").

⁸ *Proposed Auditing Standard –The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2022-009 (Dec. 20, 2022) ("2022 Proposal"). In this release, the term "proposed standard" refers to the proposed auditing standard relating to the auditor's use of confirmation as described in the 2022 Proposal.

proposed standard. We considered the comments on the 2022 Proposal, as well as on the 2009 Concept Release and the 2010 Proposal, in developing the final amendments.⁹ We also considered observations from PCAOB oversight activities.

B. Existing Standard

This section discusses key provisions of the existing PCAOB auditing standard on the confirmation process.

In 2003, the PCAOB adopted the standard now known as AS 2310 (at that time, AU sec. 330), when it adopted the AICPA's standards then in existence. Existing AS 2310 indicates that confirmation is the process of obtaining and evaluating a direct communication from a third party in response to a request for information about a particular item affecting financial statement assertions.¹⁰ For example, an auditor might request a company's customers to confirm balances owed at a certain date, or request confirmation of a company's accounts or loans payable to a bank at a certain date.

Key provisions of existing AS 2310 include the following:

- A presumption that the auditor will request confirmation of accounts receivable. The standard states that confirmation of accounts receivable is a generally accepted auditing procedure and provides the situations in which the auditor may overcome the presumption.
- 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.
- Procedures relating to the use of both positive and negative confirmation requests. A positive confirmation request directs the recipient to send a response back to the auditor stating the recipient's agreement or disagreement with information stated in the request, or furnishing requested information. A negative confirmation request directs the recipient to respond back to the auditor only when the recipient disagrees with information in the auditor's request. The standard states that "[n]egative confirmation requests may be used to reduce audit risk to an acceptable

⁹ The comment letters received on the 2009 Concept Release, 2010 Proposal, and 2022 Proposal are available in the docket for this rulemaking on the PCAOB's website (<https://pcaobus.org/Rulemaking/Pages/Docket028Comments.aspx>).

¹⁰ Under PCAOB standards, financial statement assertions can be classified into the following categories: existence or occurrence, completeness, valuation or allocation, rights and obligations, and presentation and disclosure. See, e.g., AS 1105.11.

level when (a) the combined assessed level of inherent and 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 consideration.”¹¹ If negative confirmation requests are used, the auditor should consider performing other substantive procedures to supplement their use.¹²

- A requirement for the auditor to maintain control over confirmation requests and responses by establishing direct communication between the intended recipient and the auditor.
- Procedures to consider when the auditor does not receive a written confirmation response via return mail, including how the auditor should evaluate the reliability of oral and facsimile responses to written confirmation requests. The standard provides that, when confirmation responses are in other than a written format mailed to the auditor, additional evidence may be necessary to establish the validity of the respondent.
- A requirement that the auditor should perform alternative procedures when the auditor has not received a response to a positive confirmation request.
- Requirements for the auditor’s evaluation of the results of confirmation procedures and any alternative procedures performed by the auditor. These provisions include the requirement that, if the combined evidence provided by confirmation, alternative procedures, and other procedures is not sufficient, the auditor should request additional confirmations or extend other tests, such as tests of details or analytical procedures.

C. Current Practice

This section discusses our understanding of current practice based on, among other things, observations from oversight activities of the Board and SEC enforcement actions.

1. Overview of Current Practice

The audit confirmation process touches nearly every financial statement audit conducted under PCAOB auditing standards. This is due in part to the presumption in existing AS 2310 that the auditor will confirm accounts receivable, which include claims against customers that have arisen from the sale of goods or services in the normal course of business and a financial institution’s loans, unless certain exemptions apply. In addition, audit

¹¹ See AS 2310.20.

¹² *Id.*

methodologies of many larger audit firms affiliated with global networks recommend or require confirming cash accounts. In the past, the use of confirmation was a common practice for auditing a financial institution's customer deposits. In recent years, however, there has been an increased wariness about phishing attempts by unauthorized parties aimed at obtaining sensitive personal or financial information of customers. As a result, some customers might not understand or trust an unsolicited confirmation request from an auditor and, indeed, many financial institutions and other companies now advise customers not to reply to unsolicited correspondence concerning their accounts or other customer relationships.¹³

Existing AS 2310 was written at a time when paper-based confirmation requests and responses were the prevailing means of communication. Since then, e-mailed confirmation requests and responses, and the use of technology-enabled confirmation tools, including the use of intermediaries to facilitate the confirmation process, have become commonplace. For example, numerous financial institutions in the United States, and an increasing number of international banks, mandate the use of an intermediary as part of the confirmation process and will not otherwise respond to an auditor's confirmation request.

As noted above, existing AS 2310 provides that the auditor should maintain control over the confirmation process. In practice, complying with this requirement involves the auditor directly sending the confirmation request to the confirming party via mail or e-mail, without involving company personnel. The auditor's confirmation request generally specifies that any correspondence should be sent directly to the auditor's location (or e-mail address) to minimize the risk of interference by company personnel. When an intermediary facilitates direct electronic communications between the auditor and the confirming party, the auditor is still required to maintain control over the confirmation process. Procedures performed by audit firms to address this requirement vary depending on facts and circumstances. Some auditors have used a report on controls at a service organization ("SOC report") to evaluate the design and operating effectiveness of the intermediary's controls relevant to sending and receiving confirmations.

Under the existing standard, auditors can use positive confirmation requests and, provided certain conditions are met, negative confirmation requests. A positive confirmation request either asks the recipient to respond directly to the auditor about whether the recipient agrees with information that is stated in the request or asks the recipient to provide the requested information by filling in a blank form. In comparison, a negative confirmation request directs the recipient to respond only when the recipient disagrees with the information included in the request. In practice, negative confirmation requests have typically been used to obtain audit evidence related to the completeness of deposit liabilities and other accounts of a similar nature and, less frequently, to obtain evidence related to the existence of accounts

¹³ Section III of this release discusses situations that involve using audit procedures other than confirmation and situations where companies adopt the policy of responding to electronic confirmation requests from auditors only through an intermediary.

receivable. In some cases, auditors use a combination of positive and negative confirmation requests.

2. Observations from Inspections and Enforcement Actions

This section discusses observations from PCAOB oversight activities and SEC enforcement actions, including (1) PCAOB inspections of registered public accounting firms (“firms”) and (2) enforcement actions relating to deficient confirmation procedures performed by the auditor. These observations have informed our view that providing greater clarity as we strengthen the requirements could result in improved compliance by auditors.

Inspections. Over the past several years, PCAOB inspections indicated that some auditors did not fulfill their responsibilities under the existing standard when performing confirmation procedures. The shortcomings have been noted at large and small domestic firms, and at large firms with domestic and international practices. For example, some auditors did not: (1) consider performing procedures to verify the source of confirmation responses received electronically; (2) perform sufficient alternative procedures; (3) restrict the use of negative confirmation requests to situations where the risk of material misstatement was assessed as low; or (4) maintain appropriate control over the confirmation process, including instances where company personnel were involved in either sending or receiving confirmations.

The PCAOB has also continued to monitor developments relating to the use of confirmation through its other oversight and research activities. For example, in 2021, the PCAOB staff issued a Spotlight discussing, among other things, the use of technology in the confirmation process.¹⁴ In addition, in 2022, the PCAOB staff issued a Spotlight that specifically discussed observations and reminders on the use of a service provider in the confirmation process.¹⁵

Enforcement actions. Over the years, there have been a number of enforcement actions by the PCAOB and the SEC alleging that auditors failed to comply with PCAOB standards related to the confirmation process. Enforcement actions have been brought against large and small firms, and against U.S. and non-U.S. firms.

For example, PCAOB enforcement cases have involved allegations that auditors failed to: (1) perform appropriate confirmation procedures to address a fraud risk;¹⁶ (2) adequately

¹⁴ See *Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>.

¹⁵ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

¹⁶ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Whitley Penn LLP*, PCAOB Rel. No. 105-2020-002 (Mar. 24, 2020); *In the Matter of PMB Helin*

respond to contradictory audit evidence obtained from confirmation procedures;¹⁷ (3) perform appropriate confirmation procedures and alternative procedures for accounts receivable;¹⁸ or (4) maintain proper control over the confirmation process.¹⁹

In several confirmation-related enforcement cases, the SEC alleged that the deficient confirmation procedures by the auditors involved companies that had engaged in widespread fraud, where properly performed confirmation procedures might have led to the detection of the fraudulent activity.²⁰ Further, in a number of proceedings, the SEC alleged that confirmation procedures were not properly designed²¹ or, more frequently, that the auditors failed to adequately evaluate responses to confirmation requests and perform alternative or additional procedures in light of exceptions, nonresponses, or responses that should have raised issues as to their reliability or the existence of undisclosed related parties.²² Several of these proceedings were brought in recent years, suggesting that problems persist in this area.

Donovan, LLP, PCAOB Rel. No. 105-2019-031 (Dec. 17, 2019); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015).

¹⁷ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

¹⁸ See, e.g., *In the Matter of Whitley Penn LLP*, PCAOB Rel. No. 105-2020-002 (Mar. 24, 2020); *In the Matter of PMB Helin Donovan, LLP*, PCAOB Rel. No. 105-2019-031 (Dec. 17, 2019); *In the Matter of Wander Rodrigues Teles*, PCAOB Rel. No. 105-2017-007 (Mar. 20, 2017); *In the Matter of Ronald R. Chadwick, P.C.*, PCAOB Rel. No. 105-2015-009 (Apr. 28, 2015); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

¹⁹ See, e.g., *In the Matter of Marcum LLP*, PCAOB Rel. No. 105-2020-012 (Sept. 24, 2020); *In the Matter of Price Waterhouse, Bangalore*, PCAOB Rel. No. 105-2011-002 (Apr. 5, 2011).

²⁰ See, e.g., *In the Matter of CohnReznick LLP*, SEC Rel. No. 34-95066 (June 8, 2022); *In the Matter of Ravindranathan Raghunathan, CPA*, SEC Rel. No. 34-93133 (Sept. 27, 2021); *In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020); *In the Matter of Schulman Lobel Zand Katzen Williams & Blackman, LLP A/K/A Schulman Lobel LLP*, SEC Rel. No. 34-88653 (Apr. 15, 2020); *In the Matter of William Joseph Kouser Jr., CPA*, SEC Rel. No. 34-80370 (Apr. 4, 2017).

²¹ See, e.g., *In the Matter of RSM US LLP*, SEC Rel. No. 34-95948 (Sept. 30, 2022); *In the Matter of Ravindranathan Raghunathan, CPA*, SEC Rel. No. 34-93133 (Sept. 27, 2021); *In the Matter of Winter, Kloman, Moter & Repp, S.C.*, SEC Rel. No. 34-83168 (May 4, 2018); *In the Matter of Edward Richardson, Jr., CPA*, SEC Rel. No. 34-80918 (June 14, 2017).

²² See, e.g., *In the Matter of Jason Jianxun Tang, CPA*, SEC Rel. No. 34-96347 (Nov. 17, 2022); *In the Matter of Steven Kirn, CPA*, SEC Rel. No. 34-95949 (Sept. 30, 2022); *In the Matter of Friedman LLP*, SEC Rel. No. 34-95887 (Sept. 23, 2022); *In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020); *In the Matter of Schulman Lobel Zand Katzen Williams & Blackman, LLP A/K/A Schulman Lobel LLP*, SEC Rel. No. 34-88653 (Apr. 15, 2020); *In the Matter of Anton & Chia, LLP*, SEC Rel. No. 34-87033 (Sept. 20, 2019); *In the Matter of Edward Richardson, Jr., CPA*, SEC Rel. No. 34-80918 (June 14, 2017); *In the Matter of William Joseph Kouser Jr., CPA*, SEC Rel. No. 34-80370 (Apr. 4, 2017).

D. Reasons to Improve Auditing Standards

The amendments to PCAOB standards being adopted are intended to enhance audit quality by clarifying and strengthening the requirements for the auditor's use of confirmation. The final amendments are also more expressly integrated with the PCAOB's risk assessment standards by incorporating certain risk-based considerations and emphasizing the auditor's responsibilities for obtaining relevant and reliable audit evidence through the confirmation process. We believe that these improvements will enhance both audit quality and the credibility of the information provided in a company's financial statements.

1. Areas of Improvement

We have identified two important areas where improvements are warranted to existing standards, discussed below: (1) updating the standards to reflect developments in practice and (2) clarifying the auditor's responsibilities to evaluate the reliability of evidence obtained through confirmation responses.

i. Updating the Standards to Reflect Developments in Practice

The new standard supports the auditor's use of electronic forms of communication between the auditor and the confirming party. Since the AICPA standard on the confirmation process adopted by the PCAOB took effect in 1992, there has been a significant change in the auditing environment and the means by which an auditor communicates with confirming parties. E-mails and other forms of electronic communications between auditors and confirming parties have become ubiquitous, and third-party intermediaries now often facilitate the electronic transmission of confirmation requests and responses between auditors and confirming parties.

In addition, we believe our auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence. Traditionally, auditors have used confirmation in circumstances where reliable evidence about financial statement assertions could be obtained directly from a third party that transacts with the company (e.g., to confirm the existence of cash or accounts receivable). Generally, audit evidence obtained directly from knowledgeable external sources, including through confirmation, has been viewed as more reliable than evidence obtained through other audit procedures available to the auditor,²³

²³ The confirmation process involves obtaining audit evidence from a confirming party. Under PCAOB standards, in general, evidence obtained from a knowledgeable source that is independent from the company is more reliable than evidence obtained only from internal company sources. *See, e.g., AS 1105.08.*

especially where the auditor identified a risk of fraud, chose not to test controls, or determined that controls could not be relied on.²⁴

The staff's research indicates that some audit firms may have developed or may yet develop audit techniques that enable the auditor to obtain relevant and reliable audit evidence for the same assertions by performing substantive audit procedures that do not include confirmation, as discussed in more detail below. To reflect these developments, the new standard allows the performance of other procedures in lieu of confirmation for cash and accounts receivable in situations where the auditor can obtain relevant and reliable audit evidence by directly accessing information maintained by knowledgeable external sources. Further, the new standard acknowledges that, in certain situations, it may not be feasible for the auditor to obtain audit evidence for accounts receivable directly from a knowledgeable external source and provides that in those situations the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details.

ii. Clarifying the Auditor's Responsibilities to Evaluate the Reliability of Confirmation Responses

While information obtained through the confirmation process can be an important source of audit evidence, the confirmation process must be properly executed for the evidence obtained to be relevant and reliable. The enforcement actions discussed in Section II.C and other recent high-profile financial reporting frauds have also called attention to the importance of well-executed confirmation procedures, including the confirmation of cash.²⁵ In addition, PCAOB oversight activities have identified instances in which auditors did not obtain sufficient appropriate audit evidence when using confirmation. Accordingly, the new standard includes a new requirement to confirm certain cash balances and clarifies the auditor's responsibilities to

²⁴ See, e.g., Staff Audit Practice Alert No. 8, *Audit Risks in Certain Emerging Markets* (Oct. 3, 2011) ("SAPA No. 8") at 11 (stating that, when an auditor has identified fraud risks relating to a company's bank accounts or amounts due from customers, "it is important for the auditor to confirm amounts included in the company's financial statements directly with a knowledgeable individual from the bank or customer who is objective and free from bias with respect to the audited entity rather than rely solely on information provided by the company's management"). The requirements of the new standard are consistent with the guidance in SAPA No. 8, which auditors should continue to consider when using confirmations to address fraud risks in emerging markets.

²⁵ See, e.g., *In the Matter of Mancera, S.C.*, SEC Rel. No. 34-90699 (Dec. 17, 2020) (failure by auditors to properly evaluate confirmation responses to requests for information on cash balances of a Mexican homebuilder subsequently found to have engaged in a "multi-billion dollar financial fraud"). See also Olaf Storbeck, Tabby Kinder, and Stefania Palma, *EY failed to check Wirecard bank statements for 3 years*, *Financial Times* (June 26, 2020) (potential failure by auditors to confirm cash balances purportedly held by Wirecard AG, a German company whose securities were not registered with the SEC, directly with a Singapore-based bank).

evaluate the reliability of evidence obtained through confirmation responses (and, when necessary, to obtain audit evidence through alternative procedures).

2. Comments on the Reasons for Standard Setting

Many commenters on the 2022 Proposal broadly expressed support for revisions to our standard on the auditor's use of confirmation to reflect developments in practice since the AICPA standard on the confirmation process adopted by the PCAOB took effect in 1992. A number of commenters also agreed that the standard on the auditor's use of confirmation should be more closely aligned with the Board's risk assessment standards. In addition, some commenters stated that updates to the PCAOB's standard on the auditor's use of confirmation would be generally consistent with their prior recommendations to the Board that we modernize our interim auditing standards. Other commenters suggested that we should also engage in additional outreach with investors or that we consider other mechanisms to engage with stakeholders prior to the adoption of standards, such as roundtables and pre-implementation "field testing" of proposed standards.

In addition, several commenters expressed support for the proposition that the PCAOB's auditing standards should allow for continued innovation by auditors in the ways they obtain audit evidence. These commenters generally stated that standards should be written to evolve with future technologies, including new methods of confirmation that may arise from technological changes in auditing in the future. A few commenters stated that the 2022 Proposal provided flexibility to respond to the current use of technology in the audit process, or left enough room for judgment-based application for further advances in technology. In comparison, some commenters stated that the proposed standard was not sufficiently forward looking. Several commenters cautioned against more explicitly addressing the use of technology (i.e., by adding prescriptive requirements), noting that doing so might not allow the standard to age effectively with time and innovation.

Several commenters broadly expressed support for the Board's goal, as described in the 2022 Proposal, of improving the quality of audit evidence obtained by auditors when using confirmation. One of these commenters stated that it was critical that confirmation requests are properly designed and that confirmation responses are appropriately evaluated, especially when there are confirmation exceptions or concerns about their reliability. In addition, other commenters generally expressed support for the proposed requirements and stated they would lead to improvements in audit quality. A number of commenters, primarily firms and firm-related groups, asserted that certain requirements in the 2022 Proposal were unduly prescriptive and that the final standard should be more principles-based and risk-based to allow for more auditor judgment. In comparison, an investor-related group suggested that we remind auditors that, in exercising professional judgment, their judgments must be reasonable, careful, documented, and otherwise in compliance with applicable professional requirements.

In adopting the new standard, we have considered these comments on the 2022 Proposal, as well as the comments received on the 2010 Proposal and the 2009 Concept Release. Based on the information available to the Board – including the current regulatory baseline, observations from our oversight activities, academic literature, and comments – we believe that investors will benefit from strengthened and clarified auditing standards in this area. To the extent that commenters provided comments or expressed concerns about specific aspects of the proposed revisions to our existing standard on the auditor’s use of confirmation, our consideration of these comments is discussed further in Section III and elsewhere in this release. While we do not expect that the new standard will eliminate inspection deficiencies observed in practice, it is intended to clarify the auditor’s responsibilities and align the requirements for the use of confirmation more closely with the PCAOB’s risk assessment standards.

The new standard also reflects several changes that were made after our consideration of comments received about the potential impact of the proposed new standard on auditors, issuers, and intermediaries. In addition, some commenters called for a broader alignment of PCAOB standards with standards issued by other standard setters, namely the International Auditing and Assurance Standards Board (“IAASB”) and the AICPA’s Auditing Standards Board (“ASB”). A few commenters stated that PCAOB standards should be harmonized with IAASB standards, in the interest of global comparability, and, in the view of one commenter, with ASB standards. A few commenters stated that we should provide robust and detailed explanations of differences between PCAOB standards and the standards of other standard setters. One commenter indicated that the dual standard-setting structure in the United States (i.e., the existence of both PCAOB and ASB standards) creates issues that could erode audit quality.

We carefully considered the approaches of other standard setters when developing the 2022 Proposal, and the new standard reflects the approach that we believe best protects investors and furthers the public interest. As a result, certain differences will continue to exist between our new standard and those of other standard setters, including a number of provisions that we believe are appropriate and consistent with our statutory mandate to protect the interests of investors and further the public interest.

III. DISCUSSION OF FINAL RULES

A. Overview of New Standard

The new standard replaces existing AS 2310 in its entirety. The provisions of the new standard the Board is adopting are intended to strengthen existing requirements for the auditor’s use of confirmation. Key aspects of the new standard:

- *Include principles-based requirements that are designed to apply to all methods of confirmation.* The new standard is designed to enhance requirements that apply to longstanding methods, such as the use of paper-based confirmation requests and responses sent via regular mail; methods that involve electronic means of

communications, such as the use of e-mail or an intermediary to facilitate direct electronic transmission of confirmation requests and responses; and methods that are yet to emerge, thus encouraging audit innovation.

- *Expressly integrate the requirements for the auditor's use of confirmation with the requirements of the Board's risk assessment standards, including AS 1105.* The new standard specifies certain risk-based considerations and emphasizes the auditor's responsibilities for obtaining relevant and reliable audit evidence when performing confirmation procedures.
- *Emphasize the use of confirmation procedures in certain situations.* The new standard adds a new requirement that the auditor should perform confirmation procedures for cash held by third parties, carries forward an existing requirement that the auditor should perform confirmation procedures for accounts receivable, and adds a new provision that the auditor may otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source for cash and accounts receivable. In addition, the new standard carries forward an existing requirement to consider confirming the terms of certain other transactions.
- *Address situations in which it would not be feasible for the auditor to obtain information directly from a knowledgeable external source.* The new standard provides that if it would not be feasible for the auditor to obtain audit evidence directly from a knowledgeable external source for accounts receivable, the auditor should perform other substantive audit procedures, including tests of details, that involve obtaining audit evidence from external sources indirectly.
- *Communicate to the audit committee certain audit responses to significant risks.* Under the new standard, for significant risks associated with cash or accounts receivable, the auditor is required to communicate with the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.
- *Reflect the relatively insignificant amount of audit evidence obtained when using negative confirmation requests.* Under the new standard, the use of negative confirmation requests may provide sufficient appropriate audit evidence only when combined with other substantive audit procedures. The new standard includes examples of situations in which the use of negative confirmation requests in combination with other substantive audit procedures may provide sufficient appropriate audit evidence.
- *Emphasize the auditor's responsibility to maintain control over the confirmation process.* The new standard states that the auditor should select the items to be confirmed, send confirmation requests, and receive confirmation responses.

- *Provide more specific direction for circumstances where the auditor is unable to obtain relevant and reliable audit evidence through confirmation.* The new standard identifies situations where other procedures should be performed by the auditor as an alternative to confirmation. The new standard also includes examples of alternative procedures that individually or in combination may provide relevant and reliable audit evidence.

B. Introduction and Objective

See paragraphs .01 and .02 of the new standard in Appendix 1

The 2022 Proposal included requirements for the auditor's use of confirmation. As discussed in the proposal, the confirmation process involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions. Confirmation is one of the specific audit procedures described in PCAOB standards that an auditor could perform when addressing a risk of material misstatement.²⁶ As is the case with other audit procedures, information obtained through confirmation may support and corroborate management's assertions or it may contradict such assertions.²⁷

Under the 2022 Proposal, the auditor's objective in designing and executing the confirmation process was to obtain relevant and reliable audit evidence about one or more relevant financial statement assertions of a significant account or disclosure.²⁸ Existing AS 2310 does not include an objective.

As discussed below, we have modified the introduction and objective in the proposed standard in several respects.

A number of commenters stated that the objective of the proposed standard was clear. One commenter stated that the objective should be to provide requirements and guidance in situations where the auditor, as a result of its risk-assessment procedures, determines that confirmation procedures provide an appropriate response to one or more assertions related to an identified risk of material misstatement. Another commenter asserted that the objective in

²⁶ See, e.g., AS 1105.14 and .18.

²⁷ See AS 1105.02.

²⁸ An account or disclosure is a significant account or disclosure if there is a reasonable possibility that the account or disclosure could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements, considering the risks of both overstatement and understatement. See footnote 33 of AS 2110, *Identifying and Assessing Risks of Material Misstatement*; paragraph .A10 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

the proposed standard did not result in greater clarity than the proposed objective in the 2010 Proposal and created a wider gap between the PCAOB's standards and the equivalent standard of the IAASB.

Having considered these comments, the Board has revised the introduction to provide that the new standard establishes requirements regarding obtaining audit evidence from a knowledgeable external source through the auditor's use of confirmation. The introduction further states that the new standard includes additional requirements regarding obtaining audit evidence for cash, accounts receivable, and terms of certain transactions. We believe that this language more clearly aligns with the approach to the auditor's use of confirmation in the new standard and the inclusion of specific requirements in the new standard with respect to cash, accounts receivable, and terms of certain transactions.

In addition, we have added the phrase "from a knowledgeable external source" to the objective, such that the new standard provides that the objective of the auditor in designing and executing the confirmation process is to obtain relevant and reliable audit evidence from a knowledgeable external source about one or more relevant financial statement assertions of a significant account or disclosure. This language underscores that, when properly designed and executed, the confirmation process involves obtaining audit evidence regarding specific items from a knowledgeable external source. A knowledgeable external source, as referred to in the new standard, generally is a third party who the auditor believes has knowledge of the information that may be used as audit evidence. To the extent that this objective differs from the objective in standards adopted by other standard-setting bodies on the auditor's use of confirmation, we believe it appropriately reflects the Board's approach in the new standard and is consistent with our statutory mandate to protect the interests of investors and further the public interest. The next section of this release further discusses the relationship of the confirmation process to the auditor's identification and assessment of, and response to, the risks of material misstatement.

C. Relationship of the Confirmation Process to the Auditor's Identification and Assessment of and Response to the Risks of Material Misstatement

See paragraphs .03 - .07 of the new standard in Appendix 1

When an auditor uses confirmation, the auditor should be mindful of, and comply with, the existing obligation to exercise due professional care in all matters relating to the audit.²⁹

²⁹ See AS 1015, *Due Professional Care in the Performance of Work*. We currently have a separate standard-setting project to reorganize and consolidate a group of interim standards adopted by the Board in April 2003, including AS 1015. See *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2023-001 (Mar. 28, 2023).

Due professional care requires the auditor to exercise professional skepticism, which is an attitude that includes a questioning mind and a critical assessment of audit evidence. Professional skepticism should be exercised throughout the audit process,³⁰ including when identifying information to confirm, identifying confirming parties, evaluating confirmation responses, and addressing nonresponses. The requirements related to exercising professional skepticism, in combination with requirements in other PCAOB standards, are designed to reduce the risk of confirmation bias, a phenomenon wherein decision makers have been shown to actively seek out and assign more weight to evidence that confirms their hypothesis, and ignore or assign less weight to evidence that could disconfirm their hypothesis.³¹

The 2022 Proposal described how the proposed standard would work in conjunction with the PCAOB standards on risk assessment. AS 2110 establishes requirements regarding the process of identifying and addressing the risks of material misstatement of the financial statements, and AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, establishes requirements regarding designing and implementing appropriate responses to the risks of material misstatement. Fundamental to the PCAOB's risk assessment standards is the concept that as risk increases, so does the amount of evidence that the auditor should obtain.³² Further, evidence obtained from a knowledgeable external source generally is more reliable than evidence obtained only from internal company sources.³³

Where the auditor uses confirmation as part of the auditor's response, the 2022 Proposal addressed the auditor's responsibilities for designing and executing the confirmation process to obtain relevant and reliable audit evidence. When properly designed and executed, the confirmation process can be an effective and efficient way of obtaining relevant and reliable external audit evidence, including in situations where the auditor identifies an elevated risk of material misstatement due to error or fraud.

