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Public Company Accounting Oversight Board
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Re: PCAOB Rulemaking Docket Matter No. 028, *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards*

Dear Board Members and Staff:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (Board or PCAOB) *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* and respectfully submit our comments and recommendations.

We support the Board's initiative to revise its interim standard extant AU sec. 330, *The Confirmation Process*, by strengthening the auditor's responsibilities related to confirmation procedures, particularly those responsibilities that relate to electronic confirmations and disclaimers and restrictive language. We also acknowledge the Board's consideration of the comments it received in response to its *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (Concept Release) and of International Standards on Auditing (ISA) 505, *External Confirmations*, in drafting the proposed standard. However, we have significant reservations as to the proposed standard's operability, efficacy, and transparency. We provide herein our overarching concerns and responses to the Board's specific questions.

We believe that the proposed standard is overly prescriptive and will unnecessarily increase the cost of an audit without a corresponding benefit in audit quality. The numerous presumptively mandatory responsibilities to confirm certain accounts and transactions, as well as those responsibilities pertaining to the selection of the confirming party and the validity of the addresses on confirmation requests, do not seem consistent with the risk assessment concepts the Board recently approved. We understand the Board's intention to require the use of confirmation procedures to address the risk of material misstatement, primarily due to fraud; however, we believe that the proposed standard over relies on the use of such procedures to attempt to reduce such risk to an acceptable level. In certain situations, confirmation procedures may not be the most effective or efficient procedure to respond to the assessed risk, even those deemed to be significant risks. This can increase the cost of an audit because time and effort will be spent on performing confirmation procedures in lower risk areas when alternative procedures may be more effective. Cost may also increase because of the auditor's

inability to use internal audit to the extent allowed in extant auditing standards. Further, we believe that the proposed standard will significantly increase audit documentation that is, in most circumstances, not commensurate with the assessed risks, which in our view will also unnecessarily increase the cost of performing audits.

We would like to also reiterate concerns we have previously expressed with regard to the Board's drafting conventions. We disagree with the Board's elimination of essential guidance from the proposed standard and the Board's inclusion of additional requirements, or their interpretation of requirements, outside of the proposed standard within the Release. Auditors look to the Board's standards to determine their responsibilities. The Board's approach makes it quite difficult for an auditor to properly comply with those standards and is, therefore, not in the public's best interest. As a much less effective alternative if the Board retains this approach, we suggest that guidance be provided via a Staff Audit Practice Alert (Alert) so that auditors can fully understand the Board's expectations. We have made several recommendations herein with regard to the use of an Alert, particularly in reference to eliminating presumptively mandatory responsibilities that are based on examples of specific situations the auditor may encounter.

Definitions

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

We believe that, for the most part, the definitions in the proposed standard are sufficiently clear and appropriate. We recommend, however, deleting the last sentence in the definition of the term *non-response*, which addresses situations in which disclaimer or restrictive language in a response to a confirmation request precludes the auditor from treating the response as a confirmation response. Although we agree that such response should be treated as a non-response, as required by paragraph 38 of the proposed standard, the response differs from situations where the confirmation request is either returned undelivered or the response to the confirmation request is incomplete. As indicated in our response to question 26, a response to a confirmation request that precludes the auditor from treating the response as a confirmation response may provide some, but not sufficiently reliable, audit evidence. Accordingly, we believe that such response should not be defined as a non-response and that the requirement in paragraph 38 is adequate to address the auditor's responsibility to obtain reliable audit evidence in these situations.

Objective

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

We believe the objective of the auditor as proposed is sufficiently clear and appropriate by focusing on the relevance and reliability of audit evidence obtained through the performance of confirmation procedures. We also appreciate that the objective was aligned with ISA 505, as we do not see a need for the objective between these standards to differ.

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

In connection with our response to question 2, we do not believe there are other matters to be included in the objective.

Receivables That Arise from Credit Sales, Loans, or Other Transactions

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?

