



California  
Society  
Certified  
Public  
Accountants

May 27, 2009

Office of the Secretary  
PCAOB  
1666 K Street, N. W.  
Washington, D.C. 20006-2803

RE: Response to PCAOB Rulemaking Docket Matter No. 028

To the Members of the PCAOB:

The Accounting Principles and Auditing Standards Committee (the AP&AS "Committee") of the California Society of Certified Public Accountants (CALCPA) is pleased to provide our comments to the Public Company Accounting Oversight Board (PCAOB) on PCAOB Rulemaking Docket Matter No. 028, "Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations."

The AP&AS Committee is the senior technical committee of CALCPA. CALCPA has approximately 32,000 members. The Committee is comprised of 50 members, of whom 67 percent are from local or regional firms, 23 percent are sole practitioners in public practice, 5 percent are in industry and 5 percent are in academia.

#### General Comment

The Committee wants to emphasize its belief that the standards the PCAOB sets related to the audit confirmation process for audits of publicly owned entities should not differ significantly from the standards set for non-publicly owned entities. We noted the extensive efforts of the PCAOB to consider all the standards regarding audit confirmations in this Concept Release and commend it for these efforts. We recommend that the PCAOB carefully consider the content of the forthcoming Auditing Standards Board proposal to amend section AU330, which is planned to update the existing standard and converge it with International Standard on Auditing 505 ("ISA 505").

#### Objectives

*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?*

1235 Radio Road  
Redwood City, CA  
94065-1217

(800) 922-5272  
www.calcpa.org

There are inconsistencies in terminology. “Obtain sufficient, competent audit evidence” is the stated PCAOB proposed objective above, and these words are basically consistent with the third standard of field work at AU150.02, as well as AU sec. 326.1, to which the PCAOB refers in footnote 5. Changes proposed to that literature late in 2008 use the term “sufficient appropriate audit evidence.” This is an overarching concept. ISA 505 on confirmations uses the words: “obtain relevant and reliable audit evidence”. (in all, emphasis added.) “Relevant and reliable,” relate specifically to confirmations within the overarching concept of sufficient competent audit evidence.

The PCAOB proposed objective of audit evidence sought is “in response to identified risks.” AU sec. 330.06 says the audit evidence sought is “about financial statement assertions made by management.” Audit evidence is sought to address financial statement assertions, and this theme appears in various places in the auditing literature. No reason is given for the PCAOB’s reference to “identified risks” instead of financial statement assertions. ISA 505 does not state to what the audit evidence relates.

We suggest that the PCAOB adopt the ISA 505 approach, which is specific to confirmations. Thus, the objective would be stated:

The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

#### Definition of confirmation

*2. Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct on line access to information held by a third party? Why or why not?*

Oral confirmations: The PCAOB definition of a confirmation on page 9 of the Concept Release does require external communication or access but does not require that the communication be in writing, which would allow oral communications to be considered “confirmations.” It also has the caveat from AU330.29 to get a written confirmation if the information is significant. ISA 505 requires the external communication be in writing, which excludes oral communications from the definition of “confirmations.” It also describes additional procedures if an auditor receives an oral communication.

We suggest that the PCAOB adopt the ISA 505 approach of requiring the external confirmation be in writing. Oral communications are not sufficiently reliable to be considered “confirmations.” Confirmation is a sufficiently important procedure that the PCAOB standard should require an adequate threshold of reliability.

Oral communications, if properly used, are a valid audit procedure. The PCAOB, in its standard, should include a discussion similar to that in ISA 505 paragraph A15.

The other than traditional responses should be allowed. Commerce is moving away from traditional mail, and audit confirmations should be able to move too. It is often easier to get a response by a non-traditional means, and in some cases, such as direct on-line access to information held by a third party, the “response” may be more reliable, and there may be better access to relevant information.

In defining a “confirmation” we recommend that the PCAOB incorporate paragraph 6 of ISA 505.

*3. What direction should the standard include regarding the use of electronic confirmations and third-party service providers?*

The PCOAB should consider direction on the design of the confirmation request, specifically on determining the validity of the address to which the electronic confirmation is sent, and on the reliability of the responses to electronic confirmations and from third-party providers. See also our response to question 13 below.

*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?*

These risks should be addressed in procedures for (i) selecting the appropriate confirming party, (ii) designing the confirmation requests, and (iii) reliability of the responses to the confirmation requests.

Selecting the appropriate confirming party is addressed in paragraph A2. of ISA 505, and we suggest that this be incorporated by the PCAOB in its standard.

The latter two are discussed in our responses to questions 9 and 10, and questions 11 through 15, respectively, below.

#### 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?*

The Board should not expand the presumptively mandatory requirement to request confirmation of accounts receivable to include the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. We are not aware of any demonstrated evidence that the existing “should consider” guidance in AU sec. 330.08 is inadequate. Articulating the

specific elements of “complex or unusual transactions” that ought to be confirmed would be difficult. And establishing the circumstances when the confirmation process may represent the most effective or efficient means to gather audit evidence with respect to assertions related to these transactions would also be difficult. Therefore, determining the appropriate audit procedures in these circumstances ought to be left to the professional judgment of the auditor.

*6. Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?*

The Board should, at a minimum, codify the guidance currently set forth in the interim audit standards, where the confirmation process is a suggested procedure, but refrain from establishing further mandatory items to confirm.

