

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on April 2, 2009 that relates to *Audit Confirmations*. The other topics discussed during the April 2, 2009 meeting are not included in this transcript excerpt. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript, which may contain typographical or other errors or omissions. An archive of the webcast of the entire meeting can be found on the Public Company Accounting Oversight Board's website at: https://pcaobus.org/news-events/events/event-details/standing-advisory-group-meeting_330

1 PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)

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3 STANDING ADVISORY GROUP MEETING

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6 8:32 a.m.

7 Thursday, April 2, 2009

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11 National Association of Home Builders

12 1201 15th Street, N.W.

13 Washington, D.C.

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1 [Recessed at 10:17 a.m.]

2 [Reconvened at 10:48 a.m.]

3 JENNIFER RAND: Okay. We're going to get
4 started to our next topic on the agenda, which is
5 audit confirmations. Dee Mirando-Gould, who is an
6 associate chief auditor in the Office of the Chief
7 Auditor, will be leading that discussion. So I will
8 go ahead and turn it over to Dee.

9 DEE MIRANDO-GOULD: Thanks, Jennifer.

10 Before we start our discussion of
11 confirmations, I'd like to introduce Chris David to my
12 left, assistant chief auditor in the office.

13 Confirmation is an important source of the
14 evidence auditors may obtain as part of an audit of a
15 company's financial statements because generally it is
16 presumed that evidence obtained from independent
17 sources outside a company is more reliable than
18 evidence solely from within the company.

19 The auditing standard on confirmation
20 defines confirmation as "a direct communication from a
21 third party in response to a request for information."
22 That definition did not contemplate advances in

1 technology, including electronic forms of
2 communication that are available today, for example,
3 electronic mail.

4 Also, auditors may now obtain direct access,
5 also referred to as direct online access, into the
6 electronic records of an audit client's customer,
7 bank, or other confirming party and check the
8 existence and amount of the audit client's balance
9 without the need for interaction with an employee of
10 the customer bank or party.

11 Direct access refers to an auditor obtaining
12 a direct link into the electronic records on a read-
13 only basis. To provide direct access to an auditor, a
14 third party would provide a temporary password to the
15 auditor to allow him or her to independently confirm
16 the information held by that third party. An auditor
17 using a client's password or sitting with a client to
18 review electronic records would not constitute direct
19 access the way we are contemplating it in this
20 discussion.

21 In addition to advances in technology, other
22 changes have occurred. Some banks and other

1 businesses have decided that they can no longer
2 dedicate the resources required to handle responses to
3 confirmations and, thus, have hired third parties to
4 respond on their behalf.

5 This leads me to our first question. Should
6 the definition of "confirmation" allow for responses
7 other than traditional mailed responses, such as oral
8 confirmation, facsimile, email, responses processed
9 through third-party service providers, and direct
10 access to information held by a third party?

11 Wayne Kolins?

12 WAYNE KOLINS: Yes. I guess I'll add to
13 that. It's certainly in this environment at least
14 Bank of America and I'm sure other financial
15 institutions now are just not responding to
16 confirmations. And that's their process.

17 But they have established another process
18 where an entity, a particular entity that we use
19 called Capital Confirmation, does have access to their
20 records and the issuer's information on their records.
21 Therefore, we have established procedures going to
22 those third parties to get access to it, and that

1 certainly is, in our view, is as strong as the normal
2 paper confirmation process and is the best
3 alternative.

4 DEE MIRANDO-GOULD: Thank you.

5 Joe Carcello?

6 JOSEPH CARCELLO: I would agree with Wayne.
7 Just to second that, I am somewhat familiar with the
8 Capital Confirmation process, and I'm sure there are
9 other competitors as well. And that seems to have a
10 lot of merit. So I would encourage you to continue
11 down that path.

12 But as it relates to some of what you have
13 up there, you have some other specific wording up
14 there beyond what Wayne talked about. To me, the big
15 issue, as it relates to all confirmations, whether
16 it's paper or anything else, is knowing who's
17 responding to the confirmation.