The 2022 Proposal also recognized that performing confirmation procedures can effectively and efficiently provide evidential matter about certain financial statement assertions, including existence, occurrence, completeness, and rights and obligations. For example, confirmation may provide audit evidence related to the existence of cash, accounts receivable, and financial instruments, or the completeness of debt. However, the confirmation process generally provides less relevant evidence about the valuation assertion (e.g., the confirming party may not intend to repay in full the amount owed, or the custodian may not know the value of shares held in custody). Confirmation could also be used to obtain audit evidence about the terms of contractual arrangements (e.g., by verifying supplier discounts or

³⁰ See AS 1015.07-.08.

³¹ For a discussion of confirmation bias, see, e.g., Raymond S. Nickerson, *Confirmation Bias: A Ubiquitous Phenomenon in Many Guises*, 2 *Review of General Psychology* 175 (1998).

³² See AS 1105.05.

³³ See AS 1105.08.

concessions, corroborating sales practices, or substantiating oral arrangements and guarantees). Information in confirmation responses may indicate the existence of related parties, or relationships or transactions with related parties, previously undisclosed to the auditor.

We also observed in the 2022 Proposal that, in some situations, an auditor may determine that evidence obtained through confirmation may constitute sufficient appropriate audit evidence for a particular assertion, while in other situations performing other audit procedures in addition to confirmation may be necessary to obtain sufficient appropriate audit evidence. For example, for significant unusual sales transactions and the resulting accounts receivable balances, an auditor might confirm significant terms of the transactions and the receivable balances with the transaction counterparties and perform additional substantive procedures, such as examination of shipping documents and subsequent cash receipts. Determining the nature, timing, and extent of confirmation procedures, and any other additional audit procedures, is part of designing and implementing the auditor's response to the assessed risk of material misstatement.

We are adopting the provisions in the 2022 Proposal that address the relationship of the confirmation process to the auditor's identification and assessment of and response to the risks of material misstatement, with certain modifications discussed below.

Overall, commenters expressed support for aligning the proposed standard on confirmation with the PCAOB's existing risk assessment standards. Several commenters stated that they had not identified changes needed to the proposed standard to align further with the PCAOB's risk assessment standards. Other commenters, as discussed below, called for various changes to the proposed provisions:

- Several commenters suggested that there could be further alignment of the 2022 Proposal with the risk assessment standards to enable the level of risk to drive the nature of the audit response. A number of commenters asserted that the 2022 Proposal included certain prescriptive requirements for the confirmation process, regardless of the assessed level of risk, and that those provisions could detract from the auditor's ability to apply professional judgment to determine the appropriate audit response. Consistent with the objective of the new standard, the requirements under the new standard apply to a significant account or disclosure.³⁴ The new standard thus does not establish a presumption to confirm cash or accounts receivable if the auditor has not determined cash or accounts receivable to be a significant account. The auditor may choose to perform confirmation procedures, however, in situations other than those specifically addressed in paragraphs .24 through .30 of the new standard. The new standard does not otherwise prescribe the timing or extent of confirmation procedures,

³⁴ AS 2110.59e directs the auditor to identify significant accounts and disclosures and their relevant assertions.

which are discussed as part of the auditor's response to the risks of material misstatement in AS 2301.

- Several commenters stated that paragraphs .06 and .07 of the proposed standard overly emphasized confirmation as being the most persuasive substantive audit procedure, with any other procedure thereby viewed as being less persuasive. One commenter asserted that the 2022 Proposal appeared to be premised on an assumption that third-party confirmations represent "first best" audit evidence, regardless of the facts and circumstances. In addition, one commenter questioned whether the Board intended for confirmation to be used whenever possible to obtain evidence. Having considered these comments, we have made several changes in the new standard to clarify certain provisions. In the new standard, we have revised paragraph .06, which discusses obtaining audit evidence from knowledgeable external sources, to emphasize the source of the audit evidence, rather than the type of audit procedure performed. We understand that advances in technology, as well as changes in attitudes towards confirmation (e.g., the potential hesitation of confirming parties to reply to a confirmation request from auditors because of the concern of falling victim to a phishing attack), have led auditors to perform other types of audit procedures that can provide relevant and reliable external evidence.
- Some commenters stated that the proposed standard could give rise to unrealistic expectations about confirmation procedures effectively addressing the risk of material misstatement due to fraud in all circumstances. While we do not believe that the new standard creates an unrealistic expectation about audit evidence obtained through confirmation, the appropriate focus of the auditor should be the obligation to obtain relevant and reliable audit evidence. Accordingly, we have not adopted paragraph .07 of the proposed standard, which had provided that "in situations involving fraud risks and significant unusual transactions, audit evidence obtained through the confirmation process generally is more persuasive than audit evidence obtained solely through other procedures."
- Several commenters recommended that the standard address the current and anticipated use of technology to enable auditors to obtain sufficient appropriate audit evidence through performing audit procedures other than confirmation. Some commenters provided examples of using technology-based procedures in lieu of confirmations, including accessing company balances directly at the relevant financial institution and testing internal data against external data sources using audit data analytics. We have considered these comments in developing the new standard. In particular, as discussed in Section III.G below, the new standard includes a presumption for the auditor to confirm cash and accounts receivable, or otherwise obtain relevant and reliable audit evidence for these accounts by directly accessing information maintained by a knowledgeable external source.

- One commenter suggested that the note to paragraph .05 of the proposed standard should also direct the auditor to take into account internal controls over cash, including segregation of duties, when there are side agreements to revenue transactions. We did not make this change in the new standard. We note that internal control considerations are addressed by existing PCAOB standards, which require obtaining an understanding of the company's controls when assessing the risk of material misstatement and identifying and testing certain controls when the auditor plans to rely on controls to respond to the assessed risk.³⁵ The auditor would consider controls over cash when performing these procedures.
- With respect to the examples of assertions in paragraph .06 of the proposed standard, one commenter asserted that 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. We did not incorporate such language in the new standard because we believe that limiting the use of confirmation to the existence assertion would be overly prescriptive and might disallow use of confirmation in other situations where the auditor has determined that confirmation could be used to obtain relevant and reliable information to test other assertions.

As discussed in Section III.G of this release, we continue to believe that confirmation procedures generally would provide relevant and reliable audit evidence for cash and accounts receivable. Accordingly, under the new standard the auditor should perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source when the auditor determines that these accounts are significant accounts. In addition, the new standard specifies that when the auditor has identified a significant risk of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk.

Other Use of Confirmation Procedures. The 2022 Proposal requested commenters' views on whether there were additional accounts or financial statement assertions for which the auditor should be required to perform confirmation procedures. In addition, the 2022 Proposal requested views on whether the proposal was sufficiently flexible to accommodate situations where an auditor chooses to confirm information about newer types of assets (e.g., digital assets based on blockchain or similar technologies).

Two investor-related groups identified specific types of additional transactions that should be subject to confirmation, including transactions (1) with unusual terms and conditions, (2) with related parties, (3) where the auditor has concern about whether side letters may exist,

³⁵ See, e.g., AS 2110 and AS 2301.

(4) where financing is obtained, including bank debt or supplier-provided financing, (5) involving certain sales practices, such as bill-and-hold arrangements or supplier discounts or concessions, (6) involving certain oral arrangements or guarantees, or (7) involving sales, lending, or liability for custodianship of digital assets. Another commenter suggested that confirmation of accounts payable should be considered, but not required, when auditors assess controls over the recording of liabilities to be ineffective. This commenter also suggested that we state that the use of confirmation is not limited to the circumstances discussed in the proposed standard.

In comparison, many firms and firm-related groups stated that the proposed standard should not prescribe additional other presumptive requirements to use confirmation. These commenters noted that doing so would be unduly prescriptive. Several commenters stated that the proposed standard provided for an appropriate amount of auditor judgment in determining when to perform confirmation procedures in situations other than those specifically addressed in the standard. In addition, several commenters indicated that the 2022 Proposal offered sufficient flexibility to accommodate situations where an auditor confirms information about newer types of assets.

Several commenters asserted that the effectiveness of confirmation procedures is negatively affected by the fact that third parties are not obligated, under legislation or regulation, to reply to an auditor's confirmation request.

The new standard does not specify additional accounts or transactions for which confirmation procedures are presumptively required beyond those in the 2022 Proposal. The PCAOB's risk assessment standards are foundational and are used by the auditor to determine the appropriate response to identified risks of material misstatement. We believe that confirmation can be an important tool for addressing certain risks for cash and accounts receivable, and for obtaining audit evidence about other financial relationships, and certain terms of complex transactions or significant unusual transactions, as discussed in Section III.G below. However, identifying additional accounts or scenarios that require the auditor to use confirmation, without regard to the specific facts and circumstances of the audit including the assessed risk of material misstatement and whether other audit procedures would provide sufficient appropriate audit evidence, would be overly prescriptive.

The auditor's responsibilities relevant to the use of confirmation are also addressed in several other PCAOB standards. AS 2315, *Audit Sampling*, which discusses planning, performing, and evaluating audit samples, is used if the auditor uses sampling in the confirmation process. AS 2510, *Auditing Inventories*, addresses confirmation of inventories in the hands of public warehouses or other outside custodians. Additionally, the new standard does not address auditor responsibilities regarding inquiries concerning litigation, claims, and assessments, which are addressed in AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

D. Designing Confirmation Requests

See paragraphs .08 - .13 of the new standard in Appendix 1

A properly designed and executed confirmation process may provide relevant and reliable audit evidence. Auditor responsibilities regarding designing a confirmation request are described in paragraphs .08 - .13, as follows:

- Paragraph .08 discusses identifying information to confirm;
- Paragraphs .09 through .11 discuss identifying the confirming parties for confirmation requests; and
- Paragraphs .12 through .13 discuss using negative confirmation requests.

The new standard does not prescribe a particular format for a confirmation request. For example, requests could be paper-based or electronic, specifying the information to be confirmed or providing a blank response form, or sent with or without the involvement of an intermediary that facilitates electronic transmission. As a practical matter, the auditor determines the format of a confirmation request to increase the likelihood that the request is received and clearly understood by the confirming party, taking into consideration, among other things, the facts and circumstances of the company and the confirming party.

1. Identifying Information to Confirm

The 2022 Proposal provided that the auditor should, as part of designing confirmation requests, identify information related to the relevant assertions that the auditor plans to verify with confirming parties or (when using a blank form) obtain from confirming parties. Such information could include transaction amounts, transaction dates, significant terms of transactions, and balances due to or from the confirming party as of a specific date. In addition, the 2022 Proposal discussed that using a blank confirmation request generally provides more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., a customer account balance). In the latter scenario, it is possible that a confirming party could agree to the information without verifying it against the confirming party's records.

We are adopting the proposed requirement relating to identifying information to confirm with certain modifications discussed below.

Several commenters indicated that the provisions of the 2022 Proposal related to identifying information to confirm were clear and appropriate. A few commenters requested retaining a statement analogous to a statement in existing AS 2310 to emphasize in the standard that responding to blank form confirmation requests generally requires additional effort, which might lower the response rates and lead auditors to perform alternative procedures. One commenter expressed concern that fraudsters could use fake confirmation

requests and, in particular, fake blank form confirmation requests, to defraud bank customers (e.g., by soliciting their bank details).

Existing AS 2310 includes details regarding the form of confirmation requests, which includes general information regarding blank form positive confirmation requests. This information has been included in the new standard in a note to paragraph .08. Further, after considering the comments received, the new standard includes language not included in the proposed standard that is similar to language in existing AS 2310. This language explains that responding to blank form confirmation requests generally requires additional effort, which might lower the response rates and lead auditors to perform alternative procedures for more selected items. Despite the possibility of lower response rates, responses to blank form confirmation requests may provide more reliable audit evidence than responses to confirmation requests using pre-filled forms.

Paragraph .17 of the proposed standard also included a reminder of an existing requirement in AS 1105.10, pursuant to which the auditor should test the accuracy and completeness of information produced by the company that the auditor uses as audit evidence. The reminder emphasized that, in the confirmation process, the requirement in AS 1105.10 applies to the information produced by the company (e.g., populations from which items are selected for confirmation, such as detailed account listings, vendor listings, and contractual agreements) that the auditor uses in selecting the items to confirm.

Several firms and firm-related groups indicated that the existing requirement in AS 1105.10 for the auditor to evaluate information produced by a company as audit evidence was sufficient and that paragraph .17 of the proposed standard was duplicative. A few commenters stated that confirmation requests are often designed to test the accuracy of a given account balance or disclosure and, accordingly, that the requirement should only focus on testing completeness. Finally, a few commenters suggested that the standard, consistent with AS 1105.10, should allow for the auditor to test controls over the accuracy and completeness of information produced by the company that the auditor uses in selecting items to confirm.

After considering these comments, in order to avoid duplication with other PCAOB standards, the new standard does not include paragraph .17 of the proposed standard.

2. Identifying Confirming Parties for Confirmation Requests

The 2022 Proposal provided that, to obtain reliable audit evidence from the confirmation process, the auditor should direct the confirmation requests to third parties (individuals or organizations) who are knowledgeable about the information to be confirmed. That provision was similar to existing AS 2310.26, which directs the auditor to send confirmation requests to third parties who the auditor believes are knowledgeable about the information to be confirmed, such as a counterparty who is knowledgeable about a transaction or arrangement.

When designing confirmation requests, an auditor may become aware of information about a potential confirming party's motivation, ability, or willingness to respond, or about the potential confirming party's objectivity and freedom from bias with respect to the audited entity. Because this type of information can affect the reliability of audit evidence provided by the confirming party to the auditor, the 2022 Proposal, similar to existing AS 2310.27, provided that the auditor should consider any such information that comes to the auditor's attention when selecting the confirming parties. The note to paragraph .19 of the proposed standard further emphasized that such information may indicate that the potential confirming party has incentives or pressures to provide responses that are inaccurate or otherwise misleading.³⁶

The 2022 Proposal also provided that the auditor should consider the source of any such information. For example, if management indicates to the auditor that a potential confirming party is unlikely to respond to a confirmation request, management may have other reasons to avoid a confirmation request being sent (e.g., concealing management's fraudulent understatement of the amount the company owes to that party).

In addition, the 2022 Proposal provided more specific direction than existing AS 2310 for situations in which the auditor is unable to identify a confirming party who, in response to a confirmation request, would provide relevant and reliable audit evidence about a selected item. In such a scenario, the 2022 Proposal prescribed that the auditor should perform alternative procedures.

The 2022 Proposal also provided that the auditor should determine that confirmation requests are properly addressed, thus increasing the likelihood that they are received by the confirming party. The 2022 Proposal did not prescribe the nature or extent of procedures to be performed by the auditor when making this determination, thereby allowing the auditor to tailor the procedures to the facts and circumstances of the audit. For example, in practice, some auditors compare some or all confirming party addresses, which are typically provided by the company, to physical addresses or e-mail domains included on the confirming party's website.

³⁶ See also paragraph .10 of AS 2401, *Consideration of Fraud in a Financial Statement Audit* (stating that fraud may be concealed through collusion among management, employees, or third parties, and that an auditor may receive a false confirmation from a third party that is in collusion with management); SAPA No. 8 at 12 (stating that, when using confirmation to address fraud risks in emerging markets, "the auditor should evaluate who the intended recipient of the confirmation request is and whether the company's management has an influence over this individual to provide false or misleading information to the auditor" and that "[f]or example, if the company is the only or a significant customer or supplier of the confirming entity, the staff of that entity may be more susceptible to pressure from the company's management to falsify documentation provided to the auditor").

Alternatively, when using an intermediary to facilitate direct electronic transmission of confirmation requests and responses, Appendix B of the proposed standard required the auditor to obtain an understanding of the intermediary's controls that address the risk of interception and alteration of the confirmation requests and responses and determine whether the relevant controls used by the intermediary are designed and operating effectively. We noted in the 2022 Proposal that, where an auditor determines that controls that address the risk of interception and alteration also include controls related to validating the addresses of confirming parties, the auditor may be able to determine that audit procedures performed in accordance with Appendix B are sufficient to determine that confirmation requests are properly addressed. In situations where the auditor determines that the intermediary's controls that address the risk of interception and alteration do not also include controls related to validating the addresses of confirming parties, we also noted that the auditor would need to perform other procedures to comply with the requirements of the proposed standard.

We are adopting the requirements relating to identifying confirming parties for confirmation requests as proposed, with certain modifications discussed below.

Several commenters indicated that the provisions of the proposed standard related to identifying confirming parties were sufficiently clear and appropriate. One commenter indicated that the Board should require the auditor to send confirmation requests directly to an individual, rather than allow the auditor to choose between sending the request either to an individual or an organization. In this commenter's view, sending a confirmation request directly to an individual could increase the reliability of audit evidence obtained through the confirmation process. One commenter indicated that we should amend paragraph .18 of the proposed standard to read "the auditor should direct confirmation requests to confirming parties (individuals or organizations) who are *expected to be* knowledgeable about the information to be confirmed and determine that the confirmation requests are appropriately addressed."

Because auditors often may have no or limited interaction with the personnel of confirming organizations, they may not be able to select an individual addressee for the confirmation request. As a result, we believe that allowing the auditor to address a confirmation request to an organization that is knowledgeable about the information to be confirmed is practicable and appropriate. Paragraph .20 of the proposed standard stated that the auditor should perform alternative procedures when the auditor is unable to identify a confirming party who, in response to a confirmation request, would provide relevant and reliable audit evidence about the selected item.

We have modified this language, which appears in paragraph .11 of the new standard, to emphasize that if the auditor is unable to identify a confirming party for a selected item who would provide relevant and reliable audit evidence in response to a confirmation request, including considering any information about the potential confirming party discussed in paragraph .10, the auditor should perform alternative procedures in accordance with

Appendix C. In addition, we have added a note to paragraph .11 of the new standard to reiterate that AS 1105.08 provides that the reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained.

These revisions are intended to underscore that auditors should consider information that may indicate that a potential confirming party has incentives or pressures to provide responses that are inaccurate or misleading, and remind auditors that the reliability of audit evidence depends not only on its nature and source, but also the circumstances under which it is obtained. For example, restrictions on access to a potential confirming party that cause the auditor to identify and send a confirmation request to a different confirming party or to perform alternative procedures may themselves raise questions as to the reliability of the audit evidence that the auditor subsequently obtains from the other confirming party or through performing alternative procedures. In addition, the revisions to paragraph .11 clarify that the paragraph applies to a confirming party for an individual item selected for confirmation, rather than more broadly to a group of confirming parties that might provide audit evidence with respect to relevant assertions for an entire account, such as accounts receivable.

Several commenters on the 2022 Proposal also indicated that the requirement to send a confirmation request directly to the confirming party and determine that the request is properly addressed was sufficiently clear and appropriate. One of these commenters indicated that the standard should address procedures to verify the recipient's mailing or e-mail address while the other commenters indicated there was no need to include specific procedures in the standard. Another commenter requested more guidance around verifying e-mail addresses. One commenter indicated that there should be no specific requirement to check addresses, as such a requirement would not, in the commenter's view, deter those intent on deceiving auditors. Lastly, one commenter requested clarification as to whether an auditor should send either an initial confirmation request or a second request when the auditor is aware of information that indicates that the confirming party would be unlikely to respond.

The Board continues to believe that requiring auditors to determine that confirmation requests are appropriately addressed is critically important to the effectiveness of the confirmation process. We have noted above some of the ways in which an auditor might comply with this requirement but are not including such examples in the text of the new standard to avoid the possible misinterpretation that the examples describe the only steps an auditor could take in determining whether a confirmation request is properly addressed.

With respect to one commenter's suggestion that we clarify whether an auditor should send a confirmation request if the auditor is aware of information indicating that the confirming party would not respond, we believe the new standard is sufficiently clear. Paragraph .10 of the new standard states, in part, that if the auditor is aware of information about a potential confirming party's "willingness to respond," the auditor should consider this information, including its source, in selecting the confirming parties. Further, paragraph .11 of the new standard states that, if the auditor is unable to identify a confirming party for a

selected item who would provide relevant and reliable audit evidence in response to a confirmation request, the auditor should perform alternative procedures for the selected item in accordance with Appendix C of the new standard.

3. Using Negative Confirmation Requests

There are “positive” and “negative” types of confirmation requests. A positive confirmation request is a confirmation request in which the auditor requests a confirmation response. With a negative confirmation request, the auditor requests a confirmation response only if the confirming party disagrees with the information provided in the request. The auditor generally obtains significantly less audit evidence when using negative confirmation requests than when using positive confirmation requests. A confirming party might not respond to a negative confirmation request because it did not receive or open the request, or alternatively the confirming party might have read the request and agreed with the information included therein.

Because of the limited evidence provided when using negative confirmation requests, the 2022 Proposal provided that the auditor may not use negative confirmation requests as the sole substantive procedure for addressing the risk of material misstatement to a financial statement assertion. Instead, the 2022 Proposal provided that the auditor may use negative confirmation requests only to supplement audit evidence provided by other substantive procedures (e.g., examining subsequent cash receipts, including comparing the receipts with the amounts of respective invoices being paid; examining shipping documents; examining subsequent cash disbursements; or sending positive confirmation requests). In addition, Appendix B to the proposed standard provided examples of situations in which the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence. In contrast, under existing AS 2310, the auditor may use negative confirmation requests where certain criteria are present and should consider performing other substantive procedures to supplement their use.

We are adopting the requirements for using negative confirmation requests as proposed. Most commenters on this aspect of the 2022 Proposal expressed support for the proposed prohibition on using negative confirmation requests as the sole substantive procedure with a number of commenters stating that negative confirmation requests alone do not provide sufficient appropriate audit evidence.

Another commenter suggested that the word “generally” should be removed from paragraph .21 of the proposed standard to emphasize that a negative confirmation is not as persuasive as a positive confirmation. This commenter indicated that, in situations where the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence, auditors should be required to specifically document their consideration of certain examples included in paragraph .B1 of the proposed standard.

Lastly, a few commenters indicated that additional guidance on the use of negative confirmations, and specifically on the use of substantive analytical procedures to supplement the use of negative confirmations, was needed while another commenter indicated that the examples in Appendix B would assist auditors in applying the requirements related to the use of negative confirmation requests.

After considering the comments on the 2022 Proposal, we have determined that the requirements in the 2022 Proposal relating to the use of negative confirmation requests are both appropriate and sufficiently clear. For ease of reference, the examples of situations in which the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence now appear in paragraph .13 of the new standard rather than Appendix B. We are not including in the new standard additional examples of other substantive procedures that may be used to supplement negative confirmation requests, as some commenters had suggested. While such procedures may be appropriate in some circumstances, including such examples in the new standard could be misperceived as establishing a formal checklist, whereas determining the necessary nature, timing, and extent of audit procedures that provide sufficient appropriate audit evidence would depend on the facts and circumstances of each audit.

Paragraph .12 of the new standard retains the word “generally” (i.e., “[g]enerally, the auditor obtains significantly less audit evidence when using negative confirmation requests than when using positive confirmation requests”) to acknowledge that in some circumstances using positive confirmations may not provide the auditor with the amount of evidence that the auditor planned to obtain (e.g., if the auditor does not receive responses to some or all positive confirmation requests).

E. Maintaining Control Over the Confirmation Process

See paragraphs .14 - .17 and .B1 - .B2 of the new standard in Appendix 1

1. The Requirement for the Auditor to Maintain Control over the Confirmation Process

The 2022 Proposal included a provision, consistent with AS 2310, that the auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted and altered. This is because the reliability of audit evidence provided by confirmation depends in large part on the auditor’s ability to control the integrity of confirmation requests and responses. The 2022 Proposal also provided that, as part of maintaining control, the auditor should send confirmation requests directly to the confirming party and receive confirmation responses directly from the confirming party.

We are adopting the requirements for maintaining control over the confirmation process as proposed, with one modification.

Commenters on this topic largely agreed that the auditor should maintain control over the confirmation process. One commenter stated that setting forth the requirement to maintain control over the confirmation process and the requirement to send confirmation requests directly to the confirming party in separate paragraphs might suggest that there are different responsibilities for the auditor. This commenter recommended combining the requirements to clarify that the auditor's responsibility is to send the confirmation directly while maintaining control of the process.

After considering the comments on the 2022 Proposal, we have determined that the proposed requirements are both appropriate and sufficiently clear, and we are adopting them as proposed, with the addition of a new paragraph that clarifies how an external auditor can use internal auditors in a direct assistance capacity as part of the confirmation process, as further discussed in Section III.E.3 below. Paragraph .14 of the new standard establishes the auditor's responsibility for maintaining control over the confirmation process, and the other paragraphs in this section of the new standard specify auditor responsibilities regarding certain aspects of maintaining control, as discussed below. For example, consistent with the definition of "confirmation process,"³⁷ paragraph .15 of the new standard requires that the auditor select the items to be confirmed, send the confirmation requests and receive the confirmation responses. Selecting an item involves the auditor identifying the information to be included on the confirmation request. Paragraph .16 of the new standard specifies that maintaining control over the confirmation process by the auditor involves sending the confirmation request directly to and obtaining the confirmation response directly from the confirming party.

2. Using an Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses

i. Background and Requirements

As discussed in Section III.C, certain financial institutions and other companies have adopted the policy of responding to electronic confirmation requests from auditors only through another party that they, or the auditor, engage as an intermediary to facilitate the direct transmission of information between the auditor and the confirming party. We understand that such policies are intended to facilitate the timeliness and quality of confirmation responses provided by the confirming party to the auditor.

While the involvement of intermediaries is not discussed in existing AS 2310, the use of an intermediary does not relieve the auditor of the responsibility under PCAOB standards to maintain control over confirmation requests and responses. Because an intermediary's involvement may affect the integrity of information transmitted between the confirming party

³⁷ The term "confirmation process" is defined in paragraph .A3 of the new standard as "[t]he process that involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions."

and the auditor, the 2022 Proposal provided that the auditor should evaluate the implications of such involvement for the reliability of confirmation requests and responses. Specifically, paragraphs .B2 and .B3 of the proposed standard provided that:

- The auditor’s evaluation should address certain aspects of the intermediary’s controls that address the risk of interception and alteration of communications between the auditor and the confirming party;
- The auditor’s evaluation should assess whether circumstances exist that give the company the ability to override the intermediary’s controls (e.g., through financial or other relationships); and
- The auditor should not use an intermediary if information obtained by the auditor indicates that (i) the intermediary has not implemented controls that are necessary to address the risk of interception and alteration of the confirmation requests and responses, (ii) the necessary controls are not designed or operating effectively, or (iii) circumstances exist that give the company the ability to override the intermediary’s controls.

