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

Dear Members and Staff of the Public Company Accounting Oversight Board:

BDO USA, LLP welcomes this opportunity to comment on the Public Company Accounting and Oversight Board's (PCAOB or the Board) Proposed Auditing Standard, *Confirmation* (the proposed standard). Overall, we support the Board's objective in addressing this topic, as there have been significant changes in the confirmation process, largely due to technological advances and the increase in the use of disclaimers and restrictive language in confirmation responses, which present unique challenges to auditors in assessing the reliability of such responses.

We note that, consistent with previously proposed standards, the Board has provided a comparison of the proposed standard with the related standards of the International Auditing and Assurance Standards Board (IAASB) and Auditing Standards Board (ASB). We support the Board's consideration of the work of these other standard setters and recognize that certain differences are necessary to reflect the U.S. public company environment; however, we also note that many of the differences between the respective standards relate to the prescriptive nature of this proposed standard when compared against either the IAASB or ASB standard. As such, we are concerned that this proposed standard may lead to a "check the box" mentality that could result in ineffective audit procedures. Rather than prescribing audit procedures in all cases, regardless of the auditor's risk assessment, we would support the application of professional judgment in evaluating the risks of material misstatement and in determining the appropriate audit approach. We encourage the Board to reconsider the impact that such a prescriptive approach may have on audit quality and cost.

Furthermore, we believe that the Board may not have fully considered the responsibility that this standard has seemingly imposed upon responding parties, over which the Board has no authority and the auditor has no influence. In that regard, we are concerned that the expanded requirements have not considered the operational challenges auditors will face in obtaining appropriate responses to the expanded confirmation requests. Accordingly, we encourage the Board to discuss this proposed standard with other organizations whose members will be expected to respond to auditor's confirmation requests, to understand how their members would be affected by the proposed standard.



A. 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?

Overall, we believe the definitions are sufficiently clear and appropriate; however, we are concerned that the proposal has expanded the definition of receivables beyond that included in extant AU sec. 330, by eliminating the exception provided in paragraph 34 of AU sec. 330, to requesting confirmation of accounts receivable when certain conditions are met. While we agree that confirmation procedures may provide an effective and efficient means of obtaining appropriate audit evidence in many circumstances, we do not believe that this is always the case, and recommend retaining the guidance from paragraph 34 of the extant standard to allow auditors to use professional judgment in determining the most appropriate audit approach. (See also our response to question 4 below.)

Additionally, we believe the term "financial institution," as it relates to employee benefit plans, should be clarified by including the following within the definition: "insurance companies and 401(k) recordkeeping service entities that are affiliated with or acting as an agent for such financial institutions."

B. 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 that the objective is appropriate as it relates to the design and performance of confirmation procedures; however, the proposed standard also addresses the auditor's response to significant and other risks, using confirmation procedures. For this reason, we recommend revising the objective as follows (additions are in bold italics and deletions in strikethrough text):

The objective of the auditor ~~is~~ *is to determine when to use and how to design* and performing confirmation procedures to obtain relevant and reliable audit evidence.

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

We have no additional comments.

C. Confirmation of Specific Accounts

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?

While we believe the description of "receivables that arise from credit sales, loans, or other transactions" is generally clear (see our comment relating to employee benefit plans below), we believe that the requirement to confirm receivables that arise not only from credit sales



of goods and services in the normal course of business but also from loans and “other transactions” is overly prescriptive. We agree that the requirement to confirm receivables from credit sales is appropriate (and consistent with extant AU sec. 330, *The Confirmation Process*); however, we do not believe it is appropriate to expand the requirement to areas other than accounts receivable. The recently adopted risk assessment standards, specifically, Auditing Standard No. 13, *The Auditor’s Responses to the Risks of Material Misstatement*, discusses the auditor’s responsibility to design and implement appropriate responses to the risk of material misstatement, which include procedures that are responsive to risks that are assessed as significant. Such procedures include confirmation procedures - if the auditor determines that such procedures effectively address the assessed risk [emphasis added].

Further, we are concerned that the guidance in extant AU sec. 330, paragraph 34, has not been carried forward to the proposed standard, such that the presumption to confirm accounts receivable would not be required if one of the following circumstances exist: (1) accounts receivable are immaterial to the financial statements, (2) the use of confirmations would be ineffective, or (3) the auditor’s combined assessed level of inherent and control risk is low, and the assessed level, in conjunction with the evidence expected to be provided by analytical procedures or other substantive tests of details, is sufficient to reduce audit risk to an acceptably low level for the applicable financial statement assertions. We note that Appendix 3 states that this guidance has not been carried forward because “if auditors consider confirmation procedures to be ineffective, auditors should determine why they are ineffective and look for ways to improve the effectiveness of confirmation procedures.” However, it may not always be possible to improve the effectiveness of confirmation procedures, and it also may not be efficient to look for ways to improve such effectiveness when there may be other procedures that provide sufficient appropriate audit evidence. Accordingly, we recommend retaining the extant guidance in the proposed standard.