18 And again, I refer to some expert witness
19 work I've done, and you do get colored by your
20 experiences. We all do. And in that particular case,
21 there was a problem, major problem with confirmations,
22 and what was happening is the sales people were

1 confirming rather than people in the accounting area.
2 And so, the confirmations weren't of a lot of value.
3 So, to me, that's a major issue to the auditor is to
4 get comfortable as to who's responding.

5 As it relates to an oral confirmation, I
6 think that can work as long as it's followed up with
7 something written eventually. The problem with
8 relying only on oral is that no written record of the
9 confirmation response exists, could always be denied,
10 could always claim misunderstanding. Phone
11 conversations are prone to a lot of risk, as we all
12 know from our personal life.

13 And then I would suggest that the board
14 think about, as it talks about confirmations, that
15 they think about incentives to respond truthfully. In
16 retailing, often you get vendor rebates. And so,
17 those can be receivables. And when you confirm them,
18 you are confirming from a supplier.

19 And so, in that case, you're their customer.
20 And so, their incentives to not make you unhappy are
21 very different than if you're confirming to somebody
22 who buys from you. What are you going to do? Not

1 sell to them any more?

2 And so, I think the board needs to think
3 carefully about those incentives to respond truthfully
4 because I think it affects the quality of the audit
5 evidence.

6 DEE MIRANDO-GOULD: Thank you.

7 Gaylen Hansen?

8 GAYLEN HANSEN: Our firm also uses an
9 outside vendor, and I think their name has been
10 mentioned. So I won't mention it again the third
11 time. And that seems to be working.

12 But I'm a little bit distressed with the
13 direction that the banking groups are going with this.
14 I won't say anything more than that.

15 As far as oral confirmations, as I think an
16 oral confirmation is essentially no confirmation, is
17 incompatible with AS3 as far as that documentation
18 standard. And until you do follow up, as Joe just
19 said, I don't think it constitutes a confirmation
20 because of that misunderstanding, because of the
21 things that can be misinterpreted.

22 And so, I would kick oral confirmations out

1 of this and basically say that it's no confirmation.

2 DEE MIRANDO-GOULD: Thank you.

3 Any other comments?

4 JENNIFER RAND: I'd just like to jump in and
5 kind of ask a follow-up to Joe's point, and I thought
6 he made a very good point about incentives to respond
7 truthfully. And Joe, just kind of wondering in
8 connection with your comment, is the suggestion that
9 it should be a consideration by the auditor to
10 consider if they're aware of any incentives, or I
11 guess kind of in connection with your point, what are
12 you thinking auditors should do?

13 It may be difficult to kind of understand
14 that, but certainly I think it is a good point. Just
15 wondering if you could expand on that to help us in
16 our thinking?

17 JOSEPH CARCELLO: Well, I think the language
18 -- I could be wrong. But my recollection of when I
19 read this, you did talk about the auditor should
20 consider the ability, the incentive, the willingness
21 of parties to respond and to respond truthfully. So
22 if my memory is right, you have language in here. So

1 I'm not sure you need additional language. That's not
2 obvious to me that you do.

3 And I'm sure most of the firms would
4 normally think that through carefully. And in those
5 cases where they don't think it through carefully,
6 that's an inspection or an enforcement issue.

7 DEE MIRANDO-GOULD: Thank you.

8 Arnold Schilder?

9 ARNOLD SCHILDER: Thank you. And I would
10 offer that the IAASB recently had a new standard on
11 confirmations, and a number of questions that are
12 addressed here are also addressed in the standards
13 that we produced. For example, you mentioned about
14 when there is a refusal to allow a confirmation or
15 deals with oral confirmations, whether or not and not
16 without sufficient corroboration, and other issues.
17 And I will not mention that again by question, just
18 would point to the existence of that standard.

