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Via e-mail: comments@pcaobus.org

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

**Re: PCAOB Request for Public Comment: *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* - PCAOB Rulemaking
Docket Matter No. 028**

Dear Board Members and Staff:

BDO Seidman, LLP appreciates the opportunity to provide comments on the *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* ("Concept Release"). We encourage the PCAOB to continue to solicit input early in the development of proposed standards through the use of the Concept Release format in an effort to obtain as wide a range of views as possible before the issuance of proposed standards. We believe that the insight gained through this process will not only supplement the advice provided to the Board by the Standing Advisory Group, but will also provide invaluable input from other interested parties in the standard setting process.

In addition to using the Concept Release process, we believe it is also important to participate actively in an open dialogue with the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board ("ASB") to benefit from the discussions held at these organizations on many of the same issues now under consideration by the Board. This is especially relevant as it relates to this Concept Release, because the ASB has recently completed its deliberations regarding external confirmations, and is expected to soon expose its proposed standard on the confirmation process that we believe will converge in many respects with International Standard on Auditing ("ISA") 505, *External Confirmations*.

Our comments to the questions posed in the Concept Release are provided below for your consideration.



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- 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 the proposed objective should clarify that only *when the auditor has concluded that confirmation procedures are appropriate*, should the auditor design and perform such procedures to obtain relevant and reliable audit evidence. This clarification is necessary to avoid any misunderstanding about when confirmation procedures should be performed. Guidance as to the determination of whether or not to perform confirmation procedures should be included within the risk assessment standards, similar to the ISA construct, such that the auditor considers whether external confirmation procedures are an appropriate response to assessed risk. (See ISA 330, *The Auditor's Responses to Assessed Risks*, paragraph 19).

Additionally, we note that the objective included in the Concept Release is derived from ISA 505, with the addition of the phrase "from knowledgeable third parties outside the company in response to identified risks." While we agree that confirmations should be from knowledgeable third parties we suggest revising the phrase "from knowledgeable third parties outside the company" to "from parties outside the company that the auditor has a reasonable expectation of being knowledgeable," to reflect the use of judgment in determining who may be a knowledgeable third party.

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?**

We agree that the definition of confirmation should allow for responses other than traditional mailed responses, such as facsimile, email, other forms of electronic communications, responses processed through third-party service providers and direct on-line access to information held by a third party. However, we do not believe that oral confirmations should be included as a confirmation procedure; instead, we believe that oral confirmations should be considered as a procedure that may provide some evidence about the relevant assertion, the sufficiency of which would be based on the auditor's judgment based on assessed risk. This is consistent with ISA 505 which defines external confirmations as:



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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.

Additionally, we believe that the following phrase, “or through direct access by the auditor to information held by a third party in response to a written request,” which we believe will be included as part of the definition in the ASB’s proposed standard on confirmations when it is exposed, should be added to the definition to recognize direct access as an acceptable confirmation procedure.

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

We believe that the AICPA’s extant guidance in AU section 9330, *The Confirmation Process: Auditing Interpretations of Section 330*, and ISA 505, paragraph A12 both provide appropriate application guidance about the use and reliability of electronic confirmations. We believe, consistent with the guidance in ISA 505, that any guidance should emphasize judgment based on assessed risk of material misstatement. The guidance in ISA 505, paragraph A12, which is consistent with AU section 9330.03, states:

Responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. A process used by the auditor and the respondent that creates a secure environment for responses received electronically may mitigate these risks. If the auditor is satisfied that such a process is secure and properly controlled, the reliability of the related responses is enhanced. An electronic confirmation process might incorporate various techniques for validating the identity of a sender of information in electronic form, for example, through the use of encryption, electronic digital signatures, and procedures to verify web site authenticity.

Additionally, the AICPA’s extant guidance in AU section 9330, paragraph .07 provides guidance in situations when a system or process, such as a third-party service provider, facilitates electronic confirmation between the auditor and the confirmation respondent. We believe such guidance should also be included as application guidance.