We are adopting the proposed requirements substantially as proposed, with certain modifications discussed below.

A few commenters on the 2022 Proposal indicated that it is not clear what an “intermediary” is and requested clarification. We are not adding a definition of the term “intermediary” in the new standard as we simply intend to use the term in describing a particular scenario under the new standard where a third party is engaged by the auditor or a confirming party to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. We believe that our intent in using the term “intermediary” is sufficiently clear.

Overall, several commenters indicated that the requirements in the 2022 Proposal to evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses were appropriate. However, as discussed below, a number of these commenters and other commenters stated that additional clarity may be required to ensure that the proposed revisions are operational in practice, or otherwise requested additional guidance. Conversely, a few commenters expressed the view that requirements in the 2022 Proposal regarding the implications of using an intermediary were not appropriate or sufficiently clear. One of those commenters asserted that the requirement to assess the intermediary would result in significant additional work for auditors and that it is not currently common practice to directly assess intermediaries in this manner. As discussed in Section IV of the 2022 Proposal, firm methodologies reviewed by the staff generally include guidance on maintaining control over the confirmation process, using intermediaries to facilitate the electronic transmission of confirmation requests and responses, and assessing controls at the intermediaries. The evidence from the staff’s review does not suggest that the

requirements in Appendix B of the new standard would create significant additional work for auditors, nor did the commenters provide evidence to the contrary.

Separately, as the 2022 Proposal provided that the auditor should not use an intermediary if information obtained by the auditor indicates that certain conditions are present, several commenters stated that the presence of indicators would not necessarily mean that the intermediary is not fit for use. For example, these commenters stated that in a situation where an intermediary's control is not designed or operating effectively, an auditor may be able to obtain an understanding of whether a specific control failure impacts the confirmation process and perform tests of other controls or other procedures at the intermediary to address the control failure.

Having considered the comments, we are clarifying in paragraph .B2 of the new standard that the auditor should not use an intermediary to send confirmation requests or receive confirmation responses if the auditor determines that (1) the intermediary has not implemented controls that are designed or operating effectively to address the risk of interception and alteration of the confirmation requests and responses and the auditor cannot address such risk by performing other procedures beyond inquiry, or (2) circumstances exist that give the company the ability to override the intermediary's controls. In the 2022 Proposal, the prohibition was based on an indication, rather than determination, that such circumstances exist.

For example, when performing an evaluation required by paragraphs .17 and .B1 of the new standard, an auditor could obtain a SOC report stating that a particular access control at an intermediary is not designed or operating effectively. The auditor may then be able to identify and test other controls that could mitigate the control failure described in the SOC report. In this scenario, if the auditor determines that the identified controls are designed and operating effectively and mitigate the control failure, or the auditor has performed other procedures such as obtaining computer systems event logs generated by the intermediary that provide evidence there was no unauthorized access during the relevant period, the information in the SOC report in this scenario would not necessarily mean that the auditor is not allowed to use the intermediary under the new standard.

In addition, several commenters asserted that, if an auditor were not allowed to use an intermediary under proposed paragraph .B3 and the confirming party had a policy requiring the use of an intermediary for receiving and responding to auditor confirmation requests, an auditor may be unable to comply with the proposed requirement to confirm cash, even if relevant and reliable audit evidence were otherwise available. Considering these comments, we have modified paragraph .B2 of the new standard to state that in circumstances where the auditor, under paragraph .B2, should not use an intermediary to send confirmation requests or receive confirmation responses, the auditor should send confirmation requests without the use of an intermediary or, if unable to do so, perform alternative procedures in accordance with Appendix C of the new standard. We believe that this modification and the adoption of a

provision regarding obtaining audit evidence by directly accessing information maintained by a knowledgeable external source (see discussion in Section III.G), address commenters' concerns that an auditor may not be able to comply with the requirement to confirm cash.

Certain commenters asked for additional guidance on what procedures an auditor should or could perform to comply with the requirements in Appendix B. Having considered these comments, we determined that the new standard, consistent with the 2022 Proposal, will not specify how the auditor should perform the particular procedures required by paragraphs .B1 and .B2 regarding evaluating the implications of using an intermediary. The new standard thus allows auditors to customize their approach based on the facts and circumstances of the audit engagement and the audit firm. For example, in obtaining an understanding of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses and determining whether they are designed and operating effectively, the auditor could (i) use, where available, a SOC report that evaluates the design and operating effectiveness of the relevant controls at the intermediary; or (ii) test the intermediary's controls that address the risk of interception and alteration directly.³⁸

Some commenters asked for guidance related to an acceptable window of time to be covered by "bridge letters."³⁹ Where an auditor uses an independent service auditor's report on a service organization's controls, such procedures may involve using a bridge letter. The new standard does not specify an appropriate window of time to be covered by a bridge letter or a permissible window of time between the date covered by a bridge letter and the period when the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses. Auditors should use their professional judgment based upon the facts and circumstances of the audit to determine the nature of procedures required to comply with paragraph .B1 of the new standard, including the note to paragraph .B1(b).

One commenter stated that paragraph .B2(b) of the proposed standard should have a specific documentation requirement. We believe that adding a specific documentation requirement is not necessary, as the auditor is required to document compliance with PCAOB standards under existing documentation requirements.⁴⁰

Lastly, the new standard modifies the language of the 2022 Proposal to provide in the note to paragraph .B1(b) of the new standard that, if the auditor performs procedures to determine that the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively at an interim date, the auditor should

³⁸ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

³⁹ Some intermediaries provide a "bridge letter" or "gap letter" issued by the independent service auditor that addresses the period from the date of the service auditor's SOC report through a subsequent date, typically the most recent calendar year end.

⁴⁰ See, e.g., paragraph .05 of AS 1215, *Audit Documentation*.

evaluate whether the results of the procedures can be used “during the period in which the auditor uses the intermediary” – rather than at “period end,” as described in the proposed standard – or whether additional procedures need to be performed to update the results. We believe that the modified provision more accurately describes the timeframe during which the results of the procedures may be used by an auditor. In addition, the modified provision clarifies that the auditor should consider the nature and extent of any changes in the intermediary’s process and controls during the period between the auditor’s procedures and the period the auditor uses the intermediary.

ii. Interaction of New Standard and Proposed QC 1000

In November 2022 the Board issued for public comment a proposed quality control standard, referred to as proposed QC 1000, *A Firm’s System of Quality Control*.⁴¹ Proposed QC 1000 addresses resources used by a registered public accounting firm that are sourced from third-party providers. An intermediary that facilitates direct electronic transmission of confirmation requests and responses is one example of a “third-party provider” under proposed QC 1000.

Under proposed QC 1000, a firm would consider the nature and extent of resources or services obtained from third-party providers in its risk assessment process and whether the use of third-party providers poses any quality risks to the firm in achieving its quality objectives. One of the required quality objectives relates to obtaining an understanding of how such resources or services are developed and maintained and whether they need to be supplemented and adapted as necessary, such that their use enables the performance of the firm’s engagements in accordance with applicable professional and legal requirements and the firm’s policies and procedures.⁴²

As noted above, the proposed standard on the auditor’s use of confirmation included specific procedures related to the use of an intermediary, which included obtaining an understanding of the intermediary’s controls that address the risk of interception and alteration of a confirmation request and response and determining whether such controls are designed and operating effectively.

A few commenters on the 2022 Proposal observed that firms may obtain and evaluate SOC reports centrally, rather than requiring that individual engagement teams obtain and evaluate the reports. One of these commenters suggested clarifying in the standard that the evaluations required by Appendix B may be performed, and the documentation may be retained centrally, as part of the firm’s quality control system. Another of these commenters suggested that the requirements related to the use of an intermediary be removed entirely

⁴¹ See *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Rel. No. 2022-006 (Nov. 18, 2022).

⁴² See paragraph .44.j of proposed QC 1000.

from the proposed confirmation standard and instead be dealt with solely in the proposed quality control standards. One commenter stated that, depending on the identified quality risks, procedures performed in accordance with QC 1000 need not align with the financial statement period-end of each audit engagement performed by the firm, which the commenter asserted was implied by paragraph .B2(b) and a related note in the proposed standard. Lastly, a few commenters indicated that it would be beneficial to explicitly link the provisions of the confirmation standard regarding the use of an intermediary with QC 1000.

Having considered these comments, the Board believes that the requirements in the new standard related to the auditor's use of intermediaries, with the modifications discussed above to the requirements in the proposed standard, are sufficiently clear and appropriate. The auditor's evaluation of the intermediary's controls could be performed by an engagement team, an audit firm's national office, or a combination of both. Where the national office performs procedures relating to the intermediary (either as part of the firm's quality control activities or specifically to comply with the new standard), the engagement team would still need to consider the procedures performed by the national office and include in its audit documentation considerations specific to the individual audit engagement. For example, if a national office evaluated an intermediary's controls at an interim date, the engagement team would need to, in accordance with the note accompanying paragraph .B1(b) of the new standard, evaluate whether the results of the interim procedures could be used during the period in which the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses or whether they needed to be updated.

3. Using Internal Audit in the Confirmation Process

The 2022 Proposal identified certain activities in the confirmation process where the auditor may not use the assistance of the company's internal audit function. Under the 2022 Proposal, the auditor was not permitted to use internal auditors for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses, because using internal audit in a direct assistance capacity for such activities would not be consistent with the auditor's responsibility to maintain control over the confirmation process.

Existing AS 2310 does not include analogous provisions. It states instead that the auditor's need to maintain control does not preclude the use of internal auditors and that AS 2605, *Consideration of the Internal Audit Function*, provides guidance on considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor.⁴³

We are adopting the proposed requirements substantially as proposed, with certain modifications discussed below.

⁴³ See footnote 3 of AS 2310.

A number of commenters, including investor-related groups, firms, and firm-related groups, agreed with the requirements proposed in the 2022 Proposal as being in line with the auditor's responsibility to maintain control over the confirmation process. Additionally, a few commenters observed that it is not current practice for auditors to use internal audit in a direct assistance capacity for selecting items to be confirmed, sending confirmation requests, or receiving confirmation responses and, therefore, that the requirements in the 2022 Proposal would not result in a significant change in practice. Conversely, one commenter stated that the proposed restrictions would impact current practice as it relates to direct assistance.

A significant number of commenters, including internal auditors and companies with internal audit functions, took exception to the provision in the 2022 Proposal to limit the external auditor's use of internal auditors in a direct assistance capacity in the confirmation process, and in some instances asserted that such limitations would be inconsistent with AS 2605. Many of these commenters also challenged the statement in the 2022 Proposal that "[i]nvolving internal auditors or other company employees in these activities [selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses] would create a risk that information exchanged between the auditor and the confirming party is intercepted and altered." These commenters asserted that this language called into question internal auditors' competence, objectivity, and independence. Additionally, a few commenters expressed concern with the prescriptiveness of the proposed restrictions on the use of internal auditors in the confirmation process.

Having considered the comments received, we note that the discussion in the 2022 Proposal was not intended to cast doubt on the qualifications, competence, or objectivity of internal auditors. Internal auditors can and often do play an important role in enhancing the quality of a company's financial reporting. At the same time, we continue to believe that in order to maintain control over the confirmation process the auditor should select items to be confirmed, send confirmation requests, and receive confirmation responses.

In addition, after considering the comments received, we are (i) relocating the requirements related to the auditor's use of internal audit in the confirmation process to the section of the new standard on maintaining control over the confirmation process and (ii) rephrasing the requirements in terms of the auditor's affirmative responsibilities, by describing procedures the auditor is required to perform. In contrast, the proposed standard described procedures that internal auditors were not allowed to perform. As stated in footnote 7 of the new standard, auditors are permitted to use internal auditors in accordance with AS 2605, except for selecting items to confirm, sending confirmation requests, and receiving confirmation responses. The new standard does not impose any new limitations on how the internal auditors' work may affect the external auditor's audit procedures.⁴⁴ Instead, the new

⁴⁴ AS 2605.12 states that "the internal auditor's work may affect the nature, timing, and extent of the audit," including "procedures the auditor performs when obtaining an understanding of the entity's

standard clarifies how an external auditor can use internal auditors in a direct assistance capacity as part of the confirmation process.⁴⁵

F. Evaluating Confirmation Responses and Confirmation Exceptions, and Addressing Nonresponses and Incomplete Responses

See paragraphs .18 - .23 of the new standard in Appendix 1

1. Overall Approach

Under the 2022 Proposal, the auditor's responsibilities related to the confirmation process included evaluating the information received in confirmation responses and addressing nonresponses and incomplete responses. The 2022 Proposal provided that if the auditor is unable to determine whether the confirmation response is reliable, or in the case of a nonresponse or an incomplete response (i.e., one that does not provide the audit evidence the auditor seeks to obtain), the auditor should perform alternative procedures.⁴⁶ The 2022 Proposal built upon requirements in existing AS 2310 that discuss addressing information obtained from the performance of confirmation procedures.

The relevant requirements in the new standard include certain modifications to the approach in the 2022 Proposal, as discussed in the sections below.

2. Evaluating the Reliability of Confirmation Responses

The 2022 Proposal was intended to provide additional direction beyond what is set forth in existing AS 2310 to assist the auditor's evaluation of the reliability of confirmation responses. Specifically, the 2022 Proposal (i) described information that the auditor should take into account when performing the evaluation, and (ii) provided examples of indicators that a confirmation response may have been intercepted or altered and thus may not be reliable. In particular, the 2022 Proposal provided that the auditor should take into account any information about events, conditions, or other information the auditor becomes aware of in assessing the reliability of the confirmation response.

Under existing PCAOB standards, the auditor is not expected to be an expert in document authentication but, if conditions indicate that a document (e.g., a confirmation response) may not be authentic or may have been altered, the auditor should modify the planned audit procedures or perform additional audit procedures to respond to those

internal control (paragraph .13)," "procedures the auditor performs when assessing risk (paragraphs .14 through .16)," and "substantive procedures the auditor performs (paragraph .17)."

⁴⁵ AS 2605.27 discusses how the auditor may use internal auditors to provide direct assistance.

⁴⁶ Alternative procedures, including the relevant exception described in Appendix C of the new standard, are discussed in Section III.H of this release.

conditions and should evaluate the effect, if any, on the other aspects of the audit.⁴⁷ The 2022 Proposal did not alter these requirements, but specified for the confirmation process that, if the auditor were unable to determine that the confirmation response is reliable, the auditor's response should include performing alternative procedures.

The requirements for evaluating the reliability of confirmation responses are being adopted substantially as proposed.

Several commenters indicated that the provisions of the 2022 Proposal related to evaluating the reliability of confirmation responses were clear and appropriate. One commenter proposed modifications to the proposed requirements, including replacing the words "taking into account" with "considering" in paragraph .25 of the proposed standard to reflect the commenter's perceived intent of the Board. One commenter asserted that paragraph .25 of the proposed standard could result in onerous documentation requirements in situations where there is a clear reason why a particular indicator is not necessarily indicative of interception or alteration of a confirmation request or confirmation response (e.g., a confirmation request is sent to a general e-mail account but returned from an e-mail account belonging to an individual monitoring the general e-mail account). Another commenter proposed that we remove one of the examples of indicators that a confirmation response may have been intercepted or altered because it appeared to create a de facto requirement that an auditor treat a confirmation response as not reliable if the original confirmation request is not returned with the confirmation response.

In addition, one commenter suggested modifying proposed paragraph .26 of the proposed standard to provide that the auditor should perform alternative procedures if the auditor became aware of any of the factors identified in paragraph .25 and was unable to overcome those factors to determine that the confirmation response is reliable. Another commenter stated that the proposed standard should acknowledge that, in certain specified circumstances, an unreliable confirmation would likely result in a scope limitation.

Having considered the comments received, we note that assessing the reliability of confirmation responses is a critical component of the confirmation process. If indicators of interception or alteration are present, it is important for the auditor to address them. When the auditor follows up on a particular indicator, an auditor may determine that the confirmation requests and responses have not been intercepted or altered. For example, an auditor could verify that a difference in the confirming party's e-mail address between the confirmation request and confirmation response occurred because the confirming party responds to confirmation requests from one central e-mail address. The note to paragraph .18 of the new standard (paragraph .25 of the proposed standard) provides examples of information that the auditor should take into account if the auditor becomes aware of it. Under PCAOB standards, the auditor would document the procedures performed in response to information that

⁴⁷ See AS 1105.09.

indicates that a confirmation request or response may have been intercepted or altered. To minimize any confusion, we replaced the word “indicator” in the note with the phrase “information that indicates,” which has the same meaning.

In addition, to clarify that the auditor performs alternative procedures for the selected item if the auditor is unable to determine that a confirmation response regarding that item is reliable, we have added the phrase “for the selected item” after the words “alternative procedures” in paragraph .19 of the new standard. We also revised the reference in paragraph .26 of the proposed standard to performing alternative procedures “as discussed in paragraph .31” to “in accordance with Appendix C” in paragraph .19 of the new standard to reflect that alternative procedures for a selected item may not be necessary under certain circumstances, as discussed in Section III.H below, and to reflect the relocation of the more detailed discussion of alternative procedures from the body of the standard to Appendix C.

AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, sets forth requirements regarding limitations on the scope of an audit,⁴⁸ including scope limitations relating to confirmation procedures with respect to accounts receivable.⁴⁹ One example of such a scope limitation would be the auditor’s inability to confirm accounts receivable balances combined with an inability to perform other procedures in respect of accounts receivable to obtain sufficient appropriate audit evidence. The new standard does not repeat such existing requirements, as doing so would merely duplicate those requirements.

3. Evaluating Confirmation Exceptions and Addressing Nonresponses and Incomplete Responses

For various reasons, information in a confirmation response received by the auditor could differ from other information in the company’s records obtained by the auditor. The 2022 Proposal provided that the auditor should evaluate the confirmation exceptions and determine their implications for certain aspects of the audit, as discussed below. The direction in the 2022 Proposal was more detailed than in existing AS 2310.

In particular, the 2022 Proposal provided that the auditor should evaluate whether confirmation exceptions individually or in the aggregate indicate a misstatement that should be evaluated in accordance with AS 2810. The 2022 Proposal did not, however, require investigating all confirmation exceptions to determine the cause of each confirmation exception. The 2022 Proposal also included a provision that the auditor should evaluate whether the confirmation exceptions individually, or in the aggregate, indicate a deficiency in the company’s internal control over financial reporting (“ICFR”).

⁴⁸ See AS 3105.05-.15.

⁴⁹ See AS 3105.07.

With regards to nonresponses and potential nonresponses, the 2022 Proposal provided that the auditor should send a second positive confirmation request to the confirming party unless the auditor has become aware of information that indicates that the confirming party would be unlikely to respond to the auditor. Additionally, the 2022 Proposal specified that if a confirmation response is returned by the confirming party to anyone other than the auditor, the auditor should contact the confirming party and request that the response be re-sent directly to the auditor. If the auditor does not subsequently receive a confirmation response from the intended confirming party, the 2022 Proposal provided that the auditor should treat the situation as a nonresponse.

Further, in contrast with existing AS 2310, which does not address the auditor's responsibilities regarding incomplete responses, the 2022 Proposal provided that the auditor should perform alternative procedures if a confirmation response is not received or is incomplete.

We are adopting the requirements for evaluating confirmation exceptions and addressing nonresponses as proposed, with certain modifications discussed below.

Some commenters indicated that the proposed provisions regarding evaluating confirmation exceptions and addressing nonresponses were sufficiently clear and appropriate. A few commenters stated that we should include requirements that limit an auditor's ability to assess confirmation exceptions as merely "isolated exceptions." Similarly, one commenter asserted that we should require auditors to resolve any confirmation exceptions by examining other third-party evidence such as purchase orders. In light of these comments, we have added a new note to paragraph .20 of the new standard that states that determining that a confirmation exception does not represent a misstatement that should be evaluated in accordance with AS 2810 generally involves examining external information, which may include information that the company received from knowledgeable external sources.

In our view, in many circumstances examining external evidence under the above provision is necessary, as doing so is consistent with both the goal of obtaining relevant and reliable audit evidence and the type of audit evidence sought from confirmation. For example, an auditor might send a confirmation request for a selected item to a knowledgeable confirming party regarding a \$20,000 accounts receivable invoice and the confirming party (i.e., the customer) indicates that the outstanding balance for this invoice at the date specified in the confirmation request is \$18,000. Having investigated the \$2,000 difference, the auditor learns that it does not represent a misstatement, as the customer overpaid for a different invoice but applied the overpayment to the invoice selected for confirmation and the company applied the overpayment differently. In this scenario, determining that there is not a \$2,000 misstatement for the selected item would involve the auditor examining audit evidence from knowledgeable external sources, such as applicable purchase orders and customer cash payments, in addition to information generated by the company, such as customer invoices.

The note to paragraph .20 of the new standard uses the word “generally” to acknowledge that in some circumstances examining external audit evidence may not be necessary. For example, an auditor may have included an incorrect figure in the confirmation request and later determined that the amount confirmed by the confirming party agrees to the amount in the company’s general ledger. Determining that such a confirmation exception does not represent a misstatement to be evaluated in accordance with AS 2810 would not require examining audit evidence from external sources.

One commenter suggested that we consider reminding auditors that, when using audit sampling, the auditor should project the misstatement results of the sample to the items from which the sample was selected in accordance with AS 2315. We considered this comment, but did not add a reminder regarding projecting the results of a sample as the new standard states in footnote 4 that AS 2315 addresses evaluating audit samples.

One commenter suggested that we restructure paragraph .27 of the proposed standard, as the auditor generally considers whether a confirmation exception is a misstatement and then determines whether there is a deficiency in internal control. In consideration of this comment, we have restructured paragraph .20 of the new standard to align with the typical order in which the auditor considers the two matters discussed therein (i.e., an auditor typically considers whether a confirmation exception indicates a misstatement that should be evaluated in accordance with AS 2810, *Evaluating Audit Results*, and then considers whether the confirmation exception represents a deficiency in the company’s ICFR).

One commenter expressed the view that we should not require auditors to evaluate whether a confirmation exception constitutes a control deficiency if the exception was a result of a clerical error or caused by a timing difference. We continue to believe that requiring the auditor to evaluate exceptions in such circumstances is appropriate and the auditor should consider whether all confirmation exceptions are control deficiencies. A clerical error or timing difference could be indicative of a deficiency in a company’s ICFR.

One commenter indicated that the proposed requirement about sending a second positive confirmation request unless the auditor has become aware of information that indicates that the confirming party would be unlikely to respond to the auditor was sufficiently clear and appropriate. However, several firms commented that the requirement was too prescriptive, with one commenter asserting that the requirement could result in unnecessary and potentially ineffective administrative effort. Additionally, a few commenters expressed concern that following up on a confirmation request would not constitute sending a second confirmation request under the proposed standard, but asserted that it should be so treated.

We considered the comments about the requirement to send a second positive confirmation request. The use of confirmation is not required under the new standard other than for cash and accounts receivable when they are significant accounts or disclosures. Under the new standard, for cash and accounts receivable, the auditor may perform other audit procedures to obtain audit evidence by directly accessing information maintained by a

knowledgeable external source. Further, for accounts receivable, in certain situations the new standard allows the auditor to obtain external information indirectly (see discussion of cash and accounts receivable in Section III.G).

Because the auditor may have a choice of the audit procedure to perform, we believe that the auditor will select confirmation in those situations where confirming parties will be more likely to respond to the auditor. In situations where a confirming party does not respond to a confirmation request, we have concluded it is appropriate to require the auditor, in the case of a nonresponse to a positive confirmation request, to follow up with the confirming party. The requirement to follow up with the confirming party is included in paragraph .21 of the new standard. The new standard does not prescribe a form of the auditor's follow-up. For example, following up using the same form of communication as in the original confirmation request (e.g., e-mail, direct electronic transmission facilitated by an intermediary) would be appropriate under the new standard. In the case of an electronic confirmation request, a follow-up request could be in the form of a reminder or automated reminder.

If the auditor subsequently receives a confirmation response, the new standard provides that the auditor should evaluate that response in accordance with paragraphs .18-.19 and evaluate any confirmation exception in accordance with paragraph .20. If the auditor's follow-up does not elicit a confirmation response, paragraph .23 of the new standard instructs the auditor to perform alternative procedures for the selected item in accordance with Appendix C of the new standard.

To clarify that the auditor performs alternative procedures for the selected item, we have added the phrase "for the selected item" after the words "alternative procedures" in paragraph .23 of the new standard. We also revised the reference in paragraph .30 of the proposed standard to performing alternative procedures "as discussed in paragraph .31" to refer to "in accordance with Appendix C" in paragraph .19 of the new standard to reflect that alternative procedures for a selected item may not be necessary under certain circumstances, as discussed in Section III.H below, and to reflect the relocation of the more detailed discussion of alternative procedures from the body of the standard to Appendix C.