19 Furthermore, in our meeting a couple of
20 weeks ago, decided that it might be helpful if we
21 issue a staff alert just to bring that standard to
22 life also in light of very recent developments that

1 cast some doubt about the reliability of
2 confirmations.

3 So that would focus even more on how it's
4 working in practice and thereby assist people in
5 applying the standard. And if we can cooperate with
6 the PCAOB in that respect, that would be great because
7 we, of course, are serving here similar objective.

8 Thanks.

9 DEE MIRANDO-GOULD: So just let me clarify.
10 You're suggesting we might consider a practice alert
11 to discuss issues related to audit confirmations?

12 ARNOLD SCHILDER: That's what the IAASB
13 decided to do. So the staff will be working on that
14 in cooperation with some experienced practitioners.
15 But if in drafting that alert, we could cooperate with
16 the PCAOB, that, of course, would be quite helpful.

17 DEE MIRANDO-GOULD: Okay. Thank you.

18 Gary Kabureck?

19 GARY KABURECK: Thank you.

20 Two comments. One on oral. I mean, I don't
21 know that oral confirmations never work, but I would
22 certainly -- if you were going to stack, rank these

1 things in priorities, you'd have it sort of
2 minimalist, very low level of evidence and sort of
3 only on an emergency-type basis. You know, last
4 minute or something, followed up. So I wouldn't put
5 too much stock in it.

6 But I'm actually looking at the last item in
7 there, direct access to information held by a third
8 party. And again, I accept technology can probably
9 allow you to do that, but I would be nervous about
10 having that be an allowable audit procedure for
11 something important. You don't necessarily know what
12 you're looking at.

13 If you're the auditor and let's say you do
14 have access into some vendor's records or some
15 outsourcing records, you think of let's say bank
16 accounts. I mean, there might be one concentration
17 account and 60 clearing accounts. So you're taking
18 upon yourself to decide have I identified the right
19 account or accounts, and have I read it correctly?

20 And seems to me you're better off having
21 someone respond on behalf of the institution itself as
22 opposed to you deciding I've interpreted somebody's

1 ledger or trial balance correctly. Again, a lot of
2 these arrangements are very complicated with dozens of
3 accounts and ledgers and stuff. I would be very
4 careful about that.

5 Again, I'm not saying it's an inappropriate
6 procedure, but I have doubts about how good it really
7 will be in the main for most of the time.

8 DEE MIRANDO-GOULD: Gaylen Hansen? Oh, Hal
9 Schroeder?

10 [Laughter.]

11 HAROLD SCHROEDER: A few weeks ago, we were
12 down here for the new members session, and I recall
13 one of the sessions went into audit deficiencies,
14 things that you all have found on inspections. And I
15 was struck by the fact that audit confirmations, I
16 think, was not -- if it wasn't number one, it was
17 number two on the hit list of things most often done
18 wrong.

19 Will this definition or some expanded
20 definition help rectify that? Is this trying to
21 address a specific problem? Could you give a little
22 bit of color in terms of how this matches up with what

1 you all are finding in the field?

2 DEE MIRANDO-GOULD: The type of inspection
3 findings related to confirmations, things like
4 auditors not following up on exceptions on
5 confirmation responses or not following up when there
6 is a nonresponse. There's no response at all.

7 There has also been confirmation where the
8 auditor has relied possibly too much for a particular
9 assertion. So, for example, valuation of investments.
10 Audit confirmations typically are better for existence
11 assertion -- maybe for some other things as well --
12 but to a lesser extent, for valuation. And so, in
13 certain cases, that was a problem.

14 I'm trying to remember some of the others.
15 I think those are some of the biggest issues with
16 confirmations that we've seen in inspections. So the
17 definition itself doesn't address those kinds of
18 exceptions. Possibly some other areas, like how to
19 deal with exceptions, which isn't discussed in this
20 SAG briefing paper, but that would address those kinds
21 of issues.