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AU section 9330, paragraph .07, states:

If a system or process that facilitates electronic confirmation between the auditor and the confirmation respondent is in place and the auditor plans to rely on such a system or process, an assurance trust services report (for example, Systrust), or another auditor's report on that process, may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls with respect to that process. Such a report would usually address the risks described in paragraph .03 [the information obtained may not be from an authentic source, a respondent may not be knowledgeable about the information to be confirmed, or the integrity of the information may have been compromised]. If these risks are not adequately addressed in the report, the auditor may perform additional procedures to address those risks.

Further, we believe that when a third-party service provider is used in the confirmation process, approval from the client should be obtained prior to the use of such a service because the process will entail providing confidential client information to a third party.

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?

Confirmation from proper source

Consistent with ISA 505, paragraph 7, we believe that as part of maintaining control over external confirmation requests, the auditor should ensure that confirmation requests are properly addressed, whether the confirmation process is electronic or in paper form, to address the risk that the confirmation response is not obtained from a proper source. However, we do not believe that specific procedures should be required but instead suggest providing guidance such that the decision to test the validity of the addresses on confirmation requests before they are sent should be based on assessed risk. For example, the greater the risk that confirmation requests are not properly addressed; the more likely it is that testing the validity of addresses would be an appropriate response.

Integrity of data

The confirmation process is not without risk, whether the process is in paper or electronic form. These risks (interception, alteration, and fraud) are mitigated in part through the appropriate design of the confirmation request and the process surrounding it. With respect to electronic confirmation requests, the design of the confirmation process may be complicated, because the proof of origin and authority of the respondent



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may be more difficult to establish and alterations may be more difficult to detect. We believe that ISA 505, paragraph A12 (refer to question 3 above for the text of paragraph A12) provides appropriate guidance in circumstances where the auditor has doubts about the reliability of the responses to a confirmation request and, as such, the audit response should be based on the auditor's judgment about the assessed risk related to the integrity of the data.

In addition to the guidance set out in ISA 505, we believe that examples that demonstrate how risks unique to the electronic confirmation process may be addressed should be included in any proposed standard. In developing such guidance and examples, we encourage the Board to reach out to information technology experts with experience in electronic confirmations.

Requirement to confirm

5. **Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU section 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?**

We do not believe that the presumptively mandatory requirement to request confirmation of accounts receivable in AU section 330 should be expanded to include items such as significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions. Instead, we support a risk-based approach to determining when the use of confirmations would provide sufficient appropriate evidence, as set out in ISA 330, paragraph A19. This paragraph states:

When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

We recognize that AU section 316, paragraph 54 (to address the presumption that there is a risk of material misstatement due to fraud relating to revenue recognition), provides guidance about procedures the auditor may consider performing, which includes confirming with customers certain relevant contract terms and the absence of side agreements. As a result of the heightened risk of material misstatement due to fraud with respect to revenue recognition for complex revenue arrangements, we support



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including guidance relating to factors to consider in determining whether to perform confirmation procedures, related to these items.

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

We do not believe that the auditor should be required to consider confirming other items, but instead believe that the decision should be based on the assessed risks of material misstatement, such that as the assessed risk increases, the more persuasive the evidence needs to be. So for example, the auditor would design audit procedures in response to the assessed risk assessment and external confirmation procedures may be the most appropriate response. Such an approach is consistent with ISA 330, which provides for a risk-based approach that provides for increasing the quantity and/or relevance and reliability of evidence as assessed risk increases.

Further, rather than prescribing when confirmations should be used, we suggest providing guidance about circumstances when confirmation procedures may be appropriate, similar to the guidance contained in ISA 330, paragraphs A48 through A51, which describe circumstances when confirmation procedures are frequently used, the assertions for which confirmations are most often relevant, and factors that assist the auditor in determining when confirmation procedures may be appropriate.

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?

We do not believe that specific procedures should be required when evaluating whether confirmation of accounts receivable would be ineffective. However, we recommend including guidance similar to that currently included in the footnote to AU section 330, paragraph 34b, which provides an example of when an auditor might consider the use of confirmations to be ineffective. The footnote offers the following as an example:

...if based on prior years' audit experience or on experience with similar engagements, the auditor concludes that response rates to properly designed confirmation requests will be inadequate, or if responses are known or expected to be unreliable, the auditor may determine that the use of confirmations would be ineffective.