G. Additional Considerations for Cash, Accounts Receivable, and Terms of Certain Transactions

See paragraphs .24 - .30 of the new standard in Appendix 1

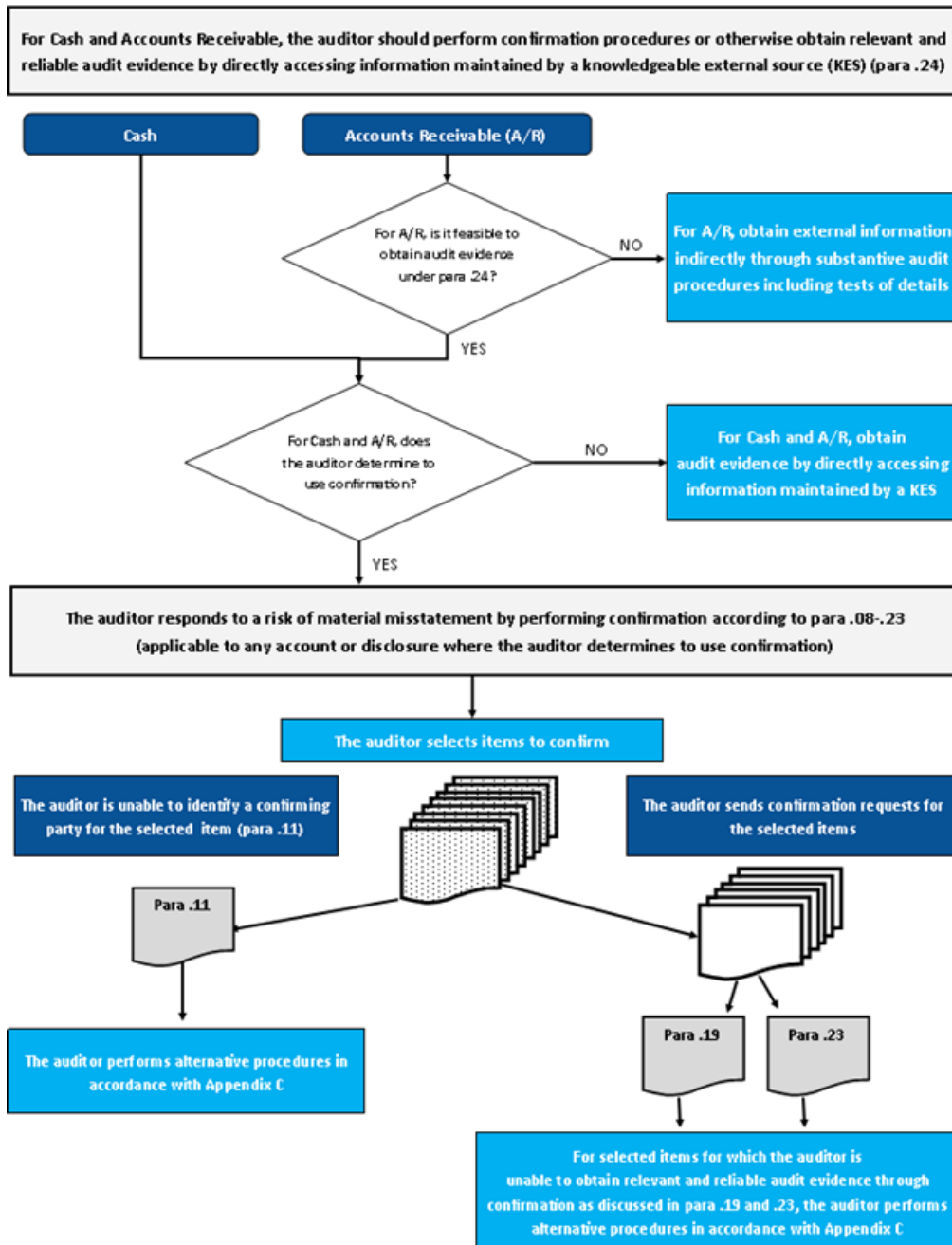
In general, evidence obtained from a knowledgeable external source is more reliable than evidence obtained only from internal company sources. When cash or accounts receivable are significant accounts, there is a presumption in the new standard that the auditor should obtain audit evidence from a knowledgeable external source by performing confirmation procedures or using other means to obtain audit evidence by directly accessing information maintained by knowledgeable external sources. In addition, the new standard addresses other situations in which the auditor should consider the use of confirmation.

We discuss below the provisions of the new standard relating to confirming cash held by third parties, confirming accounts receivable, performing other audit procedures for accounts receivable when obtaining audit evidence directly from a knowledgeable external source would not be feasible, communicating with the audit committee in certain situations, and confirming the terms of certain other transactions. To improve the flow of the requirements in the new standard, these provisions have been placed after the general provisions that describe the auditor's responsibilities related to the confirmation process (i.e., after paragraphs .08-.23).

Figure 1 depicts the relationship of the requirements in the new standard for cash and accounts receivable when they are significant accounts (paragraphs .24-.28) to the general provisions of the new standard applicable to the confirmation process (paragraphs .08-.23).⁵⁰

⁵⁰ The information in Figure 1 is intended to be for illustrative purposes and is not a substitute for the new standard; only the new standard provides the auditor with the definitive requirements.

Figure 1 - Additional Considerations for Cash and Accounts Receivable



1. Cash Held by Third Parties

i. Confirming Cash

The 2022 Proposal provided that the auditor should perform confirmation procedures when auditing cash and cash equivalents held by a third party. Existing AS 2310 does not address auditor responsibilities for confirming cash.

We noted in the 2022 Proposal that an auditor need not necessarily confirm all cash accounts in all cases. Under PCAOB standards, the alternative means of selecting items for testing are selecting all items, selecting specific items, and audit sampling.⁵¹ An auditor selects individual cash items to confirm following the relevant direction in PCAOB standards, including identifying and assessing the risk of misstatement and developing an audit response.⁵² The particular means or combination of means of selecting cash items to confirm depend on, for example, the characteristics of the cash items and the evidence necessary to address the assessed risk of material misstatement.⁵³

The 2022 Proposal emphasized that, in selecting the individual items of cash to confirm, the auditor should take into account the auditor's understanding of the company's cash management and treasury function, and the substance of the company's arrangements and transactions with third parties. For example, an auditor might select bank accounts with balances over a certain amount, accounts with a high volume of transactions, accounts opened or closed during the period under audit, or accounts the auditor identifies as particularly risk-prone. Alternatively, the auditor might determine it is appropriate to confirm all cash accounts. The auditor also follows the direction in PCAOB standards when determining whether performing procedures in addition to confirmation is necessary to address the assessed risk of material misstatement relating to cash.⁵⁴

We are adopting the proposed requirements to confirm cash, with certain modifications discussed below.

A number of commenters supported the proposed requirement for the auditor to confirm cash held by third parties. Some of these commenters stated that confirming cash has long been an audit best practice and that requiring cash confirmation would lead to more consistency in practice. In addition, several commenters stated that the standard was sufficiently risk-based (i.e., by allowing the auditor to select cash accounts and other financial relationships to confirm based on the risk of material misstatement associated with cash).

⁵¹ See AS 1105.22.

⁵² See, e.g., AS 2110 and AS 2301.

⁵³ See AS 1105.23 and AS 2301.03.

⁵⁴ See, e.g., AS 2301.09.

Several commenters asserted that a requirement to confirm cash was not sufficiently risk-based, despite the provisions in the 2022 Proposal that described that the auditor should take into account their understanding of the company's operations in making selections of individual cash items to confirm. In particular, several commenters stated that the proposed standard would require an auditor to confirm cash without regard to the level of risk that the auditor had determined for cash in their risk assessment or when other audit procedures could produce sufficient appropriate audit evidence. Other commenters expressed the view that the requirement to confirm cash, as well as accounts receivable, should be removed, with some of these commenters suggesting that the auditor should be able to determine the audit procedure that would be most effective in obtaining relevant and reliable audit evidence, without confirmation being the "default" procedure.

The Board continues to believe that a presumption to confirm cash is appropriate. As discussed in Section II.C, this presumption to confirm cash is consistent with current practice. Consistent with the objective of the new standard, the requirement to confirm cash, as well as accounts receivable, only applies when the auditor has determined that these accounts are significant accounts.

With respect to confirming cash, many commenters, primarily firms and firm-related groups, expressed concern that the 2022 Proposal did not contain a provision about overcoming the presumption to confirm cash. A number of commenters also expressed the view that auditors could obtain direct-access view of bank information (or would be able to do so in the future), which could provide a more effective means of directly obtaining external evidence than sending a confirmation.

We agree that if the auditor is able to perform other audit procedures that allow the auditor to obtain audit evidence by directly accessing information maintained by knowledgeable external sources, such audit evidence would be at least as persuasive as audit evidence obtained through confirmation procedures. We therefore added to the presumption to confirm cash (and accounts receivable) in the new standard the phrase "or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source."

By way of example, the auditor might satisfy this requirement to obtain relevant and reliable audit evidence under the new standard by obtaining read-only access to information maintained by a financial institution concerning its transactions or balances with the company directly online through a secure website of the financial institution using credentials provided to the auditor by the financial institution.

ii. The Term "Cash and Cash Equivalents Held by Third Parties"

The 2022 Proposal provided that the term "cash" comprised both cash and cash equivalents. Cash equivalents generally refer to short-term, highly liquid investments that are readily convertible to known amounts of cash and are so near their maturity that they present

insignificant risk of changes in value because of changes in interest rates.⁵⁵ Such assets are commonly used by companies to manage their cash holdings. The 2022 Proposal also described that the requirements for confirming cash would apply to cash held by third parties, and not limited to cash held by financial institutions. In the Board's view, this expansion of confirmation requirements was appropriate, as company funds can be held by third parties other than financial institutions, such as money transfer providers.

We are adopting this provision as proposed in the 2022 Proposal.

There was one comment related to this aspect of the 2022 Proposal, suggesting that the new standard should specify that "third parties" are not limited to financial institutions. We believe the reference to "third parties" was sufficiently clear as proposed and, accordingly, have not expanded this description.

iii. Confirming Other Financial Relationships

The 2022 Proposal provided that the auditor should consider confirming other financial relationships with the third parties with which the auditor determines to confirm cash. Such relationships can include lines of credit, other indebtedness, compensating balance arrangements, or contingent liabilities, including guarantees. As proposed, the auditor would be required under PCAOB standards to document the consideration given to the confirmation of other financial relationships and the conclusions reached.⁵⁶ Existing AS 2310 does not have an analogous requirement to confirm other financial relationships.

We are adopting this provision as proposed, with certain modifications discussed below.

Several commenters stated that the requirements for the auditor to consider confirming other financial relationships were clear. One commenter suggested that confirming other financial relationships should be required, and that overcoming the presumption to confirm

⁵⁵ See, e.g., definition of "cash equivalents" in the Master Glossary of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification and of "cash equivalents" in the International Financial Reporting Standards ("IFRS").

⁵⁶ See Note to PCAOB Rule 3101(a)(3), which states that "(i)f a Board standard provides that the auditor "should consider" an action or procedure, consideration of the action or procedure is presumptively mandatory, while the action or procedure is not," and AS 1215.05-.06 (audit documentation should "[d]emonstrate that the engagement complied with the standards of the PCAOB" and must "document the procedures performed ... with respect to relevant financial statement assertions"). See also *Audit Documentation and Amendment to Interim Auditing Standards*, PCAOB Rel. No. 2004-006 (June 9, 2004), at 3 ("the auditor documents not only the nature, timing, and extent of the work performed, but also the professional judgments made by members of the engagement team and others").

should be available only when the financial entity with which the company does business does not offer services that would give rise to other financial relationships.

A number of commenters asserted that auditors would be required to produce additional documentation of their considerations, even when a financial relationship(s) is not an area of significant risk of material misstatement. Some commenters recommended that the provision that the auditor “should consider” other financial relationships be changed to “may consider,” in order to allow for more auditor judgment in determining the audit procedures to perform.

The Board continues to believe that information about financial relationships, including off-balance sheet relationships, could be important for the audit, as it could be part of significant disclosures in a company’s financial statements. Accordingly, paragraph .29 of the new standard provides that, in addition to obtaining audit evidence from a knowledgeable external source regarding cash in accordance with paragraph .24, the auditor should consider sending confirmation requests to that source about other financial relationships with the company, based on the assessed risk of material misstatement. The phrase “based on the assessed risk of material misstatement” was added to clarify that the auditor has flexibility in tailoring audit procedures to the level of assessed risk (e.g., by including or not including confirmation in the audit response based on the auditor’s assessed risk of material misstatement of other financial relationships). In addition, paragraph .29 retains the examples of other financial relationships that were included in the 2022 Proposal.

2. Accounts Receivable

i. Confirming Accounts Receivable

The 2022 Proposal carried forward the requirement in existing AS 2310 to confirm accounts receivable. Similar to existing AS 2310, the 2022 Proposal did not specify the extent of confirmation procedures for accounts receivable. As noted above in Section III.C, the timing and extent of confirmation procedures are part of the auditor’s response to the risks of material misstatement under PCAOB risk assessment standards. The 2022 Proposal instead required 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. For example, an auditor might assess the risk of material misstatement relating to accounts receivable higher for a company that is being audited for the first time by the auditor, or for accounts receivable from a newly acquired operation in a foreign location.

We are adopting the proposed requirements to confirm accounts receivable, with certain modifications discussed below.

Most commenters on this aspect of the 2022 Proposal generally supported the retention of a presumption to confirm accounts receivable, and most of those commenters

stated that the requirement for the auditor to confirm accounts receivable was sufficiently clear and appropriate. Two investor-related groups stated that confirmation of cash and accounts receivable was necessary, in their view, to obtain persuasive, sufficient, and competent audit evidence.

On the other hand, a number of commenters, primarily firms and firm-related groups, expressed concerns about carrying forward the presumption for auditors to confirm accounts receivable from existing AS 2310. The common theme of those commenters was that requiring the auditor to use confirmation for certain accounts may not allow the auditor to exercise professional judgment in determining an appropriate response to the assessed risk of material misstatement for those accounts.

Regarding the selection of accounts receivable to confirm, several commenters agreed that the 2022 Proposal was sufficiently principles-based to allow auditors to use professional judgment in determining the extent of confirmation of accounts receivable.

The Board continues to believe that a presumption to confirm accounts receivable is appropriate to emphasize that audit evidence obtained from a knowledgeable external source is generally more reliable than evidence obtained only from internal company sources. Consistent with the objective of the new standard, the requirement to confirm cash and accounts receivable, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, only applies when the auditor has determined that these accounts are significant accounts.

As with cash balances discussed above, we believe that when the auditor is able to perform other audit procedures to obtain audit evidence about accounts receivable by directly accessing information maintained by knowledgeable external sources (e.g., information maintained by the receivable counterparty), such evidence would be at least as persuasive as audit evidence through confirmation procedures. We therefore added to the presumption to confirm cash and accounts receivable in the new standard the phrase “or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.”

Audit evidence that an auditor obtains by accessing a third party’s information directly can be at least as persuasive as audit evidence obtained through confirmation procedures because the auditor is able to observe first-hand the information providing such evidence. As technology continues to develop, we believe it is important for the new standard to reflect that there may be additional opportunities for the auditor to obtain audit evidence directly beyond sending a confirmation request. The new standard would allow for future innovations in audit techniques that might involve the auditor obtaining evidence for accounts receivable by directly accessing information maintained by a counterparty or other knowledgeable external source. As noted in the new standard, consistent with selecting a confirming party, when selecting the knowledgeable external source providing the auditor with access to information directly, the auditor would be required to consider whether the knowledgeable external source would have

any incentive or pressure to provide the auditor with access to information directly that is inaccurate or otherwise misleading.

Section III.G.3 below addresses situations where it would not be feasible for the auditor to obtain audit evidence for accounts receivable directly from a knowledgeable external source, through confirmation procedures or other means.

ii. The Term “Accounts Receivable”

The 2022 Proposal described “accounts receivable” as comprising receivables arising from the transfer of goods or services to a customer or from a financial institution’s loans. Existing AS 2310 describes accounts receivable as the entity’s claims against customers that have arisen from the sale of goods or services in the normal course of business, and a financial institution’s loans. The 2022 Proposal was designed to apply to the same types of items as existing AS 2310, with a modified description to align more closely with the terminology of current accounting requirements, which have been updated since existing AS 2310 was written.⁵⁷

We are adopting this provision as proposed.

Commenters on this aspect of the 2022 Proposal stated that the description of accounts receivable was clear. These commenters also noted that there was no need to further broaden the description to include additional types of receivables.

The description of accounts receivable in the new standard includes receivables that arise from the transfer of goods or services to a customer. These types of receivables generally arise from the company’s ordinary revenue-generating activities, and include items for which revenue has been or will be recognized by a company, such as receivables from selling manufactured products or providing a service to customers. The description of accounts receivable also includes a financial institution’s loans, including loans to customers that the institution has originated or purchased from another institution. Examples of financial institutions are banks, non-bank lenders, and mortgage companies that provide financing to customers.

3. Situations When Obtaining Audit Evidence for Accounts Receivable Directly Would Not Be Feasible

i. Performing Other Substantive Procedures, Including Tests of Details

In the 2022 Proposal, the presumption to confirm accounts receivable could be overcome when the auditor determined that an audit response that only included substantive

⁵⁷ See, e.g., FASB Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers*, and IFRS 15, *Revenue from Contracts with Customers*.

audit procedures other than confirmation would provide audit evidence that is at least as persuasive as evidence the auditor might expect to obtain through performing confirmation procedures. The 2022 Proposal did not carry forward the provisions in existing AS 2310 addressing overcoming the presumption to confirm accounts receivable under certain conditions, which are (i) immateriality, (ii) ineffectiveness of confirmation, or (iii) a certain combination of the assessed risk and expected results from other auditing procedures.⁵⁸

As discussed below, the new standard includes a provision to address situations when obtaining audit evidence directly from knowledgeable external sources, whether through confirmation procedures or other means, would not be feasible to execute.

Many commenters addressed the provision in the 2022 Proposal to overcome the presumption to confirm accounts receivable. A few commenters noted that the ability to overcome the presumption to confirm accounts receivable was clear and appropriate. As discussed below, many commenters focused on the proposed provision that evidence obtained through other substantive procedures should be “at least as persuasive as” evidence obtained through confirmation:

- A number of investor-related groups stated that the provision gave too much leeway to auditors to overcome the presumption to confirm accounts receivable. These commenters asserted that exceptions to confirming accounts receivable should only be available when other audit procedures would provide more persuasive or greater accumulated evidence than that obtained through confirmation. These commenters recommended additional requirements, such as allowing the auditor to overcome the presumption only if they document the evidence and basis for their conclusion and have communicated the conclusion to the audit committee and investors.
- Several firms and firm-related groups stated that the relevant provisions were not clear or more guidance would be needed about overcoming the presumption to confirm accounts receivable when other substantive procedures would be “at least as persuasive as” the evidence expected to be obtained through confirmation. A few commenters observed that the absence of a definition of the term “persuasive” in AS 1105 contributed to a lack of clarity as to the Board’s expectations and requested more guidance about how to measure or evaluate persuasiveness. Several commenters emphasized that, rather than focus the requirement for overcoming the presumption to confirm accounts receivable on whether audit evidence obtained through audit procedures other than confirmation is “at least as persuasive as” evidence expected to be obtained through confirmation, we should focus the requirement on obtaining evidence that is sufficient and appropriate to address the assessed risk of material misstatement or, as one commenter suggested, on the reliability of the audit evidence.

58

See AS 2310.34.

- Several commenters suggested that the Board retain provisions similar to those in existing AS 2310.34 for allowing the auditor to overcome the presumption to confirm accounts receivable. In addition, several firms and firm-related groups suggested that the auditor's ability to overcome the presumption to confirm should be based on risk assessment, similar to the provision in existing AS 2310 addressing when the assessed level of inherent and control risk is low.
- Many firms and firm-related groups expressed concern that the criteria for overcoming the presumption would result in auditors having to use confirmation even in situations where historically confirmations were determined by the auditor to be ineffective and not to provide persuasive audit evidence.
- One commenter stated that, if the proposed language were adopted, auditors would likely default to confirming accounts receivable over other audit procedures to avoid second-guessing of their determinations of the persuasiveness of audit evidence.
- Several commenters, primarily firms and firm-related groups, stated that the 2022 Proposal imposed a higher threshold than the existing standard for auditors to overcome the presumption to confirm accounts receivable without a corresponding increase to audit quality.

As previously discussed, the new standard creates a presumption that the auditor performs confirmation procedures or otherwise obtains relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. Under PCAOB standards, in general, evidence obtained directly by the auditor from a knowledgeable external source is more reliable than evidence obtained indirectly.⁵⁹ However, the Board appreciates that there are instances where the auditor determines that performing confirmation procedures in response to a risk of material misstatement related to accounts receivable would not be feasible. For example, commenters described situations involving a history of low response rates to confirmation requests in certain industries (e.g., healthcare, utilities), or where customers have been advised by a government agency to avoid providing personal or financial information in response to an unexpected request. The Board further understands that companies in other industries (e.g., large retailers, defense and aerospace companies that contract with the federal government) do not, as a matter of policy, respond to confirmation requests. There may also be instances in which the performance of confirmation procedures would not result in reliable audit evidence.

Accordingly, paragraph .25 allows the auditor to perform other substantive procedures in response to a risk of material misstatement, as long as such procedures include tests of details, if the auditor determines it is not feasible to obtain audit evidence directly from a knowledgeable external source pursuant to paragraph .24. Paragraph .25 specifically provides

⁵⁹

See AS 1105.08.

that the auditor's determination should be based on the auditor's experience, such as prior years' audit experience with the company or experience with similar engagements where the auditor did not receive confirmation responses, and the auditor's expectation of similar results if procedures were performed pursuant to paragraph .24. Any such determination would be performed as part of conducting the audit based on the available facts and circumstances at that time and properly supported in the audit documentation for the engagement.⁶⁰ In addition, as described below, for significant risks associated with accounts receivable, the auditor would be required to communicate with the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

This provision replaces the concept in the 2022 Proposal about obtaining audit evidence that was "at least as persuasive as" the evidence expected to be obtained through confirmation procedures. It also specifies that the auditor should perform other substantive procedures, including tests of details, in these situations to make clear that performing only substantive analytical procedures would not be sufficient to overcome the presumption to confirm. These other substantive procedures should involve obtaining external information indirectly.

For accounts receivable, the auditor may be able to satisfy this requirement by obtaining information that is in the company's possession that the company received from one or more knowledgeable external sources.⁶¹ Examples of such external information may include, for example, subsequent cash receipts, shipping documents from third-party carriers, customer purchase orders, or signed contracts and amendments thereto. This information may be in electronic form (e.g., a purchase order initiated by a customer through a company's website) or in paper form (e.g., a signed contract).

Conversely, when performing other substantive procedures under this provision, it would not satisfy the requirements of the new standard to use or rely solely on the company's internally produced information. For example, an audit procedure that involves an automated matching analysis of a company's revenue, accounts receivable, and cash journal entries recorded by the company would be insufficient on its own because such an analysis only involves the company's internally produced information. On the other hand, when such internally produced information is evaluated in conjunction with external information that the company received from a knowledgeable external source, such as checks that the company received directly from customers or information on subsequent cash receipts that the company

⁶⁰ See AS 1215.05.

⁶¹ See also *Proposed Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form*, PCAOB Rel. No. 2023-004 (June 26, 2023) (proposing amendments to PCAOB auditing standards to specify auditor responsibilities regarding certain company-provided information that the auditor uses as audit evidence, including information that the company received from external sources).

received from a financial institution, the procedures would involve audit evidence from a knowledgeable external source.

Under existing PCAOB standards, the quantity of audit evidence needed is affected by its quality, including its reliability, and in general evidence obtained directly by the auditor is more reliable than evidence obtained indirectly. This applies to all information (including external information) used by the auditor in arriving at the conclusions on which the auditor's opinion is based. For example, as the quality of the evidence increases, the need for additional corroborating evidence decreases. The auditor should be mindful of these requirements when determining an appropriate audit response to a risk of material misstatement that involves obtaining external information indirectly under the new standard.

Further, when performing audit procedures that involve obtaining external information, the auditor should be mindful of other relevant PCAOB standards that address the documentation of the procedures performed and the relevance and reliability of the audit evidence obtained.⁶² Audit documentation must clearly demonstrate the work performed by the auditor. In addition, the reliability of that audit evidence depends on the nature and source of the evidence and the circumstances under which it is obtained.

ii. Communicating with the Audit Committee About the Auditor's Response to Significant Risks for Cash and Accounts Receivable

The 2022 Proposal included a requirement for the auditor to communicate to the audit committee⁶³ instances where the auditor had determined that the presumption to confirm accounts receivable had been overcome. In proposing that requirement, the Board considered the long-standing practice by auditors in the United States to confirm accounts receivable, and noted that a communication requirement when the presumption to confirm is overcome could enhance the audit committee's understanding of the auditor's strategy. In this regard, existing standards require the auditor to communicate to the audit committee about the auditor's overall audit strategy, significant risks identified during risk assessment procedures, significant changes to the planned audit strategy, and significant difficulties encountered during the audit.⁶⁴ Existing AS 2310 does not have a requirement to communicate to the audit committee about overcoming the presumption to confirm accounts receivable.

The new standard contains a requirement for the auditor to communicate with the audit committee about the auditor's response to significant risks associated with cash or accounts receivable when the auditor did not perform confirmation procedures or otherwise

⁶² See, e.g., AS 1215.05-.06 and AS 1105.07-.08.

⁶³ The term "audit committee," as used in the new standard, has the same meaning as defined in Appendix A of AS 1301, *Communications with Audit Committees*.

⁶⁴ See AS 1301.09, .11, .23.

obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

Several commenters, primarily investor-related groups, supported the proposed requirement in the 2022 Proposal that the auditor communicate to the audit committee when an auditor overcomes the presumption to confirm accounts receivable. One of the commenters referred to a statement in the 2022 Proposal that a requirement to communicate to the audit committee when overcoming the presumption to confirm accounts receivable “may reinforce the auditor’s obligation to exercise due professional care in making that determination.” This commenter also noted that overcoming the presumption could result in a critical audit matter under AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.⁶⁵

Many commenters on this aspect of the 2022 Proposal, primarily firms and firm-related groups, disagreed with a specific requirement to communicate with the audit committee on this matter. These commenters asserted that such a requirement did not align with principles in AS 1301 to communicate with the audit committee about significant risks, including audit matters arising from the audit that are significant to the oversight of the company’s financial reporting process. A number of these commenters also noted that, if there were a significant risk in accounts receivable or associated with a critical audit matter, the auditor would already be required to communicate these matters under AS 1301. Several other commenters indicated that they did not object to a more targeted requirement to communicate with the audit committee about overcoming the presumption to confirm when accounts receivable was assessed as a significant risk.

In addition, several commenters asserted that a requirement to communicate to the audit committee about overcoming the presumption to confirm would not improve audit quality, and could be detrimental if this communication became a compliance exercise for auditors, detracting them from performing effective audit procedures. A few commenters also stated there would not be a benefit to audit quality if the Board were to mandate that auditors treat instances of overcoming the presumption to confirm as a critical audit matter.

The 2022 Proposal stated that there may be some expectation by audit committees that the auditor would use confirmation as part of a planned audit response. One commenter encouraged the Board to perform outreach with audit committees to understand whether this expectation was, in fact, widespread and whether the proposed communication requirement would be relevant and meaningful.

⁶⁵ A critical audit matter is defined in AS 3101.A2 as “[a]ny matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.”

Having considered the comments received, we do not believe it is necessary to require the auditor to inform the audit committee in every instance where the auditor performed substantive audit procedures other than confirmation to address the risk of material misstatement of cash or accounts receivable. However, we believe the auditor should inform the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source when responding to significant risks associated with either cash or accounts receivable.

This targeted requirement is consistent with the views expressed by several commenters, as discussed above. It is also consistent with the existing obligation of auditors under PCAOB standards to communicate to the audit committee an overview of the overall audit strategy and to discuss with the audit committee the significant risks of material misstatement identified during the auditor's risk assessment procedures.⁶⁶ In addition, as with other matters arising from the audit of financial statements and communicated or required to be communicated to the audit committee, the auditor is required to determine whether these matters are critical audit matters in accordance with AS 3101.⁶⁷

4. Confirming Terms of Certain Transactions

The 2022 Proposal provided that, for significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming terms of the transaction with the counterparty to the transaction. This provision updates a requirement in existing AS 2310.08 that the auditor should consider confirming the terms of certain transactions that are associated with high levels of risk. The 2022 Proposal used the terminology "significant risk" and "significant unusual transactions," but the provision was intended to be similar to that in existing AS 2310.

We are adopting the proposed requirements to consider confirming terms of certain transactions, with certain modifications discussed below.