We believe that the description of *receivables that arise from credit sales, loans, or other transactions* is sufficiently clear and appropriate. However, we also believe that the requirements in paragraph 8 of the proposed standard to perform confirmation procedures for such receivables require revision to more adequately convey the auditor’s responsibilities.

The Board’s risk assessment standards, if applied properly, eliminate the need for a presumptively mandatory responsibility to confirm receivables. Presuming that an audit procedure should always be performed conflicts with the concept of identifying and responding to the assessed risks of material misstatement present in each audit. Nevertheless, we support the presumptively mandatory responsibility to confirm receivables because we agree with the long maintained auditing tenet that evidential matter obtained from an independent party outside the entity is more reliable than that secured solely within the entity. That said, the requirements proposed in paragraph 8 unequivocally eliminate all auditor judgment in determining whether confirmation procedures will reduce the assessed risk of material misstatement to an appropriately low level or whether confirmation procedures are most effective in reducing such risk based on prior experience, particularly with regard to significant risks that require special audit consideration.

Further, although the proposed standard does not explicitly include the exceptions for not confirming receivables contained in extant AU sec. 330, we note that the Release seems to include additional requirements, specifically pertaining to the effectiveness of confirmation procedures, as well as essential guidance regarding materiality and documentation. The Board particularly makes reference to AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*, as well as Auditing Standard (AS) 3, *Audit Documentation*. We believe that it is unclear whether, with these references, the Board is implicitly retaining some elements of the exceptions identified in the extant standard.

In this regard, we request the Board to maintain the currently allowable exceptions for not confirming receivables and to appropriately modify the requirements in paragraph 8 to more clearly describe the auditor’s responsibilities. We believe that this should include modifying paragraph 8 to require the auditor to consider the assessed risk of material misstatement in determining the nature and extent of the confirmation procedures, including selecting the receivables to be confirmed, rather than requiring the auditor to assess such risk when the auditor is selecting which receivables to confirm. The auditor’s responsibilities to identify and assess the risks of material misstatement are addressed by

AS 12, *Identifying and Assessing Risks of Material Misstatement*. Confirmation procedures, on the other hand, are a response to the auditor's risk assessments.

Cash with Financial Institutions

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 believe that the requirements in paragraph 9 of the proposed standard to confirm cash and other relationships with financial institutions are fraud oriented and assume that there is always a heightened risk of fraud related to cash accounts in all audit engagements. If this were the case, the requirements may falsely convey that confirmation procedures are an appropriate and sufficient response to reduce the assessed risk of material misstatement in all or most circumstances. However, we note that there may be circumstances in which the auditor assesses risk as low and can perform other more effective and efficient audit procedures. We would not be opposed to a requirement for the auditor to confirm cash and other relationships when the auditor believes there is a heightened risk of fraud. In this circumstance, however, we believe that obtaining the confirmation itself would be insufficient, without further evaluating the related activity, reconciliations, adjustments, and relationships.

Significant Risks

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?

We do not agree with the requirement in paragraph 10 of the proposed standard for the auditor to perform confirmation procedures in response to significant risks that relate to relevant assertions that can be adequately addressed by such procedures. AS 13, *The Auditor's Responses to the Risks of Material Misstatement*, addresses the auditor's responsibilities to design and implement appropriate responses to the risks of material misstatement, including performing substantive procedures that are specifically responsive to significant risks. Although a confirmation procedure may be performed to respond to a significant risk, the auditor may determine that the confirmation procedure may not be the most effective or efficient audit procedure or that the confirmation procedure needs to be combined with other substantive procedures. In our view, to prescribe the performance of confirmation procedures for significant risks (as well as those related to agreements or transactions) as proposed in paragraph 10 challenges the Board's risk assessment standards, including the auditor's ability to vary the nature of audit procedures from year to year.

We are not opposed, however, to including a requirement similar to paragraph 19 of ISA 330, *The Auditor's Responses to Assessed Risks*, which requires the auditor to consider whether confirmation procedures are to be performed as substantive audit procedures. An Alert can

then be developed to provide additional guidance, such as that included in paragraphs A48 through A51 of ISA 330, to assist the auditor in determining whether confirmation procedures would be effective or efficient substantive procedures to respond to significant risks or other risks and, if so, the type of information to be confirmed, such as the terms of an agreement or undisclosed side agreement.