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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?

We do not believe that it would be practical to describe what constitutes “unusual” or “complex” agreements or transactions, including revenue transactions, as such a definition would depend on specific facts and circumstances. However, if the Board expands the presumptively mandatory requirement to request confirmation of accounts receivable in AU section 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions, it would be necessary to develop a framework for identifying such transactions.

Designing confirmation requests

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

ISA 505, paragraph A4, describes factors to consider when designing confirmation requests, which we believe provides appropriate direction. Some of these factors are already included within the extant standard; however, we believe these additional factors, which are similar to factors included in ISA 505, would be helpful to auditors:

- the assertions being addressed;
- specific identified risks of material misstatement, including fraud risks;
- the layout and presentation of the confirmation request;
- the method of communication (for example, in paper form, or by electronic or other medium); and
- management’s authorization or encouragement to the confirming parties to respond in a timely manner to the auditor. Confirming parties may only respond to a confirmation request containing management’s authorization.

In addition to the above, we suggest including guidance related to the timing of confirmation procedures such that the auditor may consider sending confirmations throughout the year when confirming specific transactions, rather than performing these procedures only at year-end, as this could help identify potential additional risks at an earlier stage.



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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?

As noted in our response to question 4, we believe that the decision to test the addresses of confirming parties should be based on the assessed risk that the information has been compromised.

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 believe that guidance, similar to ISA 505 and the extant PCAOB standard, that requires the auditor to maintain control over external confirmations by (a) determining the information to be confirmed, (b) selecting the appropriate confirming party, (c) designing the request, including directing it to the appropriate party, and (d) sending and receiving the request directly to/from the confirming party or applicable third-party service organization is appropriate.

In addition, our response to question 4 above provides recommendations about how the auditor may determine that confirmations are properly addressed.

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

Maintaining control over confirmations in electronic form may result in increasing certain risks that may not be as relevant when performing confirmation procedures in paper form. For example, risks relating to whether the information is obtained from an authentic source or whether the integrity of the information has been compromised may increase when the confirmation process is electronic. Although we believe that these risks exist even when confirmations are in paper form, we believe that, given the nature of electronic confirmation procedures, additional guidance about how to address these risks is appropriate.

As such, we believe additional guidance as set out in ISA 505, paragraphs A12 (refer to question 3 for text of paragraph A12) and A13, which specifically addresses the unique risks relevant to an electronic confirmation process, would be appropriate. Paragraph A13 states:

If a confirming party uses a third party to coordinate and provide responses to confirmation requests, the auditor may perform procedures



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to address the risks that: (a) the response may not be from the proper source; (b) a respondent may not be authorized to respond; and (c) the integrity of the transmission may have been compromised.

Additionally, as set out in our response to question 4, we believe that examples that demonstrate how risks unique to the electronic confirmation process may be addressed should be included in any proposed standard.

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 support incorporating the guidance from ISA 505, paragraphs 10 and 11, into a standard on external confirmations that provides guidance about what to do when (1) the reliability of a response is in doubt and (2) a response is deemed to be unreliable.

With respect to the use of electronic confirmations, additional matters to consider with respect to reliability include the guidance set out in AU Section 9330, paragraph .07. (Refer to question 3 above for text of paragraph .07).

Additionally, we recommend that the Board obtain input from information technology experts to help identify potential risks that may impact the reliability of electronic confirmation responses, including how these risks may be mitigated.

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?

Please refer to our response to question 3.

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 are not aware of any other factors.



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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 that the standard should require the auditor to perform alternative procedures for non-responses, except in the circumstance set out in AU section 330, paragraph 31, which states:

...the omission of alternative procedures may be acceptable (a) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (b) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated.

Further, we believe the requirement to perform alternative procedures for non-responses should be similar to ISA 505, paragraph 12, such that the auditor should perform alternative procedures to obtain relevant and reliable audit evidence and that examples of alternative procedures for selected accounts, similar to those provided in paragraph A18 of ISA 505, for accounts receivable and accounts payable, would be appropriate.

