

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

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