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?

Based on our response to question 6, we believe that the proposed standard should not include additional requirements with regard to sending confirmation requests in response to significant risks. The proposed standard should refer to AS 12 as a reminder to the auditor that confirmations may be the most effective response to the assessed risks.

Other Risks

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 auditors will sufficiently understand what the Board describes as other risks, and we agree that confirmation procedures may be an effective and efficient response to certain other risks. However, in consideration of our response to question 6, we believe paragraph 11 of the proposed standard would be better placed in an Alert.

Confirmation Procedures

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

Overall, we support the requirement in paragraph 12 of the proposed standard for the auditor to maintain control over the confirmation process. However, we have concerns related to the specificity of the supporting requirements in paragraphs 13-22. These concerns are expressed herein and also in response to the Board's related questions.

With respect to paragraph 15, we agree that the confirmation request should be directed to an appropriate confirming party; that is, one who is knowledgeable about the information to be confirmed. In many cases, the auditor selects the confirming party based on the company's records or inquiries of management or other personnel. Paragraph 15, however, requires the auditor to select the confirming party even if the company provides the auditor with the name of the confirming party. This requirement is troubling in that it indirectly implies that the auditor has a responsibility to verify the appropriate confirming party for every confirmation request based on external information. It would also seem that the auditor would need to document the procedures performed in determining that the confirming party is appropriate. Accordingly, we believe the requirement in paragraph 15 would increase the cost, but not the quality, of an audit, unless it is limited to confirmation requests that are in response to a heightened risk of material misstatement due to fraud. In

addition, for all other risks, the auditor may consider selecting a sample of the population to test based on the information being confirmed and the assessed risk of material misstatement. Regardless of the type of risk, the auditor can test the appropriateness of the confirming party in conjunction with testing the validity of the addresses on the confirmation requests.

We also believe that the examples provided in paragraphs 14 and 15 of the proposed standard should either be removed and included in an Alert or modified to eliminate the requirement. Examples should not include presumptively mandatory audit responsibilities.

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?

We believe that the proposed standard does not adequately describe the use of internal audit in the confirmation process. We also believe that the proposed standard appears to be inconsistent with the Release and with the direction provided to auditors as it relates to the use of the work of others in connection with AS 5, *An Audit of Internal Control Over Financial Reporting That is Integrated With an Audit of Financial Statements*.

Paragraph 26 of the proposed standard requires the auditor to evaluate the audit evidence obtained from performing confirmation procedures and does not permit the auditor to rely on the company or any other party for this evaluation, which includes such matters as performing alternative procedures for non-responses and investigating exceptions. The Release, however, seems to indicate that it would be appropriate to use internal audit, for example, in assembling information for the auditor to resolve exceptions. The Board seems to be drawing a fine line between what is required by the proposed standard and what is permitted by the Release. We believe that this will cause uncertainty as to the use of internal audit, as well as inconsistency in applying the standard in practice.

AS 5 adopts a risk-based approach related to the use of the work of others in consideration of their competence and objectivity. The same would seem to apply to the use of internal audit when the auditor performs confirmation procedures. We acknowledge that the Release addresses the use of internal audit in a similar manner; however, the Release is interpreting how to apply AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, in this context. We believe that the guidance provided by the Release belongs within the standard. Further, although we agree that the auditor should be responsible for maintaining control of the confirmation process and performing an overall evaluation of the results of that process, the auditor should clearly be permitted to use the work of internal audit in all other aspects of the confirmation process, while applying the same risk-based principles.