With respect to employee benefit plans required to file audited financial statements using Form 11-K, it is not clear whether the term receivables applies to participant loans and, as such, whether confirmation of these accounts is required by the proposed standard. Based upon the low-risk nature of these loans (i.e., fully secured by the remaining vested balance in the participants accounts, and generally repaid through payroll withholding), we recommend the Board consider specifically excluding participant loans from the confirmation requirement, and clarifying the standard as it relates to employee benefit plan registrants.

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 are concerned that the proposed standard is too prescriptive in requiring confirmation of cash with financial institutions and believe confirmation procedures should be based on the auditor’s assessment of whether such a procedure is the best way to address the assessed risk of material misstatement. Often, confirmation of cash and other relationships with financial institutions will be the most effective way to address the assessed risk; however, we do not believe it is appropriate to prescribe such a procedure. For example, a multi-location entity may have bank accounts at numerous locations - some of which are immaterial individually but in the aggregate may be material. In such circumstances, we



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believe the strength of entity level controls, supplemented by analytical procedures, may sufficiently address any assessed risks without the need to perform confirmation procedures.

- 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 believe the proposed standard appropriately addresses the risk of material misstatement in response to significant risks. The requirement in paragraph 10, to perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures, seems to be contrary to the guidance set out in the recently adopted risk assessment standards that provide for performing risk assessment procedures to identify and assess the risks of material misstatement (Auditing Standard No. 12, paragraph 4) and then based on that assessment, design and implement overall responses to address such risks (Auditing Standard No. 13, paragraph 5). Our concern with the structure of the proposed standard is that it seems to require the performance of confirmation procedures in all circumstances in which confirmation procedures could possibly be applied, regardless of the level of risk or the practicality of such an approach.

We believe a better approach would be to align this proposed standard with the concepts set out in the newly adopted risk assessment standards, which emphasize the use of professional judgment in assessing risks and responding to those assessed risks with a focused approach that considers the relevance and reliability of audit evidence to be obtained.

Further, we are concerned that given the prescriptive nature of this proposed standard and its focus on confirmations to address significant risks, auditors may over-rely on confirmations by not adequately considering certain limitations that may impact the reliability of confirmation responses, such as the confirming party's knowledge of the subject matter, the ability or willingness of the intended confirming party to respond, or the objectivity of the responding party.

- 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?**

See our response to question 6 above.

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

While we believe the description of other risks is not inappropriate within this proposed standard, Auditing Standard No. 13, paragraph 3, already explains that the auditor must design and implement audit responses (which include confirmation procedures) that address the risks of material misstatement that are identified and assessed in accordance with the



provisions set out in Auditing Standard No. 12. As such, we believe the description of other risks is unnecessary within this standard.

D. 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?

We do not think the requirements for maintaining control over the confirmation process are appropriate. While we agree that the auditor should maintain control over the confirmation process, we have concerns about certain of the requirements that may be outside the control of the auditor. For example, paragraph 16 explains that the auditor should design confirmation requests to obtain relevant and reliable audit evidence and provides a list of factors to consider. While we agree that most of these factors are appropriate, we believe that one of the factors listed, that directs the auditor to assess the local customs that might influence confirmation responses, such as a local custom of responding to confirmation requests without verifying the information, may be beyond the ability of the auditor to assess. We believe that a more appropriate factor would be for the auditor to *consider the ability* (rather than the competence or intentions) of the intended confirming party to confirm or provide the requested information (for example, by requesting confirmation of individual invoice amount versus total balance), which is consistent with International Standard on Auditing (ISA) 505, *External Confirmations*. For this reason, we recommend that the Board replace the proposed language with the language from ISA 505.

Further, we note that the second factor listed under paragraph 16, refers to “the specific risks of material misstatement;” however, to clarify that the risk being referred to is an “identified” risk, we recommend adding the word “identified” before the phrase “specific risks.”

See also our response to question 10.

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 do not agree that an auditor should not be permitted to use internal audit or others within the company to assist in performing certain confirmation procedures. We note that the proposed standard prohibits the use of internal audit or others within the company from sending confirmation requests, receiving responses, or evaluating evidence; however, we believe that in areas of low risk, for which the use of confirmations may be an effective source of evidence, the use of sufficiently competent and objective internal auditors to perform these procedures, if properly supervised, should be permitted.



