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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.

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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  
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cc: SEC

James Kroeker, Acting Chief Accountant