Designing the Confirmation Requests

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

We support including the factors that the auditor may consider in designing confirmation requests within the proposed standard. For the most part, we believe these factors are clear and appropriate. To provide additional clarity with regard to the auditor's consideration of these factors, however, we propose the following changes to paragraph 16:

- Stating that the factors *may* include the matters identified, rather than using the present tense to describe the auditor's responsibility. The present tense implies a required auditor action that may necessitate documentation.
- Eliminating or revising the second to last bullet pertaining to the company's authorization to the confirming party to respond to the auditor. The company's authorization is normally included within a confirmation request; it does not seem to be a factor to consider when designing the request.
- Eliminating or revising the last bullet pertaining to the consideration of local customs. Although local customs may indicate that confirmation requests are not customary in a specific jurisdiction, such customs may not indicate whether a particular confirming party will respond without verifying the information. Even so, this factor would pertain to the auditor's consideration of whether confirmation procedures will be effective in responding to the assessed risk of material misstatement, or whether, in the auditor's judgment, alternative procedures may be more effective. In this circumstance, any revisions made to the confirmation request would not seem to alter the confirming party's actions to respond without performing any verification.

Determining the Type of Confirmation Requests to Send

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?

We do not concur with, nor do we fully understand, the Board's divergence from ISA 505 with regard to the use of negative confirmation requests. Although the proposed standard continues to permit the use of negative confirmation requests, it does not provide any weight to their use in consideration of the risks they are intended to address. With respect to certain financial statement assertions with a low risk of material misstatement, we believe that negative confirmation requests provide more than limited, although less persuasive, audit evidence; for example, the existence of deposits in a bank.

Under ISA 505, negative confirmation requests are permitted as the sole substantive procedure to respond to a low risk of material misstatement, whereby the auditor has obtained sufficient appropriate audit evidence with regard to the effectiveness of controls relevant to the assertion. The Board's proposed approach for these types of risks, however,

would only allow the use of negative confirmation requests when the auditor also performs other substantive procedures. In addition, for all other risks where the auditor has determined to use negative confirmation requests, the proposed standard appears to require the auditor to use a combination of negative and positive confirmation requests, regardless of the other types of substantive procedures that are available for the auditor to perform. We believe that neither of these proposed requirements is warranted in consideration of the Board's risk assessment standards. Nor do we believe that the requirements permitting the use of negative confirmation requests would need to differ for audits of financial statements of issuers, as ISA 505 establishes a rather high-bar in allowing their use as the sole substantive procedure.

Accordingly, we suggest aligning the requirements for the use of negative confirmation requests with ISA 505 and also providing guidance in an Alert to more thoroughly describe the situations in which such confirmations are typically used, particularly as the sole substantive procedure.

Determining that Confirmation Requests are Properly Addressed

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?

As previously expressed in our letter to the Board in response to the Concept Release, a requirement to test all addresses would be onerous on large audits. Furthermore, a requirement to test addresses only provides limited audit evidence as to whether the confirmation reached the intended, knowledgeable confirming party. In this regard, we believe that the requirements in the proposed standard to determine the validity of the addresses on confirmation requests are both unclear and inappropriate.

Although the proposed standard permits the use of either substantive procedures or tests of controls to determine the validity of the addresses on confirmation requests and also acknowledges that the nature and extent of these procedures depend on the associated risk and materiality of the items being confirmed, the requirements in paragraph 19 are contradictory in that they also require the performance of substantive procedures for transactions or accounts that involve significant risks or are material to the financial statements. This essentially requires the auditor to determine the validity of all of the addresses on all of the confirmation requests required by paragraph 10 by only performing substantive procedures. Furthermore, while the auditor may be able *test* the validity of the addresses, the auditor cannot *determine* with certainty that all addresses are valid. In addition, as indicated in our response to question 14, invalid addresses are ordinarily identified when the confirmation request is returned undeliverable or, sometimes, when no response is received. Accordingly, we believe that the proposed requirements are not operational and that the anticipated benefits do not outweigh the costs.

