

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.

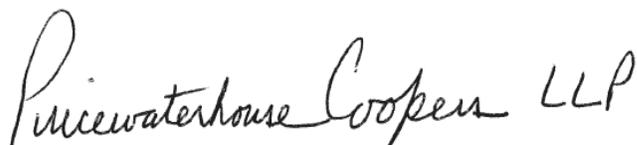
Effective Date

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.

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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,



Attachment

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. Confirmations ~~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 confirmations ~~requests~~ in addressing the existence and completeness assertions depends, in part, on whether the auditor selects from an appropriate population for testing. Receivable confirmations ~~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 confirmations ~~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

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

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.***