

September 10, 2010

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Via email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

**RE: PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2010-003  
Proposed Auditing Standard Related to Confirmation and Related Amendments to  
PCAOB Standards**

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the *PCAOB Rulemaking Docket Matter No. 028: PCAOB Release No. 2010-003 Proposed Auditing Standard Related to Confirmations and Related Amendments to PCAOB Standards*.

The views expressed in this letter and attachments are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member. We also note that three Committee members performed research that is cited in Release No. 2010-003, and these individuals were significantly involved in the drafting of this comment letter. However, we do not believe this affected the objective nature of our comments.

We hope that our attached comments and suggestions are helpful and will assist in the revisions to the proposed standard on audit confirmations. If the Board has any questions about our input, please feel free to contact our committee chair for any follow-up.

Respectfully submitted,

Auditing Standards Committee  
Auditing Section - American Accounting Association

Committee Members:

Chair – Joe Brazel, North Carolina State University  
Past Chair – James Bierstaker, Villanova University  
Larry Abbott, University of Memphis  
Paul Caster, Fairfield University  
Randal Elder, Syracuse University  
Steven Firer, Monash University – South Africa  
Diane Janvrin, Iowa State University (ad hoc member)  
Ed O'Donnell, Southern Illinois University  
Susan Parker, Santa Clara University  
Brad Reed, Southern Illinois University  
Sandra Shelton, DePaul University

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*Auditing Section – American Accounting Association*

**General Comments**

The Committee commends the PCAOB (“the Board”) for addressing the use of confirmations, including electronic confirmations, and confirmations of other accounts and special terms. We believe the proposed standard significantly improves the confirmation process. We also believe that issuance of the Concept Release (PCAOB Release No. 2009-002) significantly improved the proposed standard, and that use of concept releases is beneficial if a proposed standard significantly changes existing standards. However, use of a concept release may not be more efficient or effective than re-exposing a proposed standard after initial comments are received.

The following section presents a number of specific comments or suggestions, organized along the lines of the questions posed by the Board in the release of the proposed standard.

*1. Are the definitions included in the proposed standard clear and appropriate? If not, what changes should the board make to the definitions?*

The Board has done a good job of defining a confirmation to incorporate electronic responses, and the reference to “other medium” allows for flexibility in interpreting the nature of a confirmation for changes in technology. The Committee agrees with definition A4 that an oral response is not a confirmation, and the description in paragraph 35 of the conditions under which direct access constitutes a confirmation response.

*2. Is the objective of the standard clear and appropriate? If not, what changes should the board make to the objective?*

*3. What other matters, if any, should the objective include?*

The Committee believes that the objective is too generic to be useful. Indeed, the objective of many standards could be “to obtain relevant and reliable audit evidence.” The objective in the proposed Auditing Standards Board standard includes the term “when using confirmation procedures,” but this also does not capture the depth of the standard in providing guidance on the use of confirmations. We provide suggested wording below:

“The objective of the auditor is to perform confirmation procedures, including designing confirmation requests and evaluating confirmation responses, when required or appropriate to obtain relevant and reliable audit evidence.”

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4. *Is the description of “receivables that arise from credit sales, loans, or other transactions” sufficiently clear and appropriate? If not, what changes should the Board make?*

The Committee believes that the description is clear and appropriate. However, the Committee believes that the elimination of the exceptions for confirming receivables in AU sec. 330 needs further clarification. The Committee agrees with the elimination of the exception related to immaterial receivables. The Committee agrees with elimination of the exception related to situations where risk is low and other evidence is available to obtain sufficient appropriate evidence, because of risks related to revenue recognition, and because of the quality of evidence provided by confirmations. However, it may be helpful to footnote why this exception is not appropriate.

The exception related to ineffectiveness of confirmations is more challenging. The release indicates (p. 13) that “...if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures.” The release then indicates “Accordingly, pursuant to Auditing Standard No. 3, the auditor should document in the audit work papers his or her rationale for not performing confirmation procedures for receivables that arise from credit sales, loans, or other transactions.”