We propose a requirement for the auditor to test, either through tests of controls or substantive procedures, the validity of some of the addresses on confirmation requests. In consideration of our response to question 9, such tests would ordinarily be performed in conjunction with testing the appropriateness of the confirming party when there is a heightened risk of material misstatement due to fraud. For all other risks, the auditor may consider selecting a sample of the population to test based on the information being confirmed and the assessed risk of material misstatement. For example, an auditor might be more likely to test the address of a party confirming a large, unusual transaction, and less likely to test the addresses of parties confirming many, small account balances. The factors the auditor may consider in testing the validity of the addresses and examples of tests of controls and substantive procedures the auditor may perform can be included in an Alert.

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

We agree that the auditor should have a responsibility to develop an appropriate response when the auditor believes that the addresses on confirmation requests are invalid. Nevertheless, we believe that the requirement in paragraph 20 is unnecessarily prescriptive.

As indicated in our response to question 13, the auditor may be able to test the validity of the addresses, but cannot determine with certainty that the addresses are valid. We assume that the circumstances in paragraph 20 would primarily relate to situations in which the address provided by management on the confirmation request does not agree with the company's records or, in some cases, an external source. Yet, we believe that invalid addresses are ordinarily identified when the confirmation is returned undeliverable or, sometimes, when no response is received. In such cases, however, the auditor treats the confirmation as a non-response.

Accordingly, we suggest streamlining the requirement. For example, if the auditor believes that based on the tests performed that an address is invalid, the auditor should perform additional audit procedures as necessary to resolve the matter. If the matter appears to be intentional and therefore, is indicative of a risk of material misstatement due to fraud, the auditor should evaluate the implications on the audit.

Management Requests Not to Confirm

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 agree with the requirement in paragraph 23 of the proposed standard, which addresses the auditor's responsibility to understand management's reasons for the request not to confirm, as well as to obtain audit evidence as to the appropriateness of those reasons.

We do not entirely agree with the requirements in paragraphs 24 and 25 of the proposed standard, which differentiate the auditor's responsibility based on whether the auditor determines that management's request is appropriate, and therefore, agrees to the request. For example, we believe that regardless of whether the auditor agrees to management's request, the auditor should evaluate the implications on the auditor's relevant risk assessments and other audit procedures. Also, the auditor should not be required to communicate management's request to the audit committee or obtain written representations from management for each instance in which the auditor agrees with the request and is also able to perform alternative audit procedures to obtain sufficient appropriate audit evidence. Such communications and representations may be based on the nature of the information being confirmed, the assessed risk of material misstatement, and the audit evidence obtained to determine the appropriateness of management's request. Further, if the auditor agrees to management's request and also obtains sufficient appropriate audit evidence by performing alternative audit procedures, a significant management-imposed scope limitation does not exist and there is no associated implication on the audit report.

Our proposal to address these matters is to align the requirements in paragraphs 24 and 25 with the requirements in paragraphs 8(b-c) and 9 of ISA 505.

Evaluation

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?

In most circumstances, we believe that the auditor should perform alternative procedures for all non-responses to positive confirmation requests. However, we are uncertain as to why the Board chose to eliminate the possible exception to this rule in paragraph .31 of extant AU sec. 330. If the auditor meets the criteria for the omission of alternative procedures in this paragraph, it may be appropriate not to perform alternative procedures. We believe this would be an acceptable audit strategy because the non-response is treated as an error and projected to the population, and the potential misstatement is then evaluated individually and in the aggregate. Accordingly, we suggest that the Board retain the exception in extant AU sec. 330, but also clarify that, even if the criteria were met, omitting alternative procedures would not be appropriate if the confirmation request was in response to a specific, heightened risk of fraud.

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 that the additional procedures that are required in paragraph 28 with regard to the terms of a significant transaction or agreement, as well as those in the note to paragraph 28 with regard to accounts receivable and accounts payable are not appropriate because they are too prescriptive. Such requirements do not belong in the Board's

standards; rather, they would be better placed as guidance to the standard or in an Alert that provides guidance on how to apply the requirements. We believe that the Board's standards should remain principles-based.