22 Any other? Joe Carcello?

1 JOSEPH CARCELLO: Yes, just a quick point to
2 follow up on what Arnold said earlier. If memory
3 serves me correctly -- I haven't looked at this
4 recently. But if memory serves me correctly, a few
5 years ago, the Auditing Standards Board issued a -- it
6 wasn't a standard. I forget what they call these
7 things. It was like a practice alert, but I'm not
8 sure they call it that -- on confirmations.

9 And I thought it was pretty good. I thought
10 some of their specific suggestions in there were
11 pretty good. So if you haven't looked at that, you
12 might want to look at that.

13 DEE MIRANDO-GOULD: Thank you.

14 Yes, it's a practice alert, and we
15 definitely have looked at it. And we're definitely
16 keeping it in mind as we're considering this topic.

17 Jim Cox?

18 JAMES COX: One of the other national
19 committees I'm on is the American Bar Association's
20 Corporate Law Committee. And I just thought I'd share
21 an insight with you that something that just caused us
22 fits over the last year. We meet every quarter in

1 half-day meetings, and it relates to this question
2 about oral confirmations.

3 And which I share the same level of
4 skepticism, if not outright cynicism, about it.
5 Except for the following, is that there is pretty
6 well-advanced technology now for taking an oral
7 communication and reducing it to written format. And
8 so, you may want to think about that. There is oral,
9 and then there is oral.

10 What causes us fits about that is the
11 question about notice, which is a big deal for
12 lawyers, okay? And when you get it, and if you get a
13 message on your cell phone, is that notice at that
14 point? Or is it when you reduce it down, and what's
15 it mean to be reduced down? And not everybody has the
16 technology because it's fairly expensive. So it's
17 just adding undoubtedly an insignificant lawyer
18 footnote to this conversation. So --

19 DEE MIRANDO-GOULD: Thank you.

20 JOSEPH CARCELLO: May I have a follow up?

21 DEE MIRANDO-GOULD: Ted White?

22 JOSEPH CARCELLO: I was going to say may I

1 have a follow up?

2 In that -- Professor, in that conversation,
3 did they get into a discussion of whether it was legal
4 to actually record it and how that varies from State
5 to State?

6 JAMES COX: It does. I mean, our committee
7 has a focus on a statute that's supposed to be a model
8 for other States, and there are some variations, of
9 course, across the States.

10 MS. MIRANDO-GOULD: Ted White?

11 TED WHITE: Just a quick comment. I don't
12 really have any concerns over the alternative forms of
13 confirmation except for oral. My take on that is that
14 it just introduces too much potential problem for very
15 little benefit, and I would suggest just a bright line
16 on oral confirmation at this point to prohibit it
17 until such time that maybe there is some clear-cut
18 advance in technology in the future where you can
19 accept it.

20 But in just stepping back and thinking about
21 it, it doesn't seem that if somebody is able to give
22 an oral confirmation, it's that much harder to give a

1 written one along with it. And I just don't see the
2 benefit in it.

3 And I agree with Joe's comments earlier,
4 too, about the importance of the source as probably
5 more important actually than how it's transmitted.
6 But the source is also something that's quite
7 important there.

8 DEE MIRANDO-GOULD: Bob Dacey?

9 ROBERT DACEY: We would just like to
10 reiterate the points that Arnold raised that there are
11 a lot of good materials I think in the IAASB standard
12 that address this, and it's relatively recent and gone
13 through due process. And some of the answers to the
14 questions as we go through today I think are
15 reasonably answered by their draft, and we would
16 encourage consistency to the extent possible,
17 including the definition.

18 Secondly, with respect to the standard, it
19 ought to be clear about some of these points,
20 particularly oral. I don't think we believe that that
21 is a confirmation. It is some form of evidence, and
22 you have to evaluate it in terms of evidence quality.