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

See our response to question 9.

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

The requirement in paragraph 17, that directs the auditor not to use negative confirmation requests as the only form of confirmation request to address the assessed risk of material misstatement at the assertion level unless certain factors are present, is unclear. This requirement seems to direct the auditor to supplement negative confirmation requests with another form of confirmation request when the listed factors are not present. However, we note that a similar requirement in ISA 505 explains that negative confirmations should be supplemented with *substantive audit procedures*, not necessarily other confirmation procedures, when the listed factors are not present. We support the ISA 505 wording for reasons described previously in this letter.

Additionally, the last factor listed in paragraph 17 states that negative confirmation requests should not be used as the only form of confirmation request, unless the auditor reasonably believes that recipients of negative confirmation requests will give such requests consideration. It is unclear how an auditor would be able to determine whether recipients of negative confirmation would give such requests adequate consideration. We believe a better formulation is provided in ISA 505, which instead asks if the auditor is aware of circumstances or conditions that would cause recipients to disregard such requests. The application guidance to this requirement explains that confirming parties may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor, and less likely to respond otherwise.

Further, we note that negative confirmation procedures are often used to address the risks associated with deposit or other liability accounts, when inherent and control risks are assessed as low. We believe that in such circumstances, negative confirmations may provide sufficient appropriate audit evidence.

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?

For the most part, we agree that the procedures are sufficiently clear and appropriate; however, we recommend expanding the guidance to include a discussion about how the risks associated with a particular type of confirmation or address on a confirmation request may impact the auditor's procedures. For example, the use of electronic confirmations may require the auditor to perform different or more extensive procedures to determine a request has been directed appropriately than for a written confirmation request to an entity that is well known to the entity and the auditor.



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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?

Yes, the procedures are clear and appropriate.

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

We do not believe certain of the procedures included within paragraph 24 of the proposed standard are appropriate. Specifically, we do not believe that communication to the audit committee regarding management's request not to perform confirmation procedures is necessary in all circumstances; instead, we believe that a more effective requirement would be to communicate those instances where management refuses to authorize the confirmation procedure where the auditor deems the confirmation to be the most effective audit procedure. Further, we believe this approach would support the Board's efforts to strengthen communication with audit committees by focusing the communication on those matters that have a significant impact on the financial statement audit.

E. 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?

We agree that in the case of each non-response, the auditor should perform alternative audit procedures to obtain relevant and reliable audit evidence; however, we do not believe that it is appropriate in all cases to send or consider sending second and third requests. We believe the nature of the alternative audit procedures should be left to the judgment of the auditor in deciding which procedures would provide sufficient appropriate evidence to address the assessed risk.

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?

The additional procedures seem appropriate.

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

We are not aware of any additional circumstances.



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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 do not believe the requirement in the proposed standard that directs the auditor to investigate all exceptions is sufficiently clear. While we agree that the auditor should evaluate the results of confirmation procedures to determine whether such exceptions represent misstatements or potential misstatements, we believe that the decision about whether an exception represents a risk of material misstatement that requires the performance of additional procedures should be left to the judgment of the auditor, since some exceptions do not represent misstatements, but instead represent timing differences, or measurement or clerical errors.

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

The requirements seem sufficiently clear and appropriate.

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

Yes, the proposed standard provides adequate requirements regarding electronic confirmation procedures.

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 believe additional guidance is necessary to address the electronic confirmation process to ensure that where an intermediary is used, such intermediary employs a system that is suitably designed and operating effectively to preserve accuracy of data transmitted. As such, we recommend adding guidance that directs the auditor to obtain an assurance trust services report or a report similar to a SAS 70 report on such a process to assist the auditor in assessing not only the design, but also the operating effectiveness of the relevant controls. If such a report is not available, additional procedures should be described that could assist the auditor in addressing these risks.

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.

We have no comments.



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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?

We are not aware of any other risks.

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

We are not aware of any reasons why direct access should be limited to responses from a financial institution, as long as the risks relating to the reliability of the confirmation responses were appropriately addressed.

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 believe additional guidance is needed with respect to disclaimers and restrictive language that is used in confirmation responses, as they are becoming increasingly common in the confirmation process. While we recognize that a response that contains disclaimers or restrictions may not in all circumstances invalidate the reliability of the audit evidence for all assertions, we believe additional guidance, including examples that illustrate when such language would not impact the reliability of the confirmation response, would be helpful.

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

We believe the requirements are sufficiently clear and appropriate.

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 Auditing at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

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