Several commenters noted that the provision in the 2022 Proposal was sufficiently clear and appropriate. Other commenters suggested various modifications to the provision that they asserted would improve its clarity, such as elaborating on the meaning of the term "complex transaction" and stating that the provision applies when the assertions related to the significant risk of material misstatement can be adequately addressed through confirmation. Several commenters indicated that other audit procedures, not including confirmation, may adequately address an assessed significant risk over the existence assertion, such as obtaining and

⁶⁶ See AS 1301.09.

⁶⁷ See AS 3101.11-.12.

reviewing an original executed contract and verifying the execution of its terms over a period of time.

To provide additional clarity, the new standard provides that the auditor should consider confirming those terms of a complex transaction or significant unusual transaction that are associated with a significant risk of material misstatement, including a fraud risk. Under the new standard, examples of such terms may include terms relating to (i) oral side agreements, or undisclosed written or oral side agreements, where the auditor has reason to believe that such agreements exist, (ii) bill and hold sales, and (iii) supplier discounts or concessions. When such arrangements or agreements are part of a complex transaction or significant unusual transaction identified by the auditor, there may be a heightened risk that the transaction has been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets. Likewise, a complex transaction or a significant unusual transaction could have a heightened risk of error whereby confirmation could lead to identification of an additional term that, under an accounting standard, might have accounting implications not previously recognized by either the company or the auditor. Accordingly, the auditor's confirmation of terms related to such arrangements or agreements may assist the auditor in evaluating the business purpose, or lack thereof, of the transaction.⁶⁸ These examples are not intended to be an exhaustive list. An auditor may identify other terms to confirm relating to a complex transaction or a significant unusual transaction if the auditor decides that confirmation could result in obtaining relevant and reliable audit evidence about that transaction.

One investor-related group recommended that the provision in the 2022 Proposal addressing the terms of complex transactions and significant unusual transactions should be mandatory and read "should" instead of "should consider." In contrast, other commenters asserted that the provision was unduly prescriptive. Several commenters recommended that we change the phrase "should consider" to "may consider" to allow for more auditor judgment in determining the audit procedures to perform to address significant unusual transactions or other complex transactions. We believe that the provision stating that the auditor "should consider" confirming terms of complex transactions or significant unusual transactions associated with a significant risk of material misstatement is sufficiently risk-based for the auditor to have flexibility in selecting the audit procedures that are best suited to address significant risks of material misstatement, depending on the facts and circumstances of individual transactions.

Another commenter suggested that we place additional emphasis on the auditor having a heightened degree of professional skepticism, similar to a provision in existing AS 2310.27, and that doing so would allow auditors to make appropriate judgments in determining whether facts and circumstances indicate that confirmation procedures may not produce sufficient appropriate evidence to address the assessed risks. We did not include additional language in the new standard about the auditor's potential need to exercise a heightened degree of

⁶⁸ See AS 2401.67.

professional skepticism related to confirmation because the auditor's obligation to apply professional skepticism is relevant to all aspects of the audit.⁶⁹

H. Performing Alternative Procedures for Selected Items

See paragraphs .C1 – .C2 of the new standard in Appendix 1

The 2022 Proposal provided that the auditor should perform alternative procedures in certain scenarios involving identifying confirming parties or evaluating the reliability of confirmation responses, as well as in scenarios involving nonresponses and incomplete responses.⁷⁰ This range of scenarios was broader than under existing AS 2310, which provides that, with certain exceptions, the auditor should apply alternative procedures where the auditor has not received replies to positive confirmation requests. In addition, existing AS 2310 provides examples of alternative procedures, and requires the auditor to evaluate the combined evidence provided by confirmation and any alternative procedures and send additional confirmation requests or perform other audit tests, as needed, to obtain sufficient appropriate audit evidence.

The 2022 Proposal provided examples of alternative procedures that may provide relevant and reliable audit evidence regarding accounts receivable, accounts payable, and the terms of a transaction or agreement. These provisions expanded upon the examples of alternative procedures discussed in existing AS 2310.

The 2022 Proposal did not specify whether performing alternative procedures for the items the auditor was unable to confirm, alone or in combination with other audit procedures, is necessary to obtain sufficient appropriate audit evidence. Under the 2022 Proposal, the auditor would make that determination based on the facts and circumstances of the audit. Further, an auditor might determine that, without obtaining a reliable confirmation response, the auditor is unable to obtain sufficient appropriate audit evidence for a relevant assertion through performing alternative procedures for the items the auditor could not confirm, other audit procedures, or both (e.g., if the auditor observes conditions during the confirmation process that indicate a heightened fraud risk). In such scenarios, the 2022 Proposal provided that the auditor would consider the impact on the audit opinion in accordance with AS 3105.

The 2022 Proposal also provided that performing alternative procedures may not be necessary where items selected for confirmation for which the auditor was not able to complete audit procedures would not – if misstated – change the outcome of the auditor's evaluation of the effect of uncorrected misstatements performed in accordance with AS

⁶⁹ See AS 1015.07.

⁷⁰ See paragraphs .20 (inability to identify a confirming party), .26 (unreliable response), and .30 (nonresponse or incomplete response) of the proposed standard.

2810.17.⁷¹ For example, following the direction in AS 2810.17, under the 2022 Proposal an auditor may have determined that an item that the auditor was unable to confirm would not be material individually or in combination with other misstatements. In such situations, the auditor would not have been required to perform alternative procedures.⁷² Existing AS 2310 includes an analogous exception.

We are adopting the requirements substantially as proposed, with certain modifications discussed below.

In the 2022 Proposal, the additional discussion of alternative procedures appeared in the main body of the proposed standard (paragraph .31). To enhance the readability of these provisions and facilitate their implementation, we have relocated them to Appendix C, which includes one paragraph that describes when performing other audit procedures may be necessary (paragraph .C1) and a second paragraph that provides further direction as to when alternative procedures are required under the new standard and includes examples of alternative procedures (paragraph .C2).

In addition, to remind auditors that the auditor's assessment of risks of material misstatement, including fraud risks, should continue throughout the audit, including the confirmation process, paragraph .C1 of the new standard states that, when the auditor is unable to obtain relevant and reliable audit evidence about the selected item through confirmation, the auditor should evaluate the implications for the auditor's assessment of the relevant risks of material misstatement, including fraud risks.

Several commenters indicated that the circumstances in the 2022 Proposal under which the auditor generally would be required to perform alternative procedures were sufficiently clear and appropriate. However, multiple commenters suggested that we include an example of an alternative procedure for cash. In consideration of these comments, we have incorporated an example of an alternative procedure that may provide relevant and reliable audit evidence regarding cash, which involves the auditor verifying information about the company's cash account maintained in a financial institution's information system by viewing this information directly on a secure website of the financial institution. In this example, the auditor might verify such information by determining the validity of the financial institution's website and viewing the information directly on the secure website. The information viewed by the auditor could be

⁷¹ The auditor's evaluation of materiality under AS 2810.17 takes into account both relevant quantitative and qualitative factors.

⁷² In certain circumstances, auditors may have obligations independent of the Board's auditing standards to perform either confirmation procedures or other auditing procedures. *See, e.g.*, Section 30(g) of the Investment Company Act of 1940, 15 U.S.C. § 80a-29(g) (providing that the auditor's report on the financial statements of a registered investment company "shall state that such independent public accountants have verified securities owned, either by actual examination, or by receipt of a certificate from the custodian, as the Commission may prescribe by rules and regulations").

accessed either by the auditor, using login credentials provided by the company, or by company personnel. This additional example is intended to address some commenters' misperception that the 2022 Proposal would not allow the auditor to perform alternative procedures in the event that a positive confirmation request related to cash does not result in a confirmation response.

Several commenters asserted that the note in the 2022 Proposal identifying situations where alternative procedures may not be necessary was not clear, with one commenter indicating that the analogous exception in existing AS 2310 was clearer because it addressed audit sampling. In consideration of these comments, we have revised the note to paragraph .C2 of the new standard to clarify how the exception from performing alternative procedures for selected items should be applied and revised the footnote in the paragraph to further explain how the exception is applied in scenarios involving audit sampling.

The following example further illustrates applying this provision in an audit: An auditor selects a sample of 50 accounts receivable invoices for confirmation and receives confirmation responses for 45 invoices that do not indicate a need for the auditor to perform alternative procedures. For two nonresponses, the auditor performs alternative procedures and obtains relevant and reliable audit evidence identifying no misstatements. For the three remaining nonresponses, the auditor does not perform alternative procedures because the auditor appropriately determines that, even if the amounts associated with the invoices were projected as 100 percent misstatements to the population from which the sample was selected and added to any other accounts receivable misstatements (i.e., accounts receivable misstatements identified through audit procedures other than confirmation), the outcome of the auditor's evaluation performed in accordance with AS 2810.17 would not change.

Another commenter recommended that, for nonresponses, we require that the auditor "must" perform alternative procedures that include examining third-party evidence. This commenter also suggested that we revise the example of alternative procedures for accounts receivable by removing the phrase "one or more," such that the auditor would perform all of the procedures identified in the example (i.e., examining subsequent cash receipts, shipping documents, and other supporting documentation).

Having considered these comments, we believe that, with the modifications discussed above, the requirements in paragraph .C1 of the new standard provide appropriate direction regarding when alternative procedures are required. Additionally, we believe that including examples in paragraph .C2 of alternative procedures that may provide relevant and reliable audit evidence about selected items, without mandating specific procedures, is appropriate, as it is impracticable to describe specific procedures for all scenarios that could occur in an audit.

Additionally, as discussed in Section III.E, we have modified paragraph .B2 of the new standard to provide that in circumstances where the auditor should not use an intermediary to send confirmation requests or receive confirmation responses, the auditor should send confirmation requests without the use of an intermediary or, if unable to do so, perform

alternative procedures in accordance with Appendix C of the new standard. In light of this modification, we have added a reference to paragraph .B2 to Appendix C of the new standard.

I. Evaluating Results

See paragraph .31 of the new standard in Appendix 1

The 2022 Proposal did not carry forward a requirement, included in existing AS 2310, for the auditor to evaluate in the aggregate audit evidence obtained from performing confirmation procedures and any alternative procedures. Excluding this requirement from the 2022 Proposal was intended to avoid the duplication of certain requirements of AS 2810 that discuss the auditor's responsibilities for evaluating audit results and determining whether the auditor has obtained sufficient appropriate audit evidence.

As discussed in Section III.G, however, paragraph .24 of the new standard allows the auditor to perform audit procedures other than confirmation for cash and accounts receivable to obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. We therefore decided to remind the auditor in paragraph .31 of the new standard that the auditor should evaluate the combined audit evidence provided by confirmation procedures, alternative procedures, and other procedures to determine whether sufficient appropriate audit evidence has been obtained in accordance with AS 2810.

J. Other Matters

This section addresses certain additional matters that were also discussed in the 2022 Proposal. In addition, this section discusses definitions included in the new standard and related amendments to PCAOB auditing standards included in Appendix 2 of this release.

1. Management Requests Not to Confirm

Consistent with existing AS 2310, the 2022 Proposal did not address, nor does the new standard address, situations in which management requests that the auditor not confirm one or more items.

Several commenters agreed with the approach in the 2022 Proposal and indicated that auditor responsibilities in such situations are already addressed by existing PCAOB standards. One commenter suggested that we consider adding a requirement that, if management requests an auditor not to confirm a certain item, the auditor should both request management to indicate the reason for the request and, as appropriate, consider whether the request is indicative of a risk of material misstatement. Another commenter agreed that the potential scope limitation or fraud risk from a management request not to confirm is addressed in other PCAOB standards, but expressed the view that including guidance in the new standard unique to confirmation would be appropriate. A different commenter did not suggest changes to our approach, but observed that management requests not to confirm are primarily relevant in the

financial services industry and that it had experienced infrequent management requests not to confirm in other industries.

Having considered the comments received, we believe that existing PCAOB standards appropriately address situations involving management requests not to confirm. In particular, AS 1301 requires that the auditor communicate to the audit committee disagreements with management⁷³ and difficulties encountered in performing the audit, including unreasonable management restrictions encountered by the auditor on the conduct of the audit (e.g., an unreasonable restriction on confirming transactions or balances).⁷⁴ AS 3105 also sets forth requirements regarding limitations on the scope of an audit,⁷⁵ including scope limitations relating to confirmation.⁷⁶

Further, AS 2110 and AS 2401 describe the auditor's responsibilities regarding identifying, assessing, and responding to fraud risks. For example, AS 2401.09 states that fraud may be concealed by withholding evidence. A management request to limit audit testing by not obtaining external audit evidence through confirmation could be relevant to the auditor's consideration of fraud risk factors, including the consideration of management incentives, opportunities, and rationalization for perpetrating fraud. Considering the applicability of existing provisions to situations involving management requests not to confirm, as discussed above, we believe that including analogous requirements in the new standard could lead to unnecessary duplication of existing requirements and potential confusion.

2. Restrictions and Disclaimers

The requirements in the proposed standard relating to the auditor's evaluation of the reliability of confirmation responses included a reminder, in the form of a footnote, of the auditor's responsibilities under AS 1105 as they relate to restrictions and disclaimers. A similar reminder does not exist in existing AS 2310.

We are including this reference to AS 1105.08 as proposed, in a footnote to paragraph .18 of the new standard. No comments were received on this aspect of the 2022 Proposal. In accordance with AS 1105.08, the auditor should evaluate the effect of restrictions, limitations, or disclaimers in confirmation responses on the reliability of audit evidence.⁷⁷

⁷³ See AS 1301.22.

⁷⁴ See AS 1301.23.

⁷⁵ See AS 3105.05-.15.

⁷⁶ See AS 3105.07.

⁷⁷ See AS 1105.08.

3. Direct Access

The 2022 Proposal did not describe direct access as a confirmation procedure. Existing AS 2310 currently does not address such a procedure, but the 2010 Proposal had provided that direct access could be considered a confirmation procedure in certain circumstances.

A few commenters on the 2022 Proposal either agreed with, or indicated that they did not object to, the Board's stated position that direct access does not constitute a confirmation procedure. However, several firms and firm-related groups stated that, when properly executed, audit evidence obtained by the auditor through direct access can provide persuasive evidence about the existence of cash. One commenter recommended that the PCAOB consider aligning with the AICPA's position on this matter by acknowledging that the auditor's direct access to information held by a confirming party may meet the definition of a confirmation procedure when, for example, the confirming party provides the auditor with the electronic access codes or other information necessary to access a secure website where data that addresses the subject matter of the confirmation is held.

Having considered these comments, we are adopting the new standard as proposed in relation to direct access.

While direct access does not constitute a confirmation procedure under the new standard, the new standard provides that the auditor may obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, as discussed in Section III.G.

4. Definitions

To operationalize the requirements included in the 2022 Proposal, the proposal included definitions for "confirmation exception," "confirmation process," "confirmation request," "confirmation response," "confirming party," "negative confirmation request," "nonresponse," and "positive confirmation request."

We are adopting the definitions as proposed, with certain modifications discussed below.

Several commenters stated that, in general, the definitions in the 2022 Proposal were sufficiently clear and appropriate. Other commenters either did not provide comments on the proposed definitions or suggested certain modifications, as discussed below.

Some commenters stated that we should modify the proposed definition of "nonresponse" to reflect that a nonresponse includes a situation where the auditor does not receive a confirmation response to a positive confirmation request directly from the intended confirming party. Having considered this comment, we are aligning the definition of

“nonresponse” with the definition of “confirmation response” and the requirements of paragraph .16 of the new standard. This modification clarifies that a confirmation response that is not received directly from the confirming party would constitute a nonresponse. We have also modified the definition of “negative confirmation request” to use the defined term “confirmation request” rather than “request.”

One commenter proposed modifications to the definitions of “confirmation exception” and “confirmation process” to specify that (i) sending a confirmation request may include transmitting the request in electronic form and (ii) only differences between a confirmation response and information the auditor obtained from the company that the auditor had originally sought to confirm constitute a confirmation exception. Having considered the comment, we note that the proposed definition of “confirmation process” intentionally did not prescribe the method or methods by which confirmation requests can be sent and by which confirmation responses can be received, as the standard is intended to apply to all methods of sending and receiving confirmation requests and responses. Further, we believe that any instance where information in a confirmation response differs from information the auditor obtained from the company, even if the information in the confirmation response was not information that the auditor originally sought to confirm, should constitute a confirmation exception. Accordingly, we are adopting the definition of “confirmation exception” as proposed and adopting the definition of “confirmation process” as proposed, with one modification to include “selecting one or more items to be confirmed” in the definition to align with the requirements specifically related to the confirmation process in the new standard.

The 2022 Proposal also indicated that an oral response to a confirmation request was a nonresponse. One commenter stated that a video recording of a call between an auditor and an individual at a confirming party ought not be considered less reliable audit evidence than a written response from an organization. Another commenter suggested that the PCAOB define the term “confirmation” because the 2022 Proposal stated that an oral response was a nonresponse but did not provide guidance as to whether other forms of response would be evidence of confirmation.

As we continue to believe that obtaining direct written communication, in paper or electronic form, from a confirming party is necessary for a response to constitute a confirmation response, we have not made further modifications to the definition in the new standard beyond those described above. Accordingly, a video recording of a call between an auditor and an individual at a confirming party or an oral response would constitute nonresponses under the new standard, although the auditor could still consider the relevance and reliability of the audit evidence provided by a video recording or an oral response when determining the nature and extent of alternative procedures required to be performed under the new standard.

5. Amendments to Related PCAOB Auditing Standards

We are adopting the amendments contained in Appendix 2 to several existing PCAOB auditing standards to align with the new standard.

i. Amendments to AS 1105

See paragraph .18 of AS 1105 in Appendix 2

The 2022 Proposal included proposed amendments to AS 1105 to (i) align the description of a “confirmation response” in AS 1105 with the definition of the same term included in the 2022 Proposal and (ii) clarify that the terms “confirmation response,” “confirmation request,” and “confirming party,” as used in AS 1105, have the same meaning as defined in Appendix A of the 2022 Proposal.

We are adopting the amendments as proposed.

Existing AS 1105.18 states that “[a] confirmation response represents a particular form of audit evidence obtained by the auditor from a third party in accordance with PCAOB standards.” The 2022 Proposal used the defined term “confirming party” in lieu of “third party.” One commenter suggested retaining the phrase “third party” in AS 1105.18 to provide further clarity. We are not using this term because the new standard describes a confirming party as “a third party, whether an individual or an organization, to which the auditor sends a confirmation request,” thus making it clear that a confirming party is a third party.

Another commenter suggested that we strike the word “independent” from AS 1105.08, which states that “[e]vidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources.” This commenter asserted that, although confirmation evidence may be more reliable, it is not truly “independent.” We are not striking the word “independent” from AS 1105.08 as we believe the concept expressed in AS 1105.08 is well understood by auditors and does not purport to be a definitive statement about the “independence” of evidence from a confirming party.

ii. Amendments to AS 1301

See Appendix B to AS 1301 in Appendix 2

The 2022 Proposal included a proposed requirement for the auditor to communicate to the audit committee instances in which the auditor has determined that the presumption to confirm accounts receivable has been overcome and the basis for the auditor’s determination. The 2022 Proposal included a conforming amendment to AS 1301 that would refer to the proposed requirement.

We are adopting the conforming amendment to AS 1301 that refers to the audit committee communication requirement contained in the new standard. Section III.G of this

release discusses the required communication with the audit committee about the auditor's response to significant risks associated with cash or accounts receivable when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

iii. Amendments to AS 2401

See paragraphs .54 and .66A of AS 2401 in Appendix 2

The 2022 Proposal included a proposed amendment to AS 2401 to refer to the title of the confirmation standard as proposed in the 2022 Proposal (i.e., "The Auditor's Use of Confirmation").

We are adopting the amendment as proposed and adopting an additional conforming amendment to AS 2401, as discussed below.

One commenter suggested that we consider a conforming amendment to AS 2401 to acknowledge a requirement in proposed paragraph .15 to consider confirming terms of the transaction for significant risks of material misstatement associated with either a complex transaction or significant unusual transaction. Having considered the comment, we are adopting a conforming amendment to the note to AS 2401.66A to remind the auditor of the requirement in paragraph .30 of the new standard that for significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk.

iv. Amendments to AS 2510

See paragraph .14 of AS 2510 in Appendix 2

AS 2510.14 includes a statement that "if inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian." The 2022 Proposal included a proposed amendment to AS 2510 to remind auditors that AS 2310 establishes requirements for the auditor's use of confirmation.

We are adopting the amendment as proposed.

One commenter stated that we should address the confirmation of inventory in the new standard instead of making conforming amendments to AS 2510. We continue to believe that including requirements related to inventory in a single standard is appropriate. However, we acknowledge that AS 2510.14 includes two requirements related to the confirmation of inventory. First, AS 2510.14 provides that "[i]f inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian." Second, AS 2510.14 further states that the auditor

should perform one or more of four additional procedures, as considered necessary by the auditor, if such inventories represent a significant proportion of current or total assets. One such procedure is to confirm pertinent details of pledged receipts with lenders (on a test basis, if appropriate), if warehouse receipts have been pledged as collateral. We have added a cross-reference to AS 2510 in footnote 4 of the new standard to clarify that AS 2510 also includes auditor responsibilities relevant to the auditor's use of confirmation.

v. Amendments to AS 2605

See paragraphs .22 and .27 of AS 2605 in Appendix 2

AS 2605.22 includes a statement that “for certain assertions related to less material financial statement amounts where the risk of material misstatement or the degree of subjectivity in the valuation of the audit evidence is low, the auditor may decide, after considering the circumstances and the results of work (either test of controls or substantive tests) performed by internal auditors on those particular assertions, the audit risk has been reduced to an acceptable level and that testing of the assertions directly by the auditor may not be necessary.” The paragraph then includes assertions about the existence of cash, prepaid assets, and fixed-asset additions as examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence.

The 2022 Proposal included a proposed amendment to strike the word “cash” from AS 2605.22 to avoid confusion, as the 2022 Proposal required the auditor to perform confirmation procedures in respect of cash.

In addition, the 2022 Proposal included a proposed amendment to acknowledge in paragraph .27 of AS 2605, which discusses using internal auditors to provide direct assistance to the auditor, the proposed restrictions on the use of internal audit in a direct assistance capacity in the confirmation process.

We are adopting the amendments substantially as proposed, with certain modifications discussed below.

One commenter indicated that the proposed amendment to AS 2605.22 (i.e., striking the word “cash” from the list of accounts that might have a low risk of material misstatement), inappropriately assumed that there is always a heightened risk of fraud related to cash accounts in all audit engagements. Having considered the comment, we note that neither the 2022 Proposal nor the new standard suggests that there is heightened risk of fraud associated with cash in every engagement. However, we believe that where an auditor identifies a risk of material misstatement for cash (i.e., where cash is a significant account) it is necessary for the auditor to perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source in

respect of cash. Accordingly, we continue to believe that the conforming amendment to AS 2605.22 is appropriate.

Another commenter indicated that the proposed amendment to AS 2605.27 would not be necessary should we adopt the commenter's other recommendation to remove the proposed restrictions regarding the use of internal audit in the new standard. As discussed in Section III.E, we continue to believe that in order to maintain control over the confirmation process the auditor should select items to be confirmed, send confirmation requests, and receive confirmation responses. We modified the conforming amendments to AS 2605.27, however, to align with paragraph .15 of the new standard.

IV. ECONOMIC ANALYSIS

The Board is mindful of the economic impacts of its standard setting. This section describes the economic baseline, need, and expected economic impacts of the new standard, as well as alternative approaches considered by the Board. Because there are limited data and research findings available to estimate quantitatively the economic impacts of the new standard, the economic analysis is largely qualitative in nature.

A. Baseline

Section II describes important components of the baseline against which the economic impact of the new standard can be considered, including the Board's existing standard governing the audit confirmation process, firms' current practices when performing confirmation procedures, and observations from the Board's inspections program and enforcement cases. We discuss below two additional components that inform our understanding of the economic baseline: (i) the staff's analysis of audit firm methodologies and the use of technology-based tools in the confirmation process, and (ii) a summary of academic and other literature on the confirmation process.

1. Auditing Practices Related to the Confirmation Process

Through its inspection and other oversight activities, the PCAOB has access to sources of information that help inform our understanding of how firms currently engage in the confirmation process. As part of this standard-setting project, the staff has reviewed a selection of firms' audit methodologies, as well as other information about firms' use of technology-based tools when performing confirmation procedures. While this information is not a random sample that can be extrapolated accurately across all registered public accounting firms, we are able to make some general inferences that help inform development of the economic baseline.

i. PCAOB Staff Analysis of Audit Methodologies

PCAOB staff has reviewed the methodologies of selected registered public accounting firms to determine how they currently address the confirmation process and the extent to

which changes to those methodologies will be necessary to implement the new standard. Specifically, the staff compared methodologies of selected global network firms (“GNFs”)⁷⁸ and some methodologies commonly used by U.S. non-affiliate firms (“NAFs”),⁷⁹ which are smaller than GNFs, to existing AS 2310 as well as to the new standard. The review focused on the following aspects of the new standard which represent more notable changes relative to existing AS 2310:

- Substantive procedures for confirming cash and cash equivalents (paragraphs .24, .26, and .29);
- Substantive procedures for confirming accounts receivable (paragraphs .24-.25 and .27);
- The auditor’s use of negative confirmation requests (paragraphs .12-.13);
- Maintaining control over the confirmation process, including when an intermediary is used (paragraphs .14-.17 and Appendix B); and
- Other areas addressed in the new standard, including the evaluation of the reliability of confirmation responses (paragraphs .18-.19), and the performance of alternative procedures (Appendix C).

For the GNF methodologies reviewed, we observed that the methodologies generally reflect requirements in existing AS 2310 and other auditing standards on external confirmation, such as ISA 505 and AU-C 505. In addition, some of the methodologies already incorporate certain concepts included in the new standard, although revisions to the methodologies will nonetheless be needed to implement the new standard.

Specifically, some GNF methodologies, but not all, include requirements for confirmation of cash and cash equivalents held by third parties similar to the new requirements described in the new standard. Other GNF methodologies suggest, but do not require, that engagement teams consider specific confirmation procedures for cash and cash equivalents held by third parties. GNF methodologies for confirmation of accounts receivable are generally consistent with existing AS 2310. Some also include guidance that is similar in certain respects to the requirements in the new standard when the auditor is unable to obtain relevant and reliable audit evidence through confirmation procedures. With respect to negative confirmation requests, GNF methodologies acknowledge that negative confirmation requests

⁷⁸ GNFs are the member firms of the six global accounting firm networks (BDO International Ltd., Deloitte Touche Tohmatsu Ltd., Ernst & Young Global Ltd., Grant Thornton International Ltd., KPMG International Ltd., and PricewaterhouseCoopers International Ltd.).