1 And the other point with direct access. I
2 think some of the language now about direct
3 communication is a better issue because when you do
4 that, there is some risk that who you are connecting
5 to isn't the party you think you're connecting to.
6 And therefore, I think you'd have to employ a lot of
7 procedures to ensure that you're actually getting it
8 from that party to meet the requirements of what I
9 think a confirmation would be.

10 So one of the concerns about the proposed
11 language might make too broadly open the direct access
12 because I do think there are a lot of issues related
13 to verifying that other party.

14 Thanks.

15 DEE MIRANDO-GOULD: Thank you.

16 Joe Carcello?

17 JOSEPH CARCELLO: One other thought that I
18 thought to mention earlier. The proposal doesn't talk
19 at all, unless I missed it, is the importance of
20 evaluating the form that comes back, and here's what I
21 mean by that. My understanding of what most firms do
22 and what we did when I was in practice is the firm had

1 a standard confirmation form that was sent out.

2 And there is at least one prominent case
3 that I'm aware of where what was sent back is what I
4 would call customized letters from each client. It
5 wasn't the firm's confirmation form. And what ended
6 up being confirmed wasn't the balance but the total
7 revenue transactions during the year. And obviously,
8 what needed to have been confirmed was the receivables
9 balance at the end of the year.

10 And again, maybe in some sense, you think do
11 you even need to say things like this in a standard?
12 Because most auditors are going to be, I would hope,
13 very sensitive to that. But you may want to at least
14 consider the issue of what is the implication if the
15 auditor sends out a confirmation form and gets back
16 something that's very different, how he or she should
17 respond to that?

18 DEE MIRANDO-GOULD: Thank you.

19 Warren Malmquist?

20 WARREN MALMQUIST: Just from a preparer's
21 point of view, I would take exception or I do take
22 exception, I guess, to the use of oral confirmations

1 because I think it's a less quality standard to
2 follow, and I think that it makes it more inefficient
3 for both the external auditor and also for the
4 preparer.

5 Other point here on direct access, I think
6 this would go a long ways in increasing the response
7 rate and the quality of confirmations if you do have
8 or give direct access to the auditors to customers, to
9 banks, to other financial institutions with whom you
10 might have debt with. But to Gary's point, I think
11 there is some training that needs to take place so
12 that there is the proper use of that direct access.
13 Otherwise, it will add to the inefficiency of an audit
14 and also to that for the preparer.

15 DEE MIRANDO-GOULD: Thank you.

16 Okay, Gaylen Hansen? Did I get that right?
17 Okay.

18 GAYLEN HANSEN: I just want to follow up on
19 Joe, what you're talking about, the nonstandard
20 replies. I don't really have too much of an issue
21 with that because it's third-party evidence that is
22 coming back. As long as you can reconcile that to the

1 receivable balance, in some ways, I think that's
2 another way of getting to the same thing. I would
3 just consider that a reply with comments that you've
4 reconciled and not necessarily an exception or
5 something that you cannot rely on.

6 But I do agree it's something that should be
7 considered perhaps in the standard when you do get
8 something back that's completely different than what
9 you asked for.

10 DEE MIRANDO-GOULD: Thank you.

11 Let's move to our next discussion topic.

12 Oh, excuse me. I'm sorry.

13 HAROLD SCHROEDER: This was the challenging
14 part. We actually both had our 10 cents in.

15 DEE MIRANDO-GOULD: Hal Schroeder.

16 [Laughter.]

17 HAROLD SCHROEDER: My initial thought was
18 oral confirmations, like most people, it's very
19 problematic. But then I thought back to situations
20 where you're dealing with -- and I had one like this
21 where it was military shipments. You could get oral
22 confirmations, but you could not get written

1 confirmations.

2 I don't know if there's anyone who's got
3 certain security clearances that could address that
4 issue. But I think there are certain circumstances
5 where you're not going to get anything in writing.
6 And would this, by excluding it, preclude that? So if
7 there was a way to work that into the language where
8 it's permissible in certain circumstances, and maybe
9 that's one illustration.