When a Response to a Positive Confirmation Request is Necessary to Obtain Sufficient Appropriate Audit Evidence

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 are concerned by the question posed by the Board. Although there may be other circumstances that the auditor encounters where the auditor concludes that a positive confirmation request is necessary, we do not believe the proposed standard should include a rigid list of circumstances that will always yield this conclusion. We prefer the ISA approach, which identifies the same circumstances as being situations that *may* result in this conclusion. For instance, the second bullet in paragraph 29 does not seem operational with respect to being a circumstance where a positive confirmation is necessary because the risk of management override of controls always exists. Yet, the fact that there is a specific fraud risk factor pertaining to management override may cause the auditor to make this conclusion. It is a matter of judgment, however, in determining whether the positive confirmation request is necessary in the particular circumstances.

Exceptions

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 that the requirement in paragraph 30 of the proposed standard to investigate all exceptions in confirmation responses is clear and appropriate, except as it relates to the use of internal audit, as indicated in our response to question 10.

Reliability of Confirmation Responses

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?

We have several concerns related to the requirements in paragraphs 31 and 32 of the proposed standard addressing the reliability of confirmation responses.

Paragraph 31 contains a list of factors that the auditor should take into account in assessing the reliability of confirmation responses. Although this list is rather helpful, we believe the requirement itself will create an excessive and needless documentation burden in illustrating how the auditor complied with this presumptively mandatory responsibility for each confirmation response. Accordingly, we suggest that the proposed standard be revised to

indicate that the list represents factors that the auditor *may* consider in assessing reliability. Alternatively, the factors may be included in an Alert. We also refer the Board to our response on question 11 as it relates to local customs. As local customs may be considered by the auditor in determining whether to use external confirmation procedures, we believe that this particular factor should be removed.

Paragraph 32 requires the auditor to assess any indication that the confirming party is not competent or knowledgeable, has questionable motives, or is not objective or free from bias with respect to the company. We believe that the auditor is incapable of making this assessment by simply evaluating the confirming party's written response. Any such assessment can be made, albeit limited, through direct contact and inquiry of each confirming party or through other information that may come to the auditor's attention during the course of the audit that may indicate such. We strongly recommend that this requirement be eliminated.

Additional Procedures for Electronic Confirmation Responses

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

As electronic confirmation procedures are becoming more widespread, we commend the Board for addressing the auditor's responsibilities related to such procedures. Overall, we support the additional requirements regarding electronic confirmation procedures and believe they are adequate. We do have some specific comments and concerns about the requirements related to the use of an intermediary and direct access, which are provided below in response to the Board's related questions.

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?

We agree with the requirements pertaining to the use of an intermediary to process confirmation requests, including the risks the auditor considers in determining whether to use the intermediary's process. We believe that such risks have been adequately addressed by the proposed standard.

We do, however, recommend that the Board clarify the following matters:

- That the nature and extent of the auditor's procedures to determine whether the auditor can use the intermediary's process *may* take into account the information being confirmed, the assessed risk of material misstatement, and other tests of controls or substantive procedures being performed to respond to the assessed risk.
- That the audit team may rely on the firm's system of quality control in determining whether to use the intermediary's process and that the related audit documentation need only include a reference to the firm's central repository, in accordance with AS 3, *Audit Documentation*.

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.

It is our understanding that the PCAOB staff has obtained some information with regard to the services that an intermediary provides and the related responsibilities of the parties involved based on discussions held in association with the Concept Release. We suggest that the Board hold similar discussions with the intermediaries themselves.

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?

The proposed standard does not include specific risks related to direct access. However, regardless of the form of the confirmation response, there is an inherent risk of alteration or fraud, particularly when there is a risk of collusion. Accordingly, we believe that the risks related to direct access are similar to the risks related to the use of an intermediary's process; that is, the information might not be secure or from a proper source, or the integrity of the information might have been compromised. We believe that these risks are mitigated by the requirement to obtain a written affirmation from the confirming party, as described in the note to paragraph 35 of the proposed standard. The auditor, however, may also consider inquiring of the confirming party as to management's ability to modify the information held by the confirming party.