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

We believe the standard should require the auditor to investigate exceptions identified as a result of confirmation responses, consistent with the guidance included within ISA 505, paragraph 14, including the related application guidance in paragraphs A21 and A22. Paragraph 14 requires the auditor to investigate exceptions to determine if they are indicative of misstatements. The application guidance explains that exceptions may indicate misstatements or potential misstatements in the financial statements and that if a misstatement is identified, the auditor is required by ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, to evaluate whether such misstatement is indicative of fraud. Additionally, exceptions may provide a guide to the quality of responses received for similar accounts or confirming parties.



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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 that guidance that describes how the nature and extent of alternative audit procedures are affected by the account and assertion in question should be similar to that set out in paragraph A19 of ISA 505 and should not be a requirement. That guidance explains that a non-response to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor.

With respect to investigating exceptions, while they may indicate misstatements (or potential misstatements) that require evaluation with respect to fraud or error, they may also represent such routine matters as clerical errors in completing the confirmation or timing differences in the confirmation process that do not represent misstatements. All exceptions that do not represent these types of routine matters should be investigated and considered as to their impact on the auditor's original risk assessment.

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?

If confirmations are sent for such items as the significant terms of unusual or complex agreements or transactions, we believe that the alternative procedures in the event of non-responses would be dependent on the specific facts and circumstances, based on the nature of the item for which a confirmation was requested, the related assessment of risk and the strength of other audit evidence obtained addressing the same assertion that the confirmation was intended to address. Therefore, due to the wide variety of alternatives, it would not be appropriate to include specific alternative procedures in the standard that would be required whenever there is a non-response.

However, we believe that application guidance about how to determine the nature and extent of alternative procedures to address non-responses in this area would be helpful, in addition to examples of procedures to apply for various types of confirmed items.



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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 to confirm accounts, transactions, agreements, or other items?**

In addition to the guidance set out in the Concept Release, we believe that the guidance in ISA 505, paragraph 9, as set out below, would be appropriate to address the increased risk associated with a request by management not to confirm certain items:

- Communicate with those charged with governance if management's request is determined to be unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative procedures; and
- Evaluate the implications on the audit and audit opinion.

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 believe that the auditor should be required to evaluate the effect of disclaimers and restrictive language on confirmation responses and to document the impact of such disclaimer or restrictive language on the use of the confirmation as audit evidence. In this regard, the guidance provided in ISA 505, paragraph A16, should be (1) supplemented to provide examples of the type of restrictive language being contemplated in the guidance (for example, language that disclaims on the accuracy or completeness of information), and (2) enhanced to include guidance about procedures the auditor should consider when the auditor has doubts about the reliability of the confirmation response due to the use of the restrictive language, in addition to when the restrictive language precludes the use of such information and as such, the confirmation response would be treated as a non-response. For example, if a restricted response is received in response to a confirmation request to confirm there are no side agreements, this should ordinarily cause a reevaluation of the auditor's risk assessment.

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Further, we believe that the use of disclaimers and restrictive language on confirmations has had a negative impact on the reliability of audit confirmations, and we encourage the Board to engage in a dialogue with representatives of the banking regulators, the SEC, and others to develop an approach to confirmations that meets the needs of all interested parties and that is in the public interest.

Negative confirmations

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

We believe that there are instances when negative confirmations may be appropriate, such as those circumstances described in ISA 505, paragraph 15, where the auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion; the population comprises a large number of small, homogeneous, account balances, transactions or conditions; a very low exception rate is expected; and the auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

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

We believe that negative confirmations should continue to be permitted where considered appropriate, but should not be the sole source of evidence such that either the circumstances in ISA 505, paragraph 15 (as set out above), have been met or additional substantive procedures are performed that address the assessed risk of material misstatement at the assertion level.

We appreciate your consideration of our comments and suggestions, and would be pleased to discuss these with you at your convenience. Please direct any questions to Wayne Kolins, National Director of Assurance at 212-885-8595 (wkolins@bdo.com) or Susan Lister, National Director of Audit Policy at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO Seidman, LLP

BDO Seidman, LLP