

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:

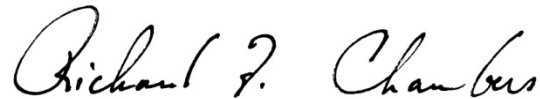
The Institute of Internal Auditors (IIA) welcomes the opportunity to comment on the PCAOB's proposed auditing standard, *Confirmation*, which would supersede the Board's standard AU section 330, *The Confirmation Process*. Our comments are based on a thorough analysis and discussion, utilizing a core 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, flowing style.

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.