With respect to paragraph 35, we do not agree with the requirement related to revenue agreements. We believe that requirements should not be based on examples. Also, we do not believe that revenue agreements can be confirmed via direct access, which this paragraph inappropriately implies. An Alert can include examples of situations in which direct access is most likely used and effective.

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 believe that a principles-based standard should allow direct access as a confirmation response regardless of the type of entity providing such access. A standard that appropriately addresses the risks involved need not limit the use of direct access as a confirmation response from a financial institution. Also, other entities that may not be considered financial institutions, such as mortgage servicers, may also provide direct access.

Disclaimers and Restrictive Language

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?

We concur with the Board that "...the use of disclaimers and restrictive language has become more prevalent and that it raises issues for auditors regarding their reliance on

confirmation responses.” Accordingly, we support the additional requirements in the proposed standard related to such disclaimers and restrictive language.

Nonetheless, because the extent of reliance on a confirmation response is affected by the nature of the disclaimer or restrictive language, we believe that an Alert can provide additional guidance to the auditor by comparing and contrasting boilerplate disclaimers and restrictive language that may not affect reliability and other language that causes doubts about reliability. This Alert can also differentiate situations in which the entire confirmation may be unreliable from those whereby only a portion of the confirmation may be unreliable because the disclaimer or restrictive language only affects certain financial statement assertions. The Alert can further include the illustrative disclaimers and restrictive language identified by the Board in the Release and can also provide examples of language that could preclude the auditor from treating the response as a confirmation response. It should be noted, however, that even if the disclaimer or restrictive language precludes the auditor from treating the response as a confirmation response, such response may provide some, but not sufficiently reliable, audit evidence about the matter being confirmed.

Evaluating Results

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 that the requirements related to evaluating the results of confirmation procedures are clear and appropriate and that no changes need to be made by the Board.

Proposed Amendments to PCAOB Auditing Standards

In consideration of our comments herein, we also request the Board to reconsider the proposed amendments in Appendix 2. In particular, we believe the following:

- We believe that the amendment to AU sec. 322 may be misinterpreted as a simple modification of the examples of assertions that might have low risk of material misstatement or involve a low degree of subjectivity in the evaluation of audit evidence. However, in concert with the statements made in the Release, it can be interpreted to imply that cash and pre-paid assets should never be assessed as having low risk, and the auditor should not use the work of internal audit in these areas. Depending on the nature of the entity and the assessed risks of material misstatement, we believe that this often is not the case. Regardless, the Board should unambiguously indicate its position on this matter, rather than modifying what is clearly just an example.
- The amendment to AU sec. 331, *Inventories*, will now require the auditor, in all circumstances, to confirm inventories that are in the hands of public warehouses or other outside custodians. The Board should reconsider the necessity of this requirement if the auditor performs the procedures listed in paragraph .14 of AU sec. 331 when the inventory

represents a significant proportion of current or total assets. In this situation, we believe that the auditor need not confirm inventories with the custodians.

We also believe that the amendments to AU sec. 333, *Management Representations*, should be eliminated based on our responses to questions 15 and 17.

Comparison of Objectives and Requirements with Other Analogous Standards

We support and appreciate including a comparison of the significant differences in the objectives and requirements of the Board's standards and those of the International Auditing and Assurance Standards Board (IAASB) and the American Institute of Certified Public Accountants (AICPA). However, we believe that the comparison in the proposed standard is quite cumbersome and propose that the Board consider the following:

- Eliminate comparisons in which the Board believes that the IAASB and AICPA include similar objectives or requirements whereby the auditor's actions are not expected to differ.
- Indicate the additional objectives or requirements included in the Board's standards that are not included in the IAASB or AICPA standards by simply referencing the relevant paragraphs and the related topic, rather than repeating those objectives or requirements.
- Not include objectives or requirements, or any essential guidance that is necessary to understand the auditor's responsibilities that is not also included in the Board's standards.

We would be pleased to discuss our letter with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Sincerely,