This leaves auditors unclear as to whether ineffectiveness can be used as a basis for not sending confirmations. While the need to document the decision not to send confirmations can be inferred from Auditing Standard No. 3, it is not explicit. Further, it may not be beneficial to force auditors to send confirmations in all circumstances. For example, one Committee member conducted research involving confirmation decisions. On one audit, 114 invoice confirmations were sent, and only three responses were received.

We believe it is appropriate to send confirmations, even when response rates are low. A response to a positive confirmation is highly effective evidence as to the existence assertion. Even a non-response to a positive confirmation provides limited evidence as to the existence assertion to the extent the U.S. postal service can be relied on and the confirmations are not returned as undeliverable (Ashton and Hylas 1980). We suggest wording such as the following:

“Confirmations may be ineffective due to low response rates, or unreliable responses. Auditors should first evaluate whether the confirmations can be redesigned to improve response rates, and whether ineffectiveness relates to all receivables or only certain customers or types of receivables. Even when response rates are low, positive confirmations help provide evidence as to the existence assertion. In rare circumstances where the decision is made not to send confirmations because of their ineffectiveness based on the auditor’s current or prior experience, the rationale for the decision should be documented in the work papers.”

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*5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?*

We agree with the requirement to confirm cash and other financial relationships with financial institutions. The guidance to not base the confirmation decision on the reported cash balance, and the need to understand the treasury function and assess the risk of material misstatement in determining which accounts and relationships to confirm is particularly helpful.

*6. Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?*

*7. Should the proposed standard include additional requirements with regard to sending confirmation requests in response to significant risks? If so, what additional requirements should the Board include?*

We believe the guidance is unclear. Based on the example, it can be inferred that if the auditor has identified a significant risk, the auditor should confirm the amounts and terms of significant transactions, including whether there are any other undisclosed oral or undisclosed written modifications to those agreements. Paragraph 10 indicates confirmations should also be used for other significant risks, however, the note indicates that confirmations might not be specifically responsive to every significant risk. Should an auditor send confirmations if they are responsive to a significant risk, even if another form of evidence is more responsive or more efficient in addressing that risk?

We recommend making the guidance more explicit that the auditor must confirm the amounts and terms of significant transactions, including whether there are any other undisclosed oral or undisclosed written modifications to those agreements, when a significant risk is identified. We believe this is appropriate because of concerns about revenue recognition. For other significant risks, we recommend that the standard require auditors to assess whether confirmations would address that risk. In such circumstances, the auditor should perform confirmation procedures, or document why they were not performed.

We expect that many auditors might find such a requirement burdensome. However, we do not know how many significant risks are identified on an average audit. We believe this approach is clearer than indicating that the auditor should perform confirmation procedures whenever there is a significant risk that can be addressed by confirmation procedures, since it allows the auditor to select procedures that may be more effective than confirmations, even if confirmations address the assertion affected by the significant risk.

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*8. Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?*

We believe that paragraph 11 needs further clarification. It consists of one sentence, and is designed to indicate that confirmations may be appropriate in other circumstances. These circumstances may involve situations that involve a risk that is not significant, or situations where no risk has been identified. We recommend changing the heading from “Other Risks” to “Use of Confirmations in Other Circumstances.” We would change the text to terminology such as:

“Use of confirmation procedures may be an appropriate response to address other risks that are not considered significant risks. Even in circumstances where no specific risk has been identified, confirmation procedures may be an appropriate form of evidence for certain relevant assertions regarding a particular account, balance, transaction, agreement, or other item.”

*9. Are the requirements in the proposed confirmation for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?*

We believe the requirements are clear and appropriate. The guidance addresses electronic confirmations, and we found the guidance on determining the validity of addresses particularly helpful.

*10. Is the description with respect to the use of internal auditors in the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?*

The proposed standard does not provide guidance on the use of internal auditors, and primarily relies on the guidance in AU sec. 322. The guidance found on page 20 of the Release is clear, and we believe some of this should be moved into the proposed standard. We recommend a paragraph with the heading “Use of Internal Auditors.” This paragraph should indicate:

“The auditor cannot use internal auditors to send confirmation requests, receive confirmation responses, or evaluate the audit evidence from using confirmation procedures. Internal auditors may assist in other ways, such as testing whether confirmations are properly addressed or assembling information necessary for the auditor to resolve exceptions in confirmation responses, provided the auditor has assessed the internal auditors’ competence and objectivity, and the auditor supervises, reviews, evaluates, and tests the work performed by internal auditors.”