⁷⁹ NAFs are both U.S. and non-U.S. accounting firms registered with the Board that are not GNFs. Some of the NAFs belong to international networks.

provide less persuasive evidence than positive confirmation requests. However, some GNF methodologies still allow the use of negative confirmation requests as the sole substantive procedure under certain conditions.⁸⁰

The staff also observed that GNF methodologies generally include guidance on maintaining control over the confirmation process, using intermediaries to facilitate the electronic transmission of confirmation requests, and assessing controls at the intermediaries. The firms' guidance in this area focuses on the performance of audit procedures to ensure that the electronic confirmation process occurs in a secure and controlled environment and that confirmation responses received are reliable. For example, the methodologies of some firms provide that an auditor may obtain a SOC report that would assist the engagement team in assessing the design and operating effectiveness of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses. Finally, although current GNF methodologies include guidance on the other areas being modernized or clarified in the new standard, GNFs may be required to make certain modifications to their methodologies to conform to the new standard, such as whether to perform alternative procedures.

For the NAF methodologies reviewed, the staff observed that the methodologies generally align with existing AS 2310 across each of the areas studied, but include some guidance related to the new requirements in the new standard. For example, in some of the NAF methodologies, the confirmation of cash and cash equivalents held by third parties is a consideration but not a requirement. In other NAF methodologies, the confirmation of cash and cash equivalents held by third parties and negative confirmation requests are not discussed at all. NAF methodologies for confirmation of accounts receivable are generally consistent with existing AS 2310. Some include guidance that is similar in certain respects to the requirements described in the new standard when the auditor is unable to obtain relevant and reliable audit evidence through confirmation procedures.

The NAF methodologies also generally include guidance on maintaining control, using intermediaries in the confirmation process, and assessing controls at the intermediaries. Similar to GNF methodologies, NAF guidance in this area focuses on the performance of audit procedures to ensure that the electronic confirmation process occurs in a secure and controlled environment and that confirmation responses received are reliable. For example, a firm's methodology may provide that an auditor may obtain a SOC report that would assist the engagement team in assessing the design and operating effectiveness of the intermediary's controls that address the risk of interception and alteration of confirmation requests and responses.

Commenters on the 2022 Proposal did not provide additional information on firm methodologies beyond the staff's analysis. In general, the staff's review indicates that all firms

⁸⁰ See AS 2310.20 for these conditions.

will likely need to revise their methodologies to some extent to implement the new standard. For example, all firms will need to update their methodologies to ensure that negative confirmation requests are not used as the sole source of audit evidence. NAF methodologies will likely require more revisions than the GNF methodologies, which have incorporated certain concepts included in the new standard.

ii. Use of Technology-Based Tools

The PCAOB staff has also reviewed information collected through PCAOB oversight activities on firms' use of technology-based tools in the confirmation process. The staff's review focused primarily on the use of technology-based tools by GNFs, but also encompassed certain technology-based tools used by some NAFs. In addition, the review encompassed information on both proprietary technology-based tools that firms have developed internally and third-party or "off-the-shelf" tools that firms purchase and use (in certain cases, with further customizations) to assist in performing confirmation procedures as part of the audit process. The staff found that the number of technology-based tools used in the confirmation process varies across firms, and also varies based on the facts and circumstances of specific engagements. Generally speaking, firms allow engagement teams to select a tool but do not provide that the use of one or more tools is required.

Both GNFs and NAFs within the scope of the staff's review use third-party tools to automate certain confirmation procedures, or to independently verify balances, terms of arrangements, or other information under audit. GNFs appear to be more likely to invest in customizing off-the-shelf tools they have purchased to their particular environment. For example, such modifications may permit a firm to automate the reconciliation of confirmed balances to client records. In comparison, NAFs tend to use the off-the-shelf tools without customization.

The staff's review also found that GNFs have developed proprietary applications to facilitate various aspects of the confirmation process, whether conducted manually or electronically. These applications may facilitate the preparation of confirmation requests, their dissemination to recipients (including the preparation of logs to track confirmation requests and receipts), and the analysis of confirmation responses to determine their completeness and accuracy. GNFs have also developed tools used when auditing specific accounts, other than cash and accounts receivable, where confirmation may provide audit evidence. For example, tools are used to prepare, log, and track confirmation requests and responses for various deposit, loan, and liability accounts.

As discussed in Section II, auditors or confirming parties may engage an intermediary to facilitate the direct electronic transmission of confirmation requests and responses between

the auditor and the confirming party.⁸¹ In one area, market forces have influenced firms' willingness to use an intermediary: a majority of financial institutions will only respond to confirmation requests through a centralized process and with a specified intermediary. As a result, all firms' methodologies required, and in practice firms did use, the specified intermediary in these circumstances.

The PCAOB staff has observed diverse practices related to the procedures auditors perform to support their reliance on an intermediary's controls when establishing direct communication between the auditor and the confirming party.⁸² In some situations where the procedures performed included obtaining a SOC report, the staff has observed insufficient evaluation of SOC reports, lack of consideration of the period covered and complementary user entity controls, and insufficient coordination of procedures performed centrally by the audit firm and by the engagement team.⁸³

These observations suggest that there may be a need for uniform guidance for situations involving the use of intermediaries. For example, enhanced procedures to be performed when auditors place reliance on an intermediary's controls could help address the risk of interception and alteration of communications between the auditor and the company and address the risk of override of the intermediary's controls by the company.

Commenters did not provide information about firms' use of technology-based tools that contradicted the staff's assessment. One commenter stated that some larger audit firms have established confirmation centers to centralize the sending and receiving of confirmation requests. Another commenter cited a study that noted the use of robotic process automation for confirming accounts receivable by a GNF.⁸⁴

2. Literature on the Confirmation Process

There is limited data on auditor confirmation decisions and research findings on the confirmation process.⁸⁵ The literature documents that confirmation is "extensively used" and that confirmation responses received directly from a third party are often perceived by

⁸¹ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ See Feiqi Huang and Milos A. Vasarhelyi, *Applying Robotic Process Automation (RPA) in Auditing: A Framework*, 35 *Internal Journal of Accounting Information Systems* 100433, 100436 (2019).

⁸⁵ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 254 (2008).

practitioners to be among “the most persuasive forms of audit evidence.”⁸⁶ Consistent with the staff’s observations from PCAOB oversight activities,⁸⁷ studies find that the use of electronic confirmation has become prevalent.⁸⁸ One study also observes that current U.S. auditing standards do not fully address how auditors should authenticate confirmations sent or received electronically, and asserts that there is a need for audit guidance related to electronic forms of evidence.⁸⁹ Further, an earlier study reviews enforcement actions described in the SEC’s Accounting and Auditing Enforcement Releases and concludes that additional direction regarding when cash and accounts receivable confirmation requests are required or recommended may be needed.⁹⁰ Additionally, the literature suggests that more guidance may be necessary to identify when the risk is sufficiently low to justify the use of negative confirmation requests in certain areas.⁹¹ Moreover, an article on bank confirmation advocates a risk-based approach to the determination of confirmation procedures.⁹² Finally, a study finds that “anecdotal evidence and some research suggest confirmation response rates are declining.”⁹³ Commenters did not provide information contradicting the staff’s summary of the relevant literature.

Accordingly, the academic literature is consistent with the conclusion that the Board’s auditing requirements for the confirmation process should (i) accommodate electronic communications and address the implications of using an intermediary, (ii) address the

⁸⁶ See *id.* at 253.

⁸⁷ See *Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>. See also *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

⁸⁸ See, e.g., Paul Caster, Randal J. Elder, and Diane J. Janvrin, *An Exploration of Bank Confirmation Process Automation: A Longitudinal Study*, 35 *Journal of Information Systems* 1, 5 (2021).

⁸⁹ See *id.* at 2.

⁹⁰ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 261-62 (2008).

⁹¹ See *id.* at 266.

⁹² See L. Ralph Piercy and Howard B. Levy, *To Confirm or Not to Confirm-Risk Assessment is the Answer*, 91 *The CPA Journal* 54, 54 (2021).

⁹³ See Paul Caster, Randal J. Elder, and Diane J. Janvrin, *A Summary of Research and Enforcement Release Evidence on Confirmation Use and Effectiveness*, 27 *Auditing: A Journal of Practice & Theory* 253, 254 (2008). The staff has also observed that the use of electronic confirmation may affect the confirmation response rate. See *Spotlight: Data and Technology Research Project Update* (May 2021), available at <https://pcaobus.org/resources/staff-publications>.

confirmation of cash and accounts receivable, (iii) limit the use of negative confirmation requests, and (iv) align with the PCAOB's risk assessment standards.

B. Need

Several attributes of the audit market support a need for the PCAOB to establish effective audit performance standards. First, the company under audit, investors, and other financial statement users cannot easily observe the services performed by the auditor or the quality of the audit. This leads to a risk that, unbeknownst to the company, investors, or other financial statement users, the auditor may perform a low-quality audit.⁹⁴

Second, the federal securities laws require that an issuer retain an auditor for the purpose of preparing or issuing an audit report. While the appointment, compensation, and oversight of the work of the registered public accounting firm conducting the audit is, under the Sarbanes-Oxley Act of 2002, as amended, ("Sarbanes-Oxley"), entrusted to the issuer's audit committee,⁹⁵ there is nonetheless a risk that the auditor may seek to satisfy the interests of the issuer audit client rather than the interests of investors and other financial statement users.⁹⁶ This risk can arise out of an audit committee's identification with the company or its management (e.g., for compensation) or through management's exercise of influence over the audit committee's supervision of the auditor, which can result in a *de facto* principal-agent relationship between the company and the auditor.⁹⁷ Effective auditing standards help to

⁹⁴ See, e.g., Monika Causholli and Robert W. Knechel, *An Examination of the Credence Attributes of an Audit*, 26 Accounting Horizons 631, 632 (2012):

During the audit process, the auditor is responsible for making decisions concerning risk assessment, total effort, labor allocation, and the timing and extent of audit procedures that will be implemented to reduce the residual risk of material misstatements. As a non-expert, the auditee may not be able to judge the appropriateness of such decisions. Moreover, the auditee may not be able to ascertain the extent to which the risk of material misstatement has been reduced even after the audit is completed. Thus, information asymmetry exists between the auditee and the auditor, the benefit of which accrues to the auditor. If such is the case, the auditor may have incentives to: Under-audit, or expend less audit effort than is required to reduce the uncertainty about misstatements in the auditee's financial statements to the level that is appropriate for the auditee.

⁹⁵ See Section 301 of Sarbanes-Oxley, 15 U.S.C § 78f(m). As an additional safeguard, the auditor is also required to be independent of the audit client. See 17 CFR 210.2-01.

⁹⁶ See, e.g., Joshua Ronen, *Corporate Audits and How to Fix Them*, 24 Journal of Economic Perspectives 189 (2010).

⁹⁷ See *id.*; see also, e.g., Liesbeth Bruynseels and Eddy Cardinaels, *The audit committee: Management watchdog or personal friend of the CEO?*, 89 The Accounting Review 113 (2014). Cory Cassell, Linda Myers, Roy Schmardebeck, and Jian Zhou, *The Monitoring Effectiveness of Co-Opted Audit*

address these risks by explicitly assigning responsibilities to the auditor that, if executed properly, are expected to lead to high-quality audits that satisfy the interests of audited companies, investors, and other financial statement users.

This section discusses the specific problem that the new standard is intended to address and explains how the new standard is expected to address it.

1. Problem to be Addressed

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

In situations where audit evidence can be obtained from a knowledgeable external source, the resulting audit evidence is likely to be more reliable than audit evidence obtained only from internal company sources. For evidence obtained through confirmation to be reliable, the confirmation process must be properly executed. Proper execution involves assessing the reliability of a confirmation response and performing robust, additional alternative procedures when the auditor is unable to determine that a confirmation response is reliable. Similarly, proper execution may entail the performance of alternative procedures when the auditor is unable to identify a confirming party, the auditor does not receive a confirmation response from the intended confirming party, or the confirmation response is incomplete.

As discussed in Section II, the PCAOB staff has observed situations where auditors did not perform procedures to assess the reliability of confirmation responses or, where applicable, perform sufficient alternative procedures.⁹⁸ In addition, the staff has noted that, in the case of some financial reporting frauds, the company's misconduct possibly could have been detected at an earlier point in time had the auditor made an appropriate assessment of the reliability of confirmation responses received, or performed additional procedures needed to obtain reliable audit evidence.⁹⁹ These observations suggest a need for enhancements to auditing standards to more clearly address those situations where confirmation can be expected to provide reliable audit evidence, including the requirements for evaluating the reliability of confirmation responses and, if appropriate, performing alternative procedures.

Committees, 35 *Contemporary Accounting Research* 1732 (2018); Nathan Berglund, Michelle Draeger, and Mikhail Sterin, *Management's Undue Influence over Audit Committee Members: Evidence from Auditor Reporting and Opinion Shopping*, 41 *Auditing: A Journal of Practice* 49 (2022).

⁹⁸ See Section II.C for observations from the PCAOB's audit inspections and from SEC enforcement cases.

⁹⁹ See also Diane Janvrin, Paul Caster, and Randy Elder, *Enforcement Release Evidence on The Audit Confirmation Process: Implications for Standard Setters*, 22 *Research in Accounting Regulation* 1, 10 (2010).

ii. Developments in Practice

There are areas of the confirmation process where developments in practice have outpaced existing requirements in the Board's auditing standards. In particular, existing AS 2310 does not reflect significant changes in technology and the methods by which auditors perform the confirmation process, including the use of electronic communication and the involvement of third-party intermediaries.

Regulatory standards that do not reflect changes in practice may lead to inconsistency in their application, potential misinterpretation, and ineffective regulatory intervention. For example, the PCAOB staff has observed diverse practices and audit deficiencies related to the procedures performed by auditors to support their use of an intermediary to facilitate the electronic transmission of confirmation requests and confirmation responses with confirming parties.¹⁰⁰

2. How the New Standard Addresses the Need

The new standard helps address the need by (i) strengthening requirements in certain areas to focus on the need to obtain reliable audit evidence from the confirmation process; and (ii) modernizing existing AS 2310 to accommodate certain developments in practice, including the use of electronic communications and intermediaries. The new standard is expected to promote consistent and effective practice relating to the confirmation process in audits subject to PCAOB standards, reducing the risk of low-quality audits caused by (i) the lack of observability of audit quality and (ii) the influence of the auditor-client relationship discussed above.

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new standard strengthens the Board's requirements in certain areas to focus on the need to obtain reliable audit evidence when executing the confirmation process. Specifically, the new standard includes a presumption for the auditor to confirm certain cash and cash equivalents held by third parties, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. In addition, the new standard strengthens the requirements for evaluating the reliability of confirmation responses. It also continues to emphasize the importance of maintaining control over the confirmation process and provides additional examples of information that indicates that a confirmation request or response may have been intercepted and altered. When confirmation responses are deemed to be unreliable, the auditor is directed to perform alternative procedures to obtain audit evidence.

¹⁰⁰ See *Spotlight: Observations and Reminders on the Use of a Service Provider in the Confirmation Process* (Mar. 2022), available at <https://pcaobus.org/resources/staff-publications>.

Moreover, as discussed in Section III.D, electronic communications likely have reduced the efficacy of negative confirmation requests. Under the new standard, the auditor is not able to use negative confirmation requests as the sole substantive procedure for addressing the risk of material misstatement for a financial statement assertion.

ii. Developments in Practice

Under the new standard, the requirement to maintain control over the confirmation process addresses both traditional and newer, more prevalent forms of communication between the auditor and confirming parties, including e-mailed confirmation requests and responses and intermediaries facilitating electronic communication of confirmation requests and responses. The new standard is intended to apply to methods of confirmation currently in use and to be flexible enough to apply to new methods that may arise from technological changes in auditing in the future.

The new standard emphasizes that in general, evidence obtained from a knowledgeable external source is more reliable than evidence obtained only from internal company sources. For cash and accounts receivable, if the auditor is able to perform audit procedures other than confirmation that allow the auditor to obtain audit evidence by directly accessing information maintained by knowledgeable external sources, such audit evidence could be at least as persuasive as audit evidence obtained through confirmation procedures, and the new standard allows the auditor to perform such procedures. Accordingly, to the extent that there are newer tools available to auditors now or in the future that enable them to obtain such audit evidence directly, the new standard would accommodate their use and future development.

C. Economic Impacts

This section discusses the expected benefits and costs of the new standard and potential unintended consequences. Overall, we expect that the economic impact of the new standard, including both benefits and costs, will be relatively modest, especially for those firms that have already incorporated into practice some of the new requirements. We also expect that the benefits of the new standard will justify the costs and any unintended negative effects.

1. Benefits

We expect the new standard to improve the consistency and effectiveness of the confirmation process, reducing the risk of low-quality audits caused by (i) the lack of observability of audit quality and (ii) the influence of the auditor-client relationship discussed in Section IV.B above. Specifically, there exists a risk that, unbeknownst to the company under audit, investors, or other financial statement users, the auditor may perform a low-quality audit since audit quality is difficult to observe. In addition, some auditors may aim to satisfy the interests of the company or their own financial interests rather than the interests of investors and other financial statement users — interests that may lead them to perform insufficiently

rigorous confirmation procedures to minimize the burden on clients and their counterparties to respond to confirmations, or to minimize audit costs.

The new standard helps to mitigate these risks in the audit confirmation process by strengthening and modernizing the requirements for the auditor regarding the design and execution of the confirmation process. Specifically, a confirmation process designed and executed under the new standard should benefit investors and other users of financial statements by reducing the likelihood that financial statements are materially misstated, whether due to error or fraud. Some commenters explicitly stated that the requirements described in the 2022 Proposal would improve the consistency of confirmation practices and enhance audit quality.

The enhanced quality of audits and financial information available to financial markets should also increase investor confidence in financial statements. In general, investors may use the more reliable financial information to improve the efficiency of their capital allocation decisions (e.g., investors may reallocate capital from less profitable companies to more profitable companies). Investors may also perceive less risk in capital markets generally, leading to an increase in the supply of capital. An increase in the supply of capital could increase capital formation while also reducing the cost of capital to companies.¹⁰¹

Auditors also are expected to benefit from the new standard, because the additional clarity provided by the new standard (e.g., the accommodation of current practices, including the use of electronic communications and intermediaries) will reduce regulatory uncertainty and the associated compliance costs. Specifically, the new standard provides auditors with a better understanding of their responsibilities and our expectations.

The following discussion describes the benefits of key changes to existing confirmation requirements that are expected to impact auditor behavior. As discussed in Section IV.B above, the changes aim to (1) enhance the auditor's focus on obtaining reliable audit evidence from the confirmation process, and (2) accommodate certain developments in practice. As further discussed below, the changes that enhance the auditor's focus on obtaining reliable audit evidence are expected to strengthen confirmation procedures for cash held by third parties, promote consistency in practice, improve the reliability of confirmation responses, improve the quality of audit evidence, and increase the auditor's likelihood of identifying potential financial statement fraud. The changes that accommodate developments in practice are expected to clarify the auditor's responsibilities regarding the use of electronic communications in the confirmation process, standardize the procedures that auditors perform to support their use of

¹⁰¹ See, e.g., Hanwen Chen, Jeff Zeyun Chen, Gerald J. Lobo, and Yanyan Wang, *Effects of audit quality on earnings management and cost of equity capital: Evidence from China*, 28 *Contemporary Accounting Research* 892, 921 (2011); Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research* 385, 410 (2007).

intermediaries, and allow for the use or development of more sophisticated and effective technology-based auditing tools. To the extent that a firm has already implemented certain of the provisions of the new standard into its firm methodology, the benefits described below will be reduced.

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new standard should benefit investors and other users of a company's financial statements by placing additional emphasis on the auditor's need to obtain reliable audit evidence when performing confirmation procedures. In this regard, the new standard: (1) identifies certain accounts for which the auditor should perform confirmation procedures, (2) enhances the requirements for assessing the reliability of confirmation responses, (3) addresses the performance of alternative procedures when the auditor is unable to obtain relevant and reliable audit evidence through confirmation, (4) strengthens requirements regarding the use of negative confirmation requests, and (5) specifies certain activities in the confirmation process that should be performed by the auditor and not by other parties.

Specifically, the new presumption for the auditor to confirm certain cash and cash equivalents held by third parties or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source may reduce the risk of material errors in financial statements and strengthen investor protection to the extent that auditors are not already confirming cash pursuant to their existing audit methodologies.¹⁰² This requirement also specifies that the extent of audit evidence to obtain through cash confirmation procedures should be based on the auditor's understanding of the company's cash management and treasury function.

The standard does not require that all cash accounts or all accounts receivable should be selected for confirmation. The auditor's assessment of the risk of material misstatement is an important consideration when designing audit procedures, including the use of confirmation. Consistent with the objective of the new standard, the requirement to confirm cash and accounts receivable, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, only applies when the auditor has determined that these accounts are significant accounts. Further, for both cash and accounts receivable, the new standard specifies that the auditor should take into account the auditor's understanding of the substance of a company's arrangements and transactions with third parties when selecting the individual items to confirm. These provisions

¹⁰² As discussed above, the staff's review of firm methodologies indicated that some firms are already confirming cash balances, while other firms' methodologies do not require auditors to perform procedures beyond those required by AS 2310. The growth in corporate cash holdings also highlights the need to confirm cash and cash equivalents. See, e.g., Kevin Amess, Sanjay Banerji, and Athanasios Lampousis, *Corporate Cash Holdings: Causes and Consequences*, 42 *International Review of Financial Analysis* 421, 422 (2015).

in the new standard should encourage the auditor to determine the extent of confirmation procedures with regard to an assessment of the risk of material misstatement and avoid more work than necessary to obtain sufficient appropriate audit evidence.

However, to the extent that cash or accounts receivable fall within the scope of the new standard, the new standard strengthens the requirement to obtain relevant and reliable audit evidence, whether through performing confirmation procedures or otherwise obtaining audit evidence by directly accessing information maintained by a knowledgeable external source. At the same time, the new standard also addresses situations where, based on the auditor's experience, confirmation would not be feasible for accounts receivable. The additional clarity provided by these requirements in the new standard should reduce uncertainty in auditor responsibilities and promote consistency in practice with respect to the confirmation of cash and accounts receivable.

The new standard strengthens requirements addressing the reliability of confirmation responses by describing information that the auditor should take into account when evaluating the reliability of confirmation responses and providing examples of information that indicates that a confirmation request or response may have been intercepted or altered. These requirements are expected to improve the reliability of confirmation responses and therefore increase the quality of the audit evidence obtained by the auditor.

The requirement to communicate to the audit committee instances where, for significant risks associated with cash or accounts receivable, the auditor did not perform confirmation procedures or obtain audit evidence by directly accessing information maintained by a knowledgeable external source is expected to reinforce the auditor's obligation to exercise due professional care in determining not to perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

The new standard also expands on the existing requirement to address the auditor's potential need to apply alternative procedures. The enhanced requirements for alternative procedures provide a greater level of detail and clarity to auditors for situations that are not currently addressed explicitly in existing AS 2310, potentially raising the quality of evidence obtained by auditors.

Under the new standard, the auditor may only use negative confirmation requests to supplement other substantive audit procedures; negative confirmation requests may not be used as the sole substantive audit procedure. As discussed in Section II.D, the amount of electronic correspondence has increased dramatically over the years, leading to an increased likelihood that a negative confirmation request would not be appropriately considered by the confirming party and, therefore, would provide less persuasive audit evidence. The new standard addresses this issue by providing examples of situations in which negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence. As negative confirmation

requests cannot be the sole source of audit evidence obtained, insofar as the new standard affects practice, the overall quality of audit evidence obtained by the auditor likely will increase.¹⁰³

Overall, the additional requirements and examples discussed above are expected to improve the reliability of confirmation responses and, therefore, increase the quality of the audit evidence obtained by the auditor. By introducing a new requirement to confirm certain cash balances (or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source) and enhancing the requirements for evaluating the reliability of confirmation responses, the new standard may also increase the auditor's likelihood of identifying potential financial statement fraud. Early detection of accounting fraud is an important aspect of investor protection because such fraud can cause significant harm to investors in the companies engaged in fraud, as well as indirect harm to investors in other companies.¹⁰⁴ In addition, by clarifying and strengthening the auditor's responsibilities, including by specifying additional situations where alternative procedures may be necessary and providing additional examples of information that indicates that a confirmation request or response may have been intercepted and altered, the new standard takes into account past inspection findings by the Board that auditors did not obtain sufficient appropriate audit evidence when using confirmation.

One commenter on the proposing release expressed the view that the proposed standard would not achieve a significant reduction in inspection findings or improvements to audit quality because adverse inspection findings have historically focused on a failure to appropriately execute existing requirements. As discussed in Section IV.B above, however, the need for this rulemaking is not limited to noncompliance with the current standard detected through our inspections program, but also reflects undetected financial reporting frauds and developments in practice. We continue to believe, therefore, that the rule will achieve its intended benefits, which include increased clarity from the new standard.

ii. Developments in Practice

The new standard modernizes existing AS 2310 by accommodating certain developments in practice, including the use of electronic communications and intermediaries.

¹⁰³ The Board understands through its oversight activities that few, if any, GNFs use negative confirmation requests as the sole substantive procedure in practice. As discussed in Section IV.A, however, the staff's firm methodology review suggests that all the GNFs and NAFs reviewed will need to update their methodologies to ensure that negative confirmation requests are not used as the sole source of audit evidence.

¹⁰⁴ See Yang Bao, Bin Ke, Bin Li, Y. Julia Yu, and Jie Zhang, *Detecting Accounting Fraud in Publicly Traded US Firms Using a Machine Learning Approach*, 58 *Journal of Accounting Research* 199, 200 (2020).

Specifically, the new standard accommodates changes in how communications occur between the auditor and confirming parties. It clarifies the auditor's responsibilities by taking into account current confirmation practices among auditors and acknowledging differing methods of confirmation. These methods include longstanding methods, such as the use of paper-based confirmation requests and responses sent via postal mail. They also include methods that have become commonplace since the existing standard was adopted, including confirmation requests and responses communicated via e-mail and the use of intermediaries to facilitate the direct electronic transmission of confirmation requests and responses. This additional clarity may enhance the reliability of audit evidence by decreasing the risk that a confirmation request or response is intercepted and altered. In addition, the new standard includes requirements specific to an intermediary's controls that mitigate the risk of interception and alteration. The requirements are expected to standardize the procedures auditors perform to support their use of intermediaries and reduce audit deficiencies in this area.

With regard to both cash and accounts receivable, the new standard accommodates the potential for future evolution of audit tools by allowing auditors to directly obtain access to relevant and reliable audit evidence from knowledgeable external sources other than through confirmation without the involvement of the company. This change allows for the use or development of technology-based auditing tools, subject to the requirement that they provide audit evidence by directly accessing information maintained by knowledgeable external sources about the relevant financial statement assertion. Accordingly, this change could potentially improve the efficiency and effectiveness of the audit.