*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?*

Many auditors have found the ability to confirm accounts receivable severely limited in certain industries, because of the lack of interest on the part of the debtors to respond to such confirmations (noted in the retail fashion industry, for example), or because the active response rate is inadequate, and have found the guidance in AU sec. 330.34 to be very useful. Therefore, the provision in AU sec. 330 allowing the auditor to apply professional judgment in determining when the use of confirmations would be ineffective ought to be retained in the standard. We believe the guidance set forth in Footnote 4 to AU sec. 330.34 that “if, based on prior years’ audit experience or on experience with similar engagements, the auditor concludes that responses are known or expected to be unreliable, the auditor may determine that the use of confirmations would be ineffective,” can be brought forward without modification.

*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?*

Consistent with our response to Question 5 above, we believe the existing guidance set forth in AU. sec. 330.08 is adequate. Auditors should be allowed to determine what constitutes “unusual” or “complex” agreements or transactions based on the application of professional judgment.

#### *Designing confirmation requests*

*9. Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?*

Yes. The first bullet point in this section should also address the assessed risks of material misstatement due to fraud. Fraud is discussed in the next section "maintaining control over the confirmation requests"; however, it is equally important to consider the design of confirmation requests to obtain additional corroborative information to address material misstatement due to fraud at the assertion level.

The confirmation requests should be designed to reflect management's authorization to respond to parties. Some parties may not be willing to respond to a confirmation request if not authorized by management.

The contents of ISA 505 paragraphs 7.(c) and A3. through A6. would be helpful and should be included.

*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?*

Yes, addresses of confirming parties should be tested. The auditor needs assurance that confirmations are not misdirected by false addresses or interception to mitigate fraud risks.

The electronic form of confirmation requests presents a difficult situation. The auditor needs assurance that the confirmation process is secure and properly controlled. If the confirmation request and response are sent by electronic mail, the auditor should perform appropriate procedures to verify email addresses and to assure that the requests are sent to and received by the appropriate intended recipients. The auditor must consider what methods to use to mitigate the risk that the requests and responses are intercepted or altered. Such procedures as verifying email addresses or Web site authenticity, using encryption, or using digital signatures may help mitigate these risks.

#### Maintaining control over confirmation requests and responses

We recommend that a proposed standard not deal with control and reliability separately. It would be clearer if they were combined under a single heading "Reliability of confirmation procedures."

*11. What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?*

We recommend that the PCAOB incorporate paragraphs 7. and A2. through A.7 of ISA 505.

*12. What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?*

See response to question 13, below.

*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?*

We recommend that the PCAOB incorporate paragraphs 10. and 11. and paragraphs A11., A12, A14. and A17 of ISA 505. In addition to our comments in response to Question 10 above, we recommend that the PCAOB provide guidance that the auditor should consider electronic confirmation results reliable if the electronic confirmation process is properly controlled, the information obtained is directly in response to a request, and the information is obtained from the intended respondent.

If the auditor plans to rely on a process for electronic confirmation between the auditor and the respondent, an assurance report addressing the risks discussed above may assist the auditor in assessing the design and operating effectiveness of the electronic and manual control techniques imbedded in that process. If these risks are not adequately addressed in an assurance report, the auditor may consider performing additional procedures to address those risks.

*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?*

We recommend that the PCAOB incorporate paragraph A13. of ISA 505.

*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?*

Response incorporated into response to question 13 above.

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?*

Yes, the standard should, although it should employ the word "should" so that it will be a presumptively mandatory rather than an unconditional requirement. We recommend that the PCAOB incorporate paragraphs 12, 13, A18., A19. and A20. of ISA 505.

In performing alternative procedures for receivables by examining evidence of subsequent cash receipts, the auditor may consider documentation evidencing the existence assertion other than the invoices being paid and related shipping documentation.

We recommend that the standard permit an auditor to take into account an oral response to a confirmation request when considering what alternative procedures would be appropriate.

We recommend that circumstances under which an auditor, when testing for overstatement of amounts, may decide not to perform alternative procedures on non-responses be included. These circumstances may relate to the number, amounts or qualitative factors of the non-responses.

*17. Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?*

Yes. We recommend that the PCAOB incorporate paragraphs 14, A21. and A22. of ISA 505.

*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?*

Yes, this is consistent with paragraphs A21. and A22. of ISA 505 and we recommend that the PCAOB incorporate those paragraphs.

*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?*

Alternate procedures should be required, but the specific procedures performed should be left to the judgment of the auditor. We recommend that examples of specific alternative procedures not be included in the standard but perhaps alternatively in application guidance or supplementary information.

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?*

Yes. We recommend that the PCAOB incorporate paragraphs 8., 9., and A8. through A10. of ISA 505.

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?*

Yes. We recommend that the PCAOB incorporate paragraph A16. of ISA 505. We also recommend including guidance regarding when the auditor has doubts about the reliability of a response because of disclaimers or restrictive language. In those circumstances, the auditor should obtain additional audit evidence to resolve those doubts or treat the response as a non-response and perform alternate procedures.

Negative confirmations

*22. Should auditors be allowed to use negative confirmations and, if so, in what circumstances?*

Yes. We recommend that the PCAOB incorporate paragraphs 15 and A23. of ISA 505.

*23. Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?*

Yes. Additional substantive procedures are contemplated by ISA 505, paragraph 15.

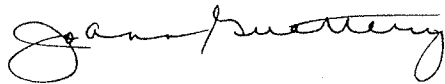


*Evaluating the Evidence Obtained*

We note that the PCAOB did not request comment on evaluating the results of the confirmation procedures, even though the requirement is currently in AU sec. 330.33. We recommend that, for consistency, the PCAOB incorporate paragraphs 16, A24, and A25 of ISA 505 into any final standard.

We thank you for the opportunity to comment on this Concept Release. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Very truly yours,

A handwritten signature in cursive script, appearing to read "JoAnn Guattery".

JoAnn Guattery, Chair  
Accounting Principles and Auditing Standards Committee  
California Society of Certified Public Accountants