*11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?*

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The factors identified are clear and appropriate. We believe that paragraph 16 on designing the confirmation requests should follow paragraph 17 on determining the type of confirmation requests to send. We believe the factors to consider should include addressing whether risks have been identified related to side agreements. A footnote or other information on balance, invoice, and blank form confirmations would also be beneficial.

*12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?*

The guidance is clear and appropriate. We appreciate the suggestion that negative confirmations may be used in combination with positive confirmation requests. We also believe the guidance that the auditor must perform other substantive procedures when negative confirmations are used, without specifying the nature of the substantive procedures, is appropriate.

*13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?*

*14. Are the procedures the auditor should perform to when he or she determine that the confirmation request does not include a valid address sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?*

The guidance is clear and appropriate. We appreciate the guidance that the procedures should depend on risk and materiality, and that the testing of validity of addresses could be based on substantive procedures or tests of controls.

*15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements.?*

We believe the guidance is sufficiently clear and appropriate, especially the need to evaluate the implications of the request on the auditor's assessment of relevant risks. We also agree with the note in 24.b. that the auditor should obtain more persuasive evidence when performing alternative procedures when management has requested that the balance or item not be confirmed, but believe an example or footnote guidance would be helpful to illustrate this. For example, in addition to examining subsequent cash receipts, the auditor may also examine the customer order and evidence of shipment to verify the validity of the sale.

*16. Are there circumstances in which it would not be necessary for the auditor to perform alternative procedures for non-responses to positive confirmation requests? If so, what are those circumstances?*

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We do not believe there are circumstances when it would not be necessary to perform alternative procedures for non-responses to positive confirmation requests. Even if an individual request is not material, even when projected to the population items not tested, it was still part of the sample selected for testing, and the alternative procedures are necessary to obtain evidence regarding the existence assertion.

*17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?*

We believe the additional procedures are appropriate.

*18. Are there additional circumstances that make it necessary for the auditor to receive a confirmation response to a positive confirmation request to obtain sufficient appropriate audit evidence? If so, what are those circumstances?*

We did not identify additional circumstances beyond those identified in paragraph 29.

*19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?*

We believe the requirement is clear and appropriate. However, we note that in some cases it may not be necessary to determine the exact cause of an exception, especially when the difference is immaterial, but it would be sufficient to perform procedures to assess whether the difference is due to fraud or a systematic cause. An overly restrictive requirement to investigate all exceptions may cause auditors to use invoice confirmations, even when balance confirmations are preferred, because invoice confirmations are likely to result in fewer exceptions.

*20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?*

The requirement is sufficiently clear and appropriate. We especially appreciate the requirement in paragraph 32 that the auditor assess any indication that the third party has questionable motives or is not free from bias, given the number of situations in which third parties have colluded with the company under audit in providing confirmation responses.

*21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?*

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22. *Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?*

23. *The Board is interested in information about the services that an intermediary provides, specifically information about the responsibilities and obligations between the auditor and the intermediary and the intermediary and the confirming party.*

Paragraph 35 indicates that “The auditor should perform procedures to determine whether the auditor can use the intermediary’s process.” Because the auditor is relying on controls at the intermediary, the requirements should be similar to relying on controls at service organizations that process transactions for the client.

24. *Are there risks related to the auditor’s use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?*

25. *Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?*

We are not aware of risks related to direct access that have not been identified. We do not believe that direct access should be limited to financial institutions. The auditor should evaluate the reliability of direct access similar to the evaluation of the reliability of a confirmation response.

26. *Are the requirements in the proposed standard related to disclaimers and restrictive language in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make?*

The requirements related to disclaimers and restrictive language are clear and appropriate. We note that the example in paragraph 36 as to the accuracy of the confirmation response primarily affects the use of the confirmation response to address the valuation assertion. The confirmation response may still provide appropriate evidence for the existence assertion.

27. *Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?*

We believe the requirements are sufficiently clear and appropriate.

**Reference**

Ashton, R., and R. Hylas. 1980. The return of problem confirmation requests by the U.S. Postal Service. *The Accounting Review* 55 (October): 649-657.