Some commenters on the 2022 Proposal questioned the benefits of the proposed requirements, arguing that the auditor's inability under the proposed standard to overcome the presumption to confirm cash and a high threshold to overcome the presumption to confirm accounts receivable unduly restricted the ability to use professional judgment to determine the appropriateness of confirmation procedures. While we agree that professional judgment plays an important role in the execution of audit procedures, the Board's experience indicates that it is also important for investor protection that auditors obtain relevant and reliable audit evidence for both cash and accounts receivable when they are significant accounts. With regard to accounts receivable, the new standard retains the presumption to perform audit procedures to obtain relevant and reliable evidence through confirmation, or otherwise by directly accessing information maintained by a knowledgeable external source, so would not decrease or remove the auditor's current responsibility. Furthermore, the new standard includes a provision to address situations when obtaining audit evidence directly from knowledgeable external sources, whether through confirmation procedures or other means, would not be feasible to execute for accounts receivable. Accordingly, the new standard strikes a balance intended to benefit investors by recognizing the value of professional judgment generally with respect to the use of confirmation while ensuring that cash and accounts receivable, when they are significant accounts, are subject to confirmation or other audit procedures designed to obtain relevant and reliable audit evidence from knowledgeable external sources.

2. Costs

We expect the costs associated with the new standard to be relatively modest. The staff's review of audit firm methodologies related to the confirmation process indicates that some firms have already incorporated into practice some of the new requirements. For example, the methodologies of some GNFs include requirements for confirmation of cash that are similar to the requirements in the new standard. Both the GNF and NAF methodologies reviewed generally include guidance on maintaining control over the confirmation process and the use of intermediaries to facilitate the electronic transmission of confirmation requests and responses.

To the extent that audit firms need to make changes to meet the new requirements, they may incur certain fixed costs (i.e., costs that are generally independent of the number of audits performed) to implement the new standard. These include costs of updating audit methodologies and tools, and costs to prepare training materials and conduct internal training. GNFs are likely to update methodologies using internal resources, whereas NAFs are more likely to purchase updated methodologies from external vendors. The costs of updating these methodologies likely depend on the extent to which the new requirements have already been incorporated in the firms' current methodologies. For firms that have implemented confirmation procedures like those required by the new standard, the costs of updating methodologies may be lower than for firms that currently do not have such procedures. In this regard, large firms may also benefit from economies of scale. As mentioned in Section IV.A, one commenter indicated that some larger audit firms have already established confirmation centers to centrally process the sending of confirmation requests and receiving of confirmation responses. For these firms, costs to implement the new standard may be further diminished as these firms may benefit from lower training costs and more efficient performance of the enhanced procedures. Smaller audit firms may not have adequate resources to establish such confirmation centers and may not recognize similar efficiency gains. The commenter observed that the establishment of confirmation centers within audit firms would require significant resources, which smaller audit firms may not have.

In addition, audit firms may incur certain engagement-level variable costs related to implementing the new standard. For example, the requirement to confirm certain cash balances or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source could impose engagement-level costs on some auditors if additional procedures need to be performed. Similarly, limiting the use of negative confirmation requests to situations where the auditor is also performing other substantive audit procedures could lead to additional time and effort by the auditor to perform the other audit procedures.

The magnitude of the variable costs likely depends on the extent to which existing practice differs from the new requirements. As discussed above, the staff's review of firm methodologies, which included the methodologies of certain NAFs, suggests that the new

standard likely will lead to a greater impact on confirmation procedures performed by smaller firms. Because the new standard generally applies a risk-based approach (i.e., by providing that the use of confirmation may be part of the auditor's response to the assessed risks of material misstatement), the costs of performing the additional procedures are unlikely to be disproportionate to the benefits.

To the extent that auditors incur higher costs to implement the new standard and are able to pass on at least part of the increased costs through an increase in audit fees, companies being audited could incur an indirect cost.¹⁰⁵ Moreover, confirming parties could incur additional costs from supporting the confirmation process as a result of the enhanced requirements of the new standard, although the additional costs are expected to be limited. One commenter agreed that confirming parties may incur additional costs as they may have to allocate resources to respond to confirmation requests. As discussed in Section IV.A, however, confirmation is already commonly used by audit firms, and we therefore do not expect confirming parties to incur significant additional costs to respond to confirmation requests as a result of the new standard.

Some requirements under the new standard may result in more costs than others. The following discussion describes the potential costs associated with specific changes to existing confirmation requirements.

i. Focus on Obtaining Reliable Audit Evidence from the Confirmation Process

The new standard: (1) identifies certain accounts for which the auditor should perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source, (2) enhances the requirements for assessing the reliability of confirmation responses, (3) addresses the performance of alternative procedures when the auditor is unable to obtain relevant and reliable audit evidence through confirmation, (4) strengthens requirements regarding the use of negative confirmation requests, and (5) specifies certain activities in the confirmation process that should be performed by the auditor and not by other parties.

For some firms, the requirement in the new standard to confirm certain cash balances or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source could be expected to result in the revision of firm methodologies and the performance of additional audit procedures. As discussed in Section IV.A, the methodologies of some GNPs already include requirements for cash

¹⁰⁵ One commenter stated that the cost of audit would increase if auditors were required to send confirmations on any and all information that can be confirmed by external parties. While we note that the new standard does not require confirmations on any and all information that can be confirmed, we agree that companies being audited can incur indirect costs to the extent that auditors pass on at least part of the increased costs in terms of increased audit fees to companies.

confirmation that are similar to the new requirement described in the new standard. In addition, the risk-based approach in the new requirement should encourage the auditor to determine the extent of confirmation with regard to an assessment of the risks of material misstatement and conduct only the work necessary to obtain sufficient audit evidence.

Commenters on the 2022 Proposal asserted that confirming cash balances under the proposed standard would lead to increased costs, given the lack of discretion and ability to overcome the presumption in the proposed standard. In addition, some commenters on the 2022 Proposal asserted that the “at least as persuasive as” threshold in the proposed standard for overcoming the presumption to confirm accounts receivable would limit the auditor’s use of professional judgment and could result in greater costs without a commensurate benefit to audit quality.

As discussed in Section III.G above, there is a presumption in the new standard that the auditor should obtain audit evidence from a knowledgeable external source by performing confirmation procedures or using other means to obtain audit evidence by directly accessing information maintained by knowledgeable external sources. In addition, the new standard provides that if, based on the auditor’s experience, it would not be feasible for the auditor to obtain audit evidence about accounts receivable pursuant to paragraph .24, the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details. Insofar as the final standard does not otherwise provide auditors with the discretion to avoid obtaining audit evidence directly from a knowledgeable external source for cash, and the only exception applicable to accounts receivable is for situations where obtaining audit evidence directly from a knowledgeable external source would not be feasible, firms may, therefore, incur additional costs to comply with the presumptive requirements of the new standard for cash and accounts receivable. These costs, however, are necessary to the achievement of the standard’s intended benefits of emphasizing the quality and strength of the audit evidence to be obtained from knowledgeable external sources.

The new standard also requires the auditor to evaluate the reliability of confirmation responses and provides examples of information that indicate that a confirmation response may have been intercepted and altered. The costs associated with this requirement, however, are expected to be limited. First, the Board’s auditing standards already require the auditor to obtain sufficient appropriate audit evidence to provide a reasonable basis for the auditor’s report, and to evaluate the combined evidence provided by confirmation and other auditing procedures performed when the auditor has not received replies to confirmation requests (i.e., nonresponses) to determine whether sufficient evidence has been obtained about all the applicable financial statement assertions.¹⁰⁶ Second, the methodologies of some firms reflect application material in ISA 505 regarding factors (similar to indicators in the new standard) that may indicate doubts about the reliability of a confirmation response. One of these factors is analogous to the requirement in the new standard (i.e., the confirmation response appears not

¹⁰⁶ See AS 1105.04; AS 2310.33.

to come from the originally intended confirming party), which may further limit the potential costs for firms that have incorporated this factor in their methodologies. One commenter on the 2022 Proposal stated that the proposed standard's requirement for evaluating the reliability of confirmation responses might cause the auditor to need to authenticate confirmation responses, which would add significant expense to the audit. However, as discussed in Section III, AS 1105 already establishes the requirements for evaluating the reliability of audit evidence, and the new standard does not change those requirements.

The requirement for the auditor to communicate with the audit committee when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by knowledgeable external sources for significant risks associated with either cash or accounts receivable could impose a modest incremental cost. Some commenters on the 2022 Proposal had expressed concern about the proposed requirement to communicate with the audit committee in all instances where the presumption to confirm accounts receivable had been overcome, which could be detrimental if the communication became a mere compliance exercise for auditors and audit committees. The new standard's requirement to communicate with the audit committee, however, is more risk-based and therefore, we continue to believe that the incremental costs will be modest.

Insofar as the new standard identifies additional situations in which the auditor generally would be required to perform alternative procedures, firms may incur additional costs. Specifically, the new standard extends the requirement in existing AS 2310 to perform alternative procedures in relation to nonresponses to positive confirmation requests to other situations, including the auditor's inability to identify a confirming party and the receipt of an unreliable response.

In contrast with existing AS 2310, negative confirmation requests may not be used as the sole substantive audit procedure under the new standard. This limitation reflects, among other things, the increase in the volume of electronic correspondence since existing AS 2310 was issued and the increasing likelihood that a recipient of a negative confirmation request would not consider the request. As a result, auditors may have to perform other substantive audit procedures for certain financial statement assertions. Although the Board understands through its oversight activities that few, if any, GNFs use negative confirmation requests as the sole substantive procedure in practice, as discussed in Section IV.A, the staff's firm methodology review suggests that all the GNFs and NAFs reviewed will need to review their methodologies to ensure that negative confirmation requests are not used as the sole source of audit evidence.

ii. Developments in Practice

As discussed in Section III.E, the new standard includes requirements that clarify the procedures auditors should perform to support their use of intermediaries to facilitate the direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. These requirements may lead to modifications to firm methodologies.

Further, the required procedures may involve additional auditor time and effort. The resulting costs likely depend on the extent to which the new requirements have already been incorporated in a firm's current methodologies. One commenter expressed concern that the proposed requirement to assess the intermediary's controls would result in significant additional work for auditors because it is not currently common practice to directly assess intermediaries in this manner. The staff's review of firm methodologies discussed above in Section IV.A did not suggest that the requirements in Appendix B of the new standard would create significant additional work for auditors. In particular, both the GNF and NAF methodologies reviewed generally already include guidance on maintaining control over the confirmation process and the use of intermediaries, which may limit the costs. In addition, we note that the requirements in the new standard relate to relevant controls that address the risk of interception and alteration of confirmation requests and responses and that some intermediaries currently make information about relevant internal controls available to auditors through a SOC report.

If the auditor is able to obtain audit evidence by directly accessing information maintained by knowledgeable external sources instead of confirmation, such audit evidence could be at least as persuasive as audit evidence obtained through confirmation procedures, and the new standard allows the auditor to perform such procedures. This provision is not expected to impose new costs on firms, as firms would only obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source to the extent that technological advancements render it more efficient than performing confirmation procedures. Thus, to the extent that the auditor is able to replace confirmation procedures with obtaining audit evidence by directly accessing information maintained by a knowledgeable external source, the new standard could reduce costs for firms.

3. Potential Unintended Consequences

In addition to the benefits and costs discussed above, the new standard could have unintended economic impacts. The following discussion describes potential unintended consequences we have considered and, where applicable, factors that mitigate the negative consequences, such as steps we have taken or the existence of other countervailing forces.

i. Potential Decline in Auditors' Usage of Confirmation

An unintended consequence of the new standard would occur if, contrary to the Board's expectation, there were a significant reduction in the use of confirmation procedures by auditors in circumstances where confirmation would provide relevant and reliable audit evidence.

Under the new standard, auditors retain the ability to use confirmation as one procedure, among others, to audit one or more financial statement accounts or disclosures. At the same time, the new standard strengthens the requirements for an auditor regarding evaluating the reliability of confirmation responses and addressing confirmation exceptions and

incomplete responses, including performing alternative procedures to obtain audit evidence. Further, the new standard describes the types of procedures the auditor should perform in evaluating the effect of using an intermediary on the reliability of confirmation requests and responses, including determining whether relevant controls of the intermediary are designed and operating effectively. In addition, the new standard does not allow the auditor to use negative confirmation requests as the sole substantive procedure. As a result, when not required to use confirmation, auditors might decline to use confirmation and use other audit procedures more frequently than under existing AS 2310 if they perceive there could be more time or cost involved in the confirmation process relative to the performance of other procedures.

This potential unintended consequence is mitigated, however, by the requirement that the auditor should perform confirmation procedures for cash and accounts receivable, or otherwise obtain audit evidence by directly accessing information maintained by knowledgeable external sources. In addition, the Board's standards already provide that the auditor should evaluate whether the combined evidence provided by confirmation and other auditing procedures provide sufficient evidence about the applicable financial statement assertions. Several of the changes to existing requirements in the new standard align with our understanding of current practice. For example, many audit firms' methodologies include guidance on maintaining control and the use of intermediaries. Additionally, the potential unintended consequence may be mitigated to the extent that a firm has experienced efficiencies from using newer audit tools for confirmation through reduced time or costs. Further, we do not anticipate that the requirements of the new standard will cause a significant change in the timing or extent of confirmation procedures for auditors, as we have not amended the requirements of AS 2301, which is the auditing standard that addresses those matters. Accordingly, we do not believe that the new standard will lead to a significant decline in the use of confirmation.

ii. Potential Misinterpretation of the Requirements in the New Standard Relating to the Confirmation of Cash and Accounts Receivable

An unintended consequence of the presumed requirement in the new standard to confirm cash and accounts receivable would arise if auditors misinterpreted the language in the new standard as requiring the confirmation of cash and accounts receivable in all situations. For example, the new standard does not carry forward a provision included in existing AS 2310 that an auditor could overcome the presumption to confirm accounts receivable if, among other things, "[t]he use of confirmations would be ineffective." It is possible that some auditors might misinterpret the elimination of this language as precluding the exercise of auditor judgment with respect to the confirmation of accounts receivable. Some commenters on the 2022 Proposal appeared to misinterpret the proposed requirement and suggested that confirmation would be required in all situations. For example, one commenter asserted that using confirmation regardless of risk assessment may promote a checklist mentality that does not contribute to audit quality and an audit approach that may be less efficient and effective.

We do not intend, however, that an auditor send confirmation requests for accounts receivable in all situations or when such procedures do not provide relevant and reliable audit evidence. If the auditor has not determined cash or accounts receivable to be a significant account, the new standard does not require the confirmation of cash or accounts receivable. Moreover, to clarify our intent, we have modified the language in the proposed standard in several respects. First, paragraph .25 of the new standard addresses situations when obtaining audit evidence about accounts receivable directly from knowledgeable external sources, whether through confirmation procedures or other means, would not be feasible to execute. If it is not feasible for the auditor to obtain audit evidence about accounts receivable directly from a knowledgeable external source, the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details.

In addition, we are not adopting paragraph .07 of the proposed standard, which referred to situations where evidence obtained through the confirmation process “generally is more persuasive than audit evidence obtained solely through other procedures” and may have contributed to a misperception that we were proposing to require confirmation in all circumstances. In our view, the language in the new standard acknowledges the role of professional judgment in the auditor’s selection of audit procedures to obtain sufficient appropriate audit evidence, while retaining a presumption to confirm cash and accounts receivable or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. This should mitigate the potential unintended consequence described above.

D. Alternatives Considered

The development of the new standard involved considering a number of alternative approaches to address the problems described above. This section explains: (i) why standard setting is preferable to other policy-making approaches, such as providing interpretive guidance or enhancing inspection or enforcement efforts; (ii) other standard-setting approaches that were considered; and (iii) key policy choices made by the Board in determining the details of the new standard-setting approach.

1. Why Standard Setting is Preferable to Other Policy-Making Approaches

The Board's policy tools include alternatives to standard setting, such as issuing additional interpretive guidance, or increasing our focus on inspections or enforcement of existing standards. We considered whether providing guidance or increasing inspection or enforcement efforts would be effective mechanisms to address concerns with the auditor’s use of confirmation.

Interpretive guidance inherently provides additional information about existing standards. Inspection and enforcement actions take place after insufficient audit performance (and potential investor harm) has occurred. Devoting additional resources to interpretive guidance, inspections, or enforcement activities, without improving the relevant performance

requirements for auditors, would at best focus auditors' performance on existing standards and would not provide the benefits discussed in Section IV.C associated with improving the standards. The new standard, on the other hand, is designed to improve existing requirements for the auditor's use of confirmation. For example, the new standard, unlike existing AS 2310, includes requirements relating to the confirmation of cash accounts, imposes additional limitations on the use of negative confirmation requests, clarifies the circumstances in which auditors would be expected to perform alternative procedures, and includes explicit provisions addressing the auditor's responsibility for selecting items to be confirmed, sending confirmation requests, and receiving confirmation responses.

2. Other Standard-Setting Alternatives Considered

Several alternative standard-setting approaches were also considered, including: (i) making amendments to the existing standard; and (ii) adopting an approach based on ISA 505, with certain modifications to reflect the PCAOB's statutory responsibilities with respect to audits of public companies and registered broker-dealers.

i. Amendments to Existing Standard

We considered, but decided against, limiting the amendments to AS 2310 solely to modifications relating to changes in technology that have affected the confirmation process. While this approach could result in fewer changes to firms' audit methodologies, we believe there are a number of other areas discussed throughout this release, beyond amending AS 2310 to reflect the increasing use of technology in the confirmation process, where the existing standard should be improved.

ii. Standard Based on ISA 505

Some commenters on the 2009 Concept Release and the 2010 Proposal suggested that the Board should consider adopting ISA 505, the IAASB's standard on audit confirmation, which was issued in 2008. We have taken the requirements and application material of ISA 505 into account in developing the new standard (e.g., the ISA 505 application material relating to the use of a third party to coordinate and provide responses to confirmation requests).

We concluded, however, that the new standard should also establish certain requirements that are not included in ISA 505 (e.g., requirements to confirm cash and accounts receivable or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source), and should not include certain provisions that are described in ISA 505 (e.g., regarding management's refusal to allow the auditor to send a confirmation request). In addition, audit practices have continued to evolve since ISA 505 was issued in 2008, and we believe that the new standard should reflect these developments (e.g., by addressing electronic communication and the use of intermediaries in the requirements of the standard rather than in application materials).

3. Key Policy Choices

Given a preference for replacing existing AS 2310 in its entirety, we considered different approaches to addressing key policy issues.

i. Use of Confirmation Procedures for Specific Accounts

The new standard provides that when addressing an assessed risk of material misstatement of cash and cash equivalents held by third parties, as well as of accounts receivable that arise from the transfer of goods or services to a customer or a financial institution's loans, the auditor should perform confirmation procedures or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source. In addition, under the new standard, when obtaining audit evidence from a knowledgeable external source regarding cash, the auditor should consider sending confirmation requests to that source about other financial relationships with the company, based on the assessed risk of material misstatement. Also, when the auditor has identified a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk. The new standard does not specify other significant accounts or disclosures that the auditor should confirm or consider confirming. We considered several alternatives to this approach, as discussed below.

First, we considered an approach that would have no requirement for the auditor to confirm specified accounts or transactions. In our view, this approach might result in the selection by some auditors of audit procedures that provide less relevant and reliable audit evidence than confirmation with respect to cash and accounts receivable (e.g., if an auditor mistakenly assessed the risk of material misstatement too low for cash or accounts receivable). Further, confirmation of cash and accounts receivable is already a standard practice for many auditors and is consistent with the concept that audit evidence obtained from a knowledgeable external source is more reliable than evidence obtained only from internal company sources. Accordingly, we have decided against an approach that does not require the confirmation of any accounts and disclosures in the new standard.

In addition, we considered including in the new standard a requirement that the auditor should confirm other accounts in addition to cash and accounts receivable, such as investments. We have decided against this approach because it would limit auditor judgment in circumstances where the performance of other auditing procedures might provide relevant and reliable audit evidence, could be viewed as unduly prescriptive, and would not allow the auditor to take company-specific facts and circumstances into account. Instead, under the new standard, the auditor could decide to perform confirmation procedures with respect to financial statement assertions relating to other accounts and disclosures but is not required to do so.

We also considered an additional requirement that the auditor should perform confirmation procedures in response to significant risks that relate to relevant assertions, when such assertions can be adequately addressed by confirmation procedures. However we believe that such a requirement would be inconsistent with the Board's risk assessment standards, which allow for auditor judgment in determining the audit response to significant risks identified by the auditor. We have not included this provision in the new standard.

ii. Management Requests Not to Confirm

We considered addressing situations where management requests that the auditor not confirm one or more items in the new standard. Specifically, we considered requiring the auditor to obtain an understanding of the reasons for management's request, perform alternative procedures as discussed in Appendix C of the new standard, and communicate the request to the audit committee. In addition, we considered a requirement that the auditor should evaluate the implications for the auditor's report if the auditor determines that management's request impairs the auditor's ability to obtain sufficient appropriate audit evidence or indicates that one or more fraud risk factors are present. For the reasons discussed in Section III.J, we have decided not to include such provisions in the new standard.

V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

Pursuant to Section 104 of the Jumpstart Our Business Startups Act ("JOBS Act"), rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of emerging growth companies ("EGCs"), as defined in Section 3(a)(80) of the Securities Exchange Act of 1934, unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation."¹⁰⁷ As a result of the JOBS Act, the rules and related amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

To inform consideration of the application of auditing standards to audits of EGCs, PCAOB staff prepares a white paper annually that provides general information about

¹⁰⁷ See Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act, also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and analysis) shall not apply to an audit of an EGC. The new standard does not fall within either of these two categories.

characteristics of EGCs.¹⁰⁸ As of the November 15, 2021 measurement date, PCAOB staff identified 3,092 companies that self-identified with the SEC as EGCs and filed audited financial statements in the 18 months preceding the measurement date.

Confirmation is a longstanding audit procedure used in nearly all audits, including audits of EGCs. The discussion of benefits, costs, and unintended consequences in Section IV is generally applicable to audits of EGCs. The economic impacts of the new standard on an EGC audit depend on factors such as the audit firm's current methodologies, the audit firm's ability to distribute implementation costs across engagements, and the auditor's assessed risk of material misstatement.

EGCs are likely to be newer companies, which may increase the importance to investors of the external audit to enhance the credibility of management disclosures.¹⁰⁹ Further, compared to non-EGCs, EGCs are more likely to be audited by NAFs.¹¹⁰ As discussed in Section IV.A, NAFs are expected to make more changes to their methodologies and practice to comply with the new standard. Therefore, all else equal, the benefits of the higher audit quality resulting from the new standard may be larger for EGCs than for non-EGCs, including improved

¹⁰⁸ For the most recent EGC report, see *White Paper on Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2021* (Jan. 5, 2023) ("EGC White Paper"), available at <https://pcaobus.org/resources/other-research-projects>.

¹⁰⁹ Researchers have developed a number of proxies that are thought to be correlated with information asymmetry, including small issuer size, lower analyst coverage, larger insider holdings, and higher research and development costs. To the extent that EGCs exhibit one or more of these properties, there may be a greater degree of information asymmetry for EGCs than for the broader population of companies, which increases the importance to investors of the external audit to enhance the credibility of management disclosures. See, e.g., Mary E. Barth, Wayne R. Landsman, and Daniel J. Taylor, *The JOBS Act and Information Uncertainty in IPO Firms*, 92 *The Accounting Review* 25, 25 (2017); Steven A. Dennis and Ian G. Sharpe, *Firm Size Dependence in the Determinants of Bank Term Loan Maturity*, 32 *Journal of Business Finance and Accounting* 31, 59 (2005); Michael J. Brennan and Avaniidhar Subrahmanyam, *Investment Analysis and Price Formation in Securities Markets*, 38 *Journal of Financial Economics* 361, 363 (1995); David Aboody and Baruch Lev, *Information Asymmetry, R&D, and Insider Gains*, 55 *Journal of Finance* 2747, 2755 (2000); Raymond Chiang and P. C. Venkatesh, *Insider Holdings and Perceptions of Information Asymmetry: A Note*, 43 *Journal of Finance* 1041, 1047 (1988); Molly Mercer, *How Do Investors Assess the Credibility of Management Disclosures?*, 18 *Accounting Horizons* 185, 194 (2004). Furthermore, research has shown that reduced disclosure requirements for EGCs are associated with lower audit effort. The academic literature has also documented evidence of lower audit quality for EGCs. To the extent that the new standard will increase auditor effort, EGCs are expected to benefit from higher audit quality. See, e.g., Tiffany J. Westfall and Thomas C. Omer, *The Emerging Growth Company Status on IPO: Auditor Effort, Valuation, and Underpricing*, 37 *Journal of Accounting and Public Policy* 315, 316 (2018); Essam Elshafie, *The Impact of Reducing Reporting Requirements on Audit Quality, Auditor Effort and Auditor Conservatism*, 35 *Accounting Research Journal* 756, 756 (2022).

¹¹⁰ EGC White Paper at 22.

efficiency of market capital allocation, lower cost of capital, and enhanced capital formation.¹¹¹ In particular, because investors who face uncertainty about the reliability of a company's financial statements may require a larger risk premium that increases the cost of capital to companies, the improved audit quality resulting from applying the new standard to EGC audits could reduce the cost of capital to those EGCs.¹¹²

While the associated costs may also be higher for EGC audits than for non-EGC audits, because of the scalability of the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures. Moreover, if any of the new amendments were determined not to apply to the audits of EGCs, auditors would need to address differing audit requirements in their methodologies, or policies and procedures, with respect to audits of EGCs and non-EGCs, which would create the potential for confusion. The new standard could impact competition in an EGC product market if the indirect costs to audited companies disproportionately impact EGCs relative to their competitors. However, as discussed in Section IV.C above, the costs associated with the new standard are expected to be relatively modest. Therefore, the impact of the new standard on competition, if any, is expected to be limited. Overall, the new standard is expected to enhance audit quality and contribute to an increase in the credibility of financial reporting by EGCs.

Accordingly, and for the reasons explained above, the Board will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the new standard to audits of EGCs. One commenter specifically supported the application of the 2022 Proposal to EGCs.

VI. EFFECTIVE DATE

The Board determined that the amendments will take effect, subject to approval by the SEC, for audits of financial statements for fiscal years ending on or after June 15, 2025.

As part of the 2022 Proposal, the Board sought comment on the amount of time auditors would need before the proposed standard and related amendments would become effective, if adopted by the Board and approved by the SEC. Many commenters, primarily firms

¹¹¹ The enhanced quality of audits and financial information available to financial markets may result in investors perceiving less risk in capital markets. This, in turn, may lead to an increase in the supply of capital which could increase capital formation. *See, e.g.,* Hanwen Chen, Jeff Zeyun Chen, Gerald J. Lobo, and Yanyan Wang, *Effects of audit quality on earnings management and cost of equity capital: Evidence from China*, 28 *Contemporary Accounting Research* 892, 921 (2011); Richard Lambert, Christian Leuz, and Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 *Journal of Accounting Research* 385, 410 (2007).

¹¹² For a discussion of how increasing reliable public information about a company can reduce risk premium, *see* David Easley and Maureen O'Hara, *Information and the Cost of Capital*, 59 *The Journal of Finance* 1553, 1578 (2004).

and firm-related groups, supported an effective date of no earlier than two years after SEC approval, which some commenters indicated would give firms the necessary time to update firm methodologies and to develop and implement training. Additionally, as part of recommending an effective date no earlier than two years after SEC approval, a number of commenters observed that confirmation procedures are often performed as part of interim procedures and that, as a result, the new standard will impact engagement teams during the period under audit. Some commenters also stated that intermediaries involved in the confirmation process may also need to update their processes and controls as a result of the new standard. One commenter supported an effective date three years after SEC approval, while citing reasons similar to those expressed by commenters who supported an effective date of no earlier than two years after SEC approval.

The Board recognizes the preferences expressed by commenters. Nonetheless, having considered the requirements of the new standard, as well as the extent of differences between the new standard and AS 2310 and our understanding of firms' current practices, we believe that the effective date for fiscal years ending on or after June 15, 2025 will provide auditors with a reasonable period of time to implement the new standard and related amendments, without unduly delaying the intended benefits resulting from these improvements to PCAOB standards, and is consistent with the Board's mission to protect investors and protect the public interest.

* * *

On the 28th day of September, in the year 2023, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

September 28, 2023

* * *

APPENDIX 1 – NEW STANDARD

For the reasons set forth in this release, AS 2310 is retitled and amended in its entirety with the following:

AS 2310: The Auditor’s Use of Confirmation

Introduction

.01 This standard establishes requirements regarding obtaining audit evidence from a knowledgeable external source through the auditor’s use of confirmation. The standard also includes additional requirements regarding obtaining audit evidence for cash, accounts receivable and terms of certain transactions.

Objective

.02 The objective of the auditor in designing and executing the **confirmation process** is to obtain relevant and reliable audit evidence from a knowledgeable external source about one or more relevant financial statement assertions of a significant account or disclosure.¹

Relationship of the Confirmation Process to the Auditor’s Identification and Assessment of and Response to the Risks of Material Misstatement

.03 AS 2110, *Identifying and Assessing Risks of Material Misstatement*, establishes requirements regarding the process of identifying and assessing risks of material misstatement of the financial statements and provides that the auditor’s assessment of risks of material misstatement, including fraud risks, should continue throughout the audit. When the auditor obtains audit evidence during the course of the audit (including through the confirmation process) that contradicts the audit evidence on which the auditor originally based the risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in respect to the revised risk assessments.²

.04 AS 2301, *The Auditor’s Responses to the Risks of Material Misstatement*, requires the auditor to design and implement appropriate responses that address risks of material misstatement. This may include using confirmation to address the assessed risks of material misstatement for certain relevant assertions of significant accounts and disclosures.

¹ Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.

² See AS 2110.74; see also paragraphs .02 and .29 of AS 1105, *Audit Evidence*.

Note: If different components in a significant account or disclosure are subject to significantly differing risks of material misstatement, the auditor's responses should include procedures that are responsive to the differing risks of material misstatement.

.05 AS 2301 provides that as the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by substantive procedures depends upon the mix of the nature, timing, and extent of those procedures.

Note: AS 2110.68 provides that the auditor should presume that there is a fraud risk involving improper revenue recognition. According to paragraph .54 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*, examples of audit procedures that might be performed in response to this risk include confirming with customers certain relevant contract terms and the absence of side agreements.

.06 Audit evidence obtained from a knowledgeable external source is generally more reliable than evidence obtained only from internal company sources.³ The following are examples of financial statement assertions for which the confirmation process, when properly designed and executed, can provide relevant and reliable audit evidence:

- Existence (e.g., cash, accounts receivable, investments)
- Occurrence (e.g., revenue transactions)
- Completeness (e.g., accounts payable, debt)
- Rights and obligations (e.g., cash, assets pledged as collateral)

.07 This standard describes the auditor's responsibilities related to the confirmation process, as follows:

- Paragraphs .08-.13 discuss designing the **confirmation request**.
- Paragraphs .14-.17 discuss maintaining control over the confirmation process.
- Paragraphs .18-.23 discuss **confirmation responses**, **confirmation exceptions** and **nonresponses**.
- Paragraphs .24-.30 discuss additional considerations for cash, accounts receivable, and terms of certain transactions.
- Paragraph .31 discusses evaluating the results of confirmation and other audit procedures.

³ See AS 1105.08.

Other PCAOB standards also address auditor responsibilities relevant to the auditor's use of confirmation.⁴ This standard does not address matters described in AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

Designing Confirmation Requests

Identifying Information to Confirm

.08 The auditor should identify the information related to the relevant assertions that the auditor plans to verify with **confirming parties** or (when using a blank form) obtain from confirming parties.

Note: Some forms of **positive confirmation requests** ask the confirming party to indicate whether the confirming party agrees with the information stated on the request. Other forms of positive confirmation requests, referred to as blank forms, do not state the amount (or other information) to be confirmed, but request the confirming party to fill in the balance or furnish other information. Using a blank form confirmation request may provide more reliable audit evidence than using a confirmation request that includes information the auditor is seeking to confirm (e.g., a customer account balance). However, blank forms might result in lower response rates because additional effort may be required of the confirming party; consequently, the auditor may have to perform alternative procedures for more selected items.

Identifying Confirming Parties for Confirmation Requests

.09 The auditor should direct confirmation requests to confirming parties (individuals or organizations) who are knowledgeable about the information to be confirmed and determine that the confirmation requests are properly addressed.

Note: AS 2401.53 provides that when the auditor has assessed a fraud risk, sending confirmation requests to a specific party within an organization is an example of an audit response to the risk.

.10 If the auditor is aware of information about a potential confirming party's (i) motivation, ability, or willingness to respond, or (ii) objectivity and freedom from bias with respect to the

⁴ See, e.g., AS 2301 (regarding the nature, timing, and extent of audit procedures); AS 2315, *Audit Sampling* (regarding planning, performing, and evaluating audit samples); and AS 2510, *Auditing Inventories* (regarding confirmation of inventories in the hands of public warehouses or other outside custodians).

audited entity,⁵ the auditor should consider this information, including its source, in selecting the confirming parties.

Note: Such information may indicate that the potential confirming party has incentives or pressures to provide responses that are inaccurate or otherwise misleading.

.11 If the auditor is unable to identify a confirming party for a selected item who would provide relevant and reliable audit evidence in response to a confirmation request (including considering any information discussed in paragraph .10), the auditor should perform alternative procedures for the selected item in accordance with Appendix C.

Note: The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained.⁶

Using Negative Confirmation Requests

.12 Generally, the auditor obtains significantly less audit evidence when using **negative confirmation requests** than when using positive confirmation requests because the auditor typically does not receive from the confirming party a confirmation response to a negative confirmation request unless the confirming party disagrees with the information provided in the request. Therefore, the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence for addressing the risk of material misstatement to a financial statement assertion.

.13 The following are examples of situations in which the use of negative confirmation requests, in combination with the performance of other substantive audit procedures, may provide sufficient appropriate audit evidence:

- a. The auditor has (i) assessed the risk of material misstatement for the relevant assertions as low, and (ii) obtained sufficient appropriate audit evidence regarding the design and operating effectiveness of controls.⁷
- b. The population of items within the account balance or class of transactions for which the auditor considers sending negative confirmation requests is composed of many small, homogeneous items.

⁵ AS 2410, *Related Parties*, requires the auditor to perform procedures to obtain an understanding of the company's relationships and transactions with related parties.

⁶ See AS 1105.08.

⁷ See also AS 2301.16-.18 for a discussion of tests of controls.

- c. The auditor expects a low exception rate in response to negative confirmation requests and has a reasonable basis for this expectation.

Maintaining Control over the Confirmation Process

.14 The auditor should maintain control over the confirmation process to minimize the likelihood that information exchanged between the auditor and the confirming party is intercepted or altered.

.15 The auditor should (i) select the items to be confirmed, (ii) send confirmation requests, and (iii) receive confirmation responses.⁸

.16 The auditor should send the confirmation request directly to the confirming party and obtain the confirmation response directly from the confirming party.

.17 The auditor or the confirming party can engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. When using an intermediary for this purpose, the auditor should evaluate the implications on the reliability of confirmation requests and responses as discussed in Appendix B.

Evaluating Confirmation Responses and Confirmation Exceptions, and Addressing Nonresponses and Incomplete Responses

Evaluating Reliability of Confirmation Responses

.18 The auditor should evaluate the reliability of confirmation responses, taking into account any information about events, conditions, or other information that the auditor becomes aware of that (i) contradicts the information used when selecting the confirming party pursuant to paragraphs .09 and .10 or (ii) indicates that the confirmation request or confirmation response may have been intercepted and altered.⁹

Note: The following are examples of information that indicates that a confirmation request or confirmation response may have been intercepted or altered:

⁸ The auditor may use internal auditors to provide direct assistance in other aspects of the confirmation process in accordance with AS 2605, *Consideration of the Internal Audit Function*, which establishes requirements for using internal auditors to provide direct assistance to the auditor including supervising, reviewing, evaluating and testing the work performed by internal auditors.

⁹ A note to AS 1105.08 also describes the auditor's responsibilities to evaluate third-party evidence provided to the auditor subject to restrictions, limitations, or disclaimers.

- a. The confirmation response comes from a physical or electronic address other than the address on the confirmation request.
- b. The confirmation response does not include a signature of the confirming party or otherwise identify the confirming party.
- c. The confirmation response does not include a copy of the original confirmation request, e-mail chain, or any other information indicating that the confirming party is responding to the auditor's confirmation request.

.19 If the auditor is unable to determine that the confirmation response is reliable, the auditor should perform alternative procedures for the selected item in accordance with Appendix C.

Evaluating Confirmation Exceptions

.20 The auditor should evaluate confirmation exceptions and determine whether the confirmation exceptions individually or in the aggregate indicate (i) a misstatement that should be evaluated in accordance with AS 2810, *Evaluating Audit Results*, (ii) a deficiency in the company's internal control over financial reporting,¹⁰ or both.

Note: The auditor's determination under this paragraph generally involves examining external information, which may include information that the company received from knowledgeable external sources.

Addressing Nonresponses and Incomplete Responses

.21 If the auditor does not receive a confirmation response to a positive confirmation request, the auditor should follow up with the confirming party. The auditor should evaluate any confirmation response subsequently received in accordance with paragraphs .18-.19 and any confirmation exception in accordance with paragraph .20.

.22 If a confirmation response is returned by the confirming party to anyone other than the auditor, the auditor should contact the confirming party and request that the response be re-sent directly to the auditor. If the auditor does not subsequently receive a confirmation

¹⁰ In an integrated audit of financial statements and internal control over financial reporting, the auditor should perform the evaluation in accordance with AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. In an audit of financial statements, the auditor should follow the direction of AS 2201.62-.70, as stated in paragraph .03 of AS 1305, *Communications About Control Deficiencies in an Audit of Financial Statements*.

response from the intended confirming party, the auditor should treat the situation as a nonresponse.

.23 In the case of a nonresponse or an incomplete response, the auditor should perform alternative procedures for the selected item in accordance with Appendix C.

Additional Considerations for Cash, Accounts Receivable, and Terms of Certain Transactions

Obtaining Audit Evidence Directly from a Knowledgeable External Source

.24 For cash and cash equivalents held by third parties (“cash”), and for accounts receivable that arise from the transfer of goods or services to a customer or a financial institution’s loans (“accounts receivable”), the auditor should perform confirmation procedures in accordance with paragraphs .08 through .23, or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.

Note: The direction in paragraphs .08-.10 for identifying the information related to the relevant assertions that the auditor plans to verify with confirming parties and selecting confirming parties also applies when identifying the information maintained by knowledgeable external sources and selecting knowledgeable external sources.

.25 For accounts receivable, if the auditor determines it is not feasible to obtain audit evidence pursuant to paragraph .24 based on the auditor’s experience, such as prior years’ audit experience with the company or experience with similar engagements where the auditor did not receive confirmation responses, and the auditor’s expectation of similar results if procedures were performed pursuant to paragraph .24, the auditor should obtain external information indirectly by performing other substantive procedures, including tests of details.¹¹ The auditor should document any such determination in accordance with AS 1215, *Audit Documentation*.

Note: Obtaining external information indirectly may include, for example, obtaining from the company information such as subsequent cash receipts, shipping documents from third-party carriers, purchase orders, or signed contracts and amendments thereto, that the company received, in electronic form or in paper form, from one or more knowledgeable external sources.

¹¹ Under PCAOB standards, in general evidence obtained directly by the auditor is more reliable than evidence obtained indirectly. See AS 1105.08. In addition, AS 1105 establishes requirements regarding designing and performing audit procedures to obtain sufficient appropriate audit evidence and AS 2810 establishes requirements regarding the auditor’s evaluation of audit results and determination of whether sufficient appropriate audit evidence has been obtained.

Selecting Individual Items of Cash and Accounts Receivable

.26 In selecting the individual items of cash for which audit evidence should be obtained, the auditor should take into account the auditor’s understanding of the company’s cash management and treasury function, and the substance of the company’s arrangements and transactions with third parties.

.27 In selecting the individual accounts receivable for which audit evidence should be obtained, the auditor should take into account the auditor’s understanding of the substance of the company’s arrangements and transactions with third parties and the nature of items that make up account balances.

Communicating with the Audit Committee

.28 Under paragraph .09 of AS 1301, *Communications with Audit Committees*, the auditor should discuss with the audit committee the significant risks of material misstatement identified through the auditor’s risk assessment procedures. In addition, for significant risks associated with either cash or accounts receivable, the auditor should communicate when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source in accordance with paragraph .24.¹²

Other Considerations

.29 In addition to obtaining audit evidence from a knowledgeable external source regarding cash in accordance with paragraph .24, the auditor should consider sending confirmation requests to that source about other financial relationships with the company, based on the assessed risk of material misstatement. Examples of other financial relationships are lines of credit, other indebtedness, compensating balance arrangements, or contingent liabilities, including guarantees.

.30 For significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk. Examples of such terms may include terms related to: (i) oral side agreements, or undisclosed written or oral side agreements, where the auditor has reason to

¹² The term “audit committee,” as used in this standard, has the same meaning as defined in Appendix A of AS 1301. The communication to the audit committee should be made and documented in accordance with AS 1301.25 and .26.

believe that such agreements may exist, (ii) bill and hold sales,¹³ and (iii) supplier discounts or concessions.

Evaluating the Results

.31 AS 2810 establishes requirements regarding the auditor's evaluation of audit results and determination of whether the auditor has obtained sufficient appropriate audit evidence.¹⁴ In performing this evaluation, the auditor should take into account all relevant audit evidence provided by confirmation procedures,¹⁵ alternative procedures, and other procedures to determine whether sufficient appropriate audit evidence has been obtained about the relevant financial statement assertions.¹⁶

APPENDIX A – Definitions

.A1 For purposes of this standard, the terms listed below are defined as follows:

.A2 Confirmation exception – Information in a confirmation response that differs from information the auditor obtained from the company.

.A3 Confirmation process – The process that involves selecting one or more items to be confirmed, sending a confirmation request directly to a confirming party, evaluating the information received, and addressing nonresponses and incomplete responses to obtain audit evidence about one or more financial statement assertions.

.A4 Confirmation request – A request from the auditor to a confirming party regarding information about one or more particular accounts, balances, transactions, or other items as a means of obtaining audit evidence about one or more financial statement assertions.

.A5 Confirmation response – Information obtained as a direct written communication (in paper or electronic form) to the auditor from a confirming party in response to a confirmation request.

¹³ Bill and hold sales are sales of merchandise that are billed to customers before delivery and are held by the entity for the customers.

¹⁴ See AS 2810.01.

¹⁵ Evaluating evidence provided by confirmation procedures includes, for example, the evaluation of confirmation exceptions in accordance with paragraph .20.

¹⁶ AS 2810.35 addresses situations where the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion.

.A6 Confirming party – A third party, whether an individual or an organization, to which the auditor sends a confirmation request.

.A7 Negative confirmation request – A confirmation request in which the auditor requests a confirmation response only if the confirming party disagrees with the information provided in the confirmation request.

.A8 Nonresponse – A situation in which (i) after sending a confirmation request, the request is returned undelivered; (ii) the auditor does not receive a confirmation response to a positive confirmation request directly from the intended confirming party; (iii) the auditor receives correspondence from the intended confirming party indicating that the confirming party is unable or unwilling to respond to the confirmation request; or (iv) the auditor receives an oral response only.

.A9 Positive confirmation request – A confirmation request in which the auditor requests a confirmation response.

APPENDIX B – Evaluating the Implications of Using an Intermediary to Facilitate Direct Electronic Transmission of Confirmation Requests and Responses

.B1 Paragraph .17 requires that the auditor evaluate the implications of using an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party on the reliability of confirmation requests and responses. In performing the evaluation, the auditor should:

- a. Obtain an understanding of the intermediary’s controls that address the risk of interception and alteration of the confirmation requests and responses.
- b. Determine whether the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively.

Note: If the auditor performs procedures to determine whether the controls used by the intermediary to address the risk of interception and alteration are designed and operating effectively at an interim date, the auditor should evaluate whether the results of the procedures can be used during the period the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses or whether additional procedures need to be performed to update the results. In performing the evaluation, the auditor should consider the length of time between the date of the procedures and the period the auditor uses the intermediary to facilitate direct electronic transmission of confirmation requests and responses, and the nature and extent of any changes in the process and controls used by the intermediary during that time.

- c. Assess the relationship of the intermediary with the company – specifically, whether circumstances exist that give the company the ability to override the intermediary’s controls that address the risk of interception and alteration of the confirmation requests and responses (e.g., through financial, ownership, or other business relationships, contractual rights, or otherwise).

.B2 If the auditor determines that (i) the intermediary has not implemented controls that are designed and operating effectively to address the risk of interception and alteration of the confirmation requests and responses and the auditor cannot address such risk by performing other audit procedures beyond inquiry, or (ii) circumstances exist that give the company the ability to override the intermediary’s controls, the auditor should not use the intermediary to send confirmation requests or receive confirmation responses. In this case, the auditor should send confirmation requests for the selected items without the use of an intermediary or, if unable to do so, perform alternative procedures in accordance with Appendix C.

Appendix C – Performing Alternative Procedures for Selected Items

.C1 When the auditor is unable to obtain relevant and reliable audit evidence about the selected item through confirmation, performing other audit procedures may be necessary. In addition, the auditor should evaluate the implications for the auditor’s assessment of the relevant risks of material misstatement, including fraud risks.¹⁷

.C2 Paragraphs .11 (inability to identify a confirming party), .19 (unreliable response), .23 (nonresponse or incomplete response), and B2 (inability to use an intermediary) discuss certain situations in which the auditor should perform alternative procedures. The following are examples of alternative procedures that individually or in combination may provide relevant and reliable audit evidence for the selected item:¹⁸

- a. For cash items, verifying information about the company’s cash account maintained in a financial institution’s information system by viewing this information directly on a secure website of the financial institution.
- b. For accounts receivable items, examining one or more of the following:
 - (i) subsequent cash receipts, including comparing the receipts with the amounts of the respective invoices being paid, (ii) shipping documents, or (iii) other

¹⁷ If the auditor is unable to obtain sufficient appropriate audit evidence about a relevant assertion, the auditor considers the impact on the audit opinion in accordance with AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*.

¹⁸ Performing alternative procedures that involve obtaining information from knowledgeable external sources will generally provide more relevant and reliable audit evidence than performing alternative procedures that involve obtaining information from only internal company sources.

supporting documentation (e.g., purchase orders or signed contracts and amendments thereto).

- c. For terms of a transaction or agreement, inspecting the signed contract and amendments thereto, comparing contractual terms to industry norms, and discussing and verifying significant information with other parties involved in the transaction or agreement (e.g., banks, guarantors, agents, or attorneys).
- d. For accounts payable items, examining one or more of the following:
 - (i) subsequent cash disbursements, (ii) correspondence from vendors and suppliers, or (iii) other supporting documentation.

Note: Performing alternative procedures for items for which the auditor was not able to complete the audit procedures may not be necessary if these items,¹⁹ in the aggregate, and when added to the sum of all other uncorrected misstatements in relation to the account, would not change the outcome of the auditor's evaluation performed in accordance with AS 2810.17.

¹⁹ The auditor would treat the items as 100 percent misstatements and, when sampling is used, project the misstatements to the populations from which the sample was selected in accordance with AS 2315.26.

APPENDIX 2 – AMENDMENTS TO RELATED PCAOB AUDITING STANDARDS

In connection with the new standard AS 2310, *The Auditor’s Use of Confirmation*, the Board is adopting amendments to several of its auditing standards to conform to the requirements of the new standard. The table below is a reference tool for the amendments.

OTHER PCAOB STANDARDS AMENDED¹

PCAOB Standard	Paragraph	Subject Heading of Paragraph Affected	Action(s)	Page(s)
AS 1105, <i>Audit Evidence</i>	.18	Confirmation	Make conforming amendments	A2-3
AS 1301, <i>Communications with Audit Committees</i>	Appendix B	Communications with Audit Committees Required by Other PCAOB Rules and Standards	Add a bullet at the end of the appendix	A2-3
AS 2401, <i>Consideration of Fraud in a Financial Statement Audit</i>	.54	Additional Examples of Audit Procedures Performed to Respond to Assessed Fraud Risks Relating to Fraudulent Financial Reporting	Make conforming amendment to footnote 21	A2-3
AS 2401	.66A	Audit Procedures Performed to Specifically Address the Risk of	Add text to existing note to remind auditors of	A2-3

¹ This table is a reference tool for the amendments that follow. “Add” refers to a new footnote or other text being added to existing PCAOB standards. “Make conforming amendment” refers to technical changes to existing PCAOB standards, such as changes to cross-references and defined terms. “Delete” refers to removing an existing paragraph, footnote, or other text.

PCAOB Standard	Paragraph	Subject Heading of Paragraph Affected	Action(s)	Page(s)
		Management Override of Controls	requirement in paragraph .30 of new standard	
AS 2510, <i>Auditing Inventories</i>	.14	Inventories Held in Public Warehouses	Add footnote 1	A2-3, A2-4
AS 2605, <i>Consideration of the Internal Audit Function</i>	.22	Extent of the Effect of the Internal Auditors' Work	Delete "cash" from list of examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence	A2-4
AS 2605	.27	Using Internal Auditors to Provide Direct Assistance to the Auditor	Make conforming amendment, add footnote 7A	A2-4, A2-5

For the reasons set forth in this release, the standards of the Public Company Accounting Oversight Board are amended as follows:

- I. AS 1105 is amended by revising paragraph .18 and footnote 10 to paragraph .18, such that revised AS 1105.18 reads as follows:

.18 A confirmation response is information obtained as a direct written communication (in paper or electronic form) to the auditor from a confirming party in response to a confirmation request in accordance with PCAOB standards.¹⁰

¹⁰ See AS 2310, *The Auditor's Use of Confirmation*. The terms "confirmation response," "confirmation request," and "confirming party," as used in this standard, have the same meaning as defined in Appendix A of AS 2310.

- II. AS 1301 is amended by adding a bullet at the end of Appendix B to read as follows:

- AS 2310, *The Auditor's Use of Confirmation*, paragraph .28.

- III. AS 2401 is amended by revising footnote 21 to paragraph .54 to read as follows:

²¹ AS 2310, *The Auditor's Use of Confirmation*, establishes requirements regarding the use of confirmation in audits of financial statements.

- IV. AS 2401 is amended by revising the note to paragraphs .66A to read as follows:

Note: AS 2301.11A requires the auditor to take into account the types of potential misstatements that could result from significant unusual transactions in designing and performing further audit procedures. Additionally, AS 2310.30 states that for significant risks of material misstatement associated with either a complex transaction or a significant unusual transaction, the auditor should consider confirming those terms of the transaction that are associated with a significant risk of material misstatement, including a fraud risk. Examples of such terms may include terms related to: (i) oral side agreements, or undisclosed written or oral side agreements, where the auditor has reason to believe that such agreements may exist, (ii) bill and hold sales, and (iii) supplier discounts or concessions.

- V. AS 2510 is amended by adding footnote 1 to paragraph .14, such that revised AS 2510.14 reads as follows:

.14 If inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian.¹ If such inventories represent a significant proportion of current or total assets, to obtain reasonable

assurance with respect to their existence, the auditor should apply one or more of the following procedures as he considers necessary in the circumstances.

- a. Test the owner's procedures for investigating the warehouseman and evaluating the warehouseman's performance.
- b. Obtain an independent accountant's report on the warehouseman's control procedures relevant to custody of goods and, if applicable, pledging of receipts, or apply alternative procedures at the warehouse to gain reasonable assurance that information received from the warehouseman is reliable.
- c. Observe physical counts of the goods, if practicable and reasonable.
- d. If warehouse receipts have been pledged as collateral, confirm with lenders pertinent details of the pledged receipts (on a test basis, if appropriate).

¹ See AS 2310, *The Auditor's Use of Confirmation*, which establishes requirements regarding obtaining audit evidence from a knowledgeable external source through the auditor's use of confirmation.

VI. AS 2605 is amended by revising paragraph .22 to read as follows:

.22 On the other hand, for certain assertions related to less material financial statement amounts where the risk of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is low, the auditor may decide, after considering the circumstances and the results of work (either tests of controls or substantive tests) performed by internal auditors on those particular assertions, that audit risk has been reduced to an acceptable level and that testing of the assertions directly by the auditor may not be necessary. Assertions about the existence of prepaid assets and fixed-asset additions are examples of assertions that might have a low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to AS 2201.18-.19 regarding assessing the interrelationship of the nature of the controls and the competence and objectivity of those who performed the work.

VII. AS 2605 is amended by revising paragraph .27 and adding footnote 7A to paragraph .27, such that revised AS 2605.27 reads as follows:

.27 In performing the audit, the auditor may request direct assistance from the internal auditors, except when PCAOB standards require procedures to be performed by the auditor.^{7A} This direct assistance relates to work the auditor specifically requests the internal auditors to perform to complete some aspect of the auditor's work. For example, internal auditors may

assist the auditor in obtaining an understanding of internal control or in performing tests of controls or substantive tests, consistent with the guidance about the auditor's responsibility in paragraphs .18 through .22. When direct assistance is provided, the auditor should assess the internal auditors' competence and objectivity (see paragraphs .09 through .11) and supervise,⁸ review, evaluate, and test the work performed by internal auditors to the extent appropriate in the circumstances. The auditor should inform the internal auditors of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible accounting and auditing issues. The auditor should also inform the internal auditors that all significant accounting and auditing issues identified during the audit should be brought to the auditor's attention.

^{7A} See, e.g., paragraph .15 of AS 2310, *The Auditor's Use of Confirmation*, which states that the auditor should (i) select the items to be confirmed, (ii) send confirmation requests, and (iii) receive confirmation responses.

⁸ See AS 1201, *Supervision of the Audit Engagement*, for the type of supervisory procedures to apply.