10 DEE MIRANDO-GOULD: Thank you.

11 Wayne Kolins?

12 WAYNE KOLINS: I just wanted to supplement
13 what Gaylen had mentioned, which played off Joe's
14 comment. If you get confirmation back that's
15 different from what you sent out in terms of what
16 information you got back, I just think the standard
17 could be written that to assess whether the objectives
18 of your confirmation request were fulfilled by what
19 you got back. If they were not, then you need to do
20 some more work.

21 DEE MIRANDO-GOULD: Thank you.

22 Any other?

1 [No Response.]

2 DEE MIRANDO-GOULD: Okay. Now let's move to
3 our next discussion topic, the requirement for an
4 auditor to confirm accounts.

5 The current auditing standard includes the
6 presumption that the auditor will request the
7 confirmation of accounts receivable during an audit.
8 The standard further provides that an auditor should
9 consider requesting confirmation of the terms of
10 unusual agreements or transactions, such as bill in
11 wholesales, in addition to the amounts.

12 Other standard setters have differing views
13 on whether auditors should be required to request
14 confirmation of accounts receivable and other items.
15 For example, ISA 505 does not require confirmation of
16 any specific accounts, terms, or transactions, while
17 the Auditing Standards Board of the AICPA has
18 indicated that inclusion of the presumptive
19 requirement to confirm accounts receivable is
20 appropriate.

21 That leads me to my next question. Should
22 the board expand the presumptively mandatory

1 requirement to request confirmation of accounts
2 receivable in AU Section 330 to include confirmation
3 of terms of unusual agreements or transactions and
4 complex or unusual revenue transactions?

5 Tom Tefft?

6 THOMAS TEFFT: My view on this is if we're
7 to expand the mandatory requirement, you would then
8 invariably need to define what the scope of unusual
9 transactions were. And even under the best
10 circumstances, you'd never be able to contemplate
11 every kind of unusual transaction. Even if you were
12 able to define all of those today, there's going to be
13 new ones tomorrow.

14 I think you've got to leave this to the
15 judgment of the auditor to determine when is it
16 appropriate and necessary to use a confirmation as a
17 means of getting appropriate audit evidence.

18 DEE MIRANDO-GOULD: Doug Anderson?

19 DOUGLAS ANDERSON: I've always felt that
20 confirmations are one of many sources of audit
21 evidence. You can get audit evidence through all
22 sorts of different means. And making the presumption

1 that confirmations is one of the very best in every
2 risk scenario is not necessarily true. So I've never
3 been in favor of, what is it, presumptively mandatory
4 requirement because it may have no correlation with
5 the risk of what you're looking at.

6 I think a much better guidance approach
7 would be to talk about the value of confirmations, the
8 weaknesses, the pros and cons of what scenarios it
9 works well in and what scenarios it doesn't. But not
10 to have any presumptive mandatory requirement
11 regarding confirmations of receivables or anything
12 else and leave it up to the judgment of the auditor to
13 decide based on the risk of the engagement, the risk
14 of the specific area whether confirmations is a good
15 part of the audit evidence they have to gather or
16 whether there are other types of audit evidence that
17 might be better or more efficient.

18 DEE MIRANDO-GOULD: Hal Schroeder?

19 HAROLD SCHROEDER: We've actually kicked
20 this one around internally from an investment
21 standpoint. As we were talking about fair value last
22 week, and we actually had a conference call with the

1 FASB on this, one of the ideas that was kicked around
2 was a central clearinghouse of some sort where you
3 could actually confirm credit default swaps or other
4 bilateral transactions where there are really only two
5 parties involved.

6 And as I read this, I thought this is an
7 ideal place to expand confirmations, and I agree with
8 your comment. There are some places where it just
9 doesn't make sense. There's no risk there.

10 But there are other places where
11 confirmation, like a credit default swap, would be a
12 tremendous value. A, does the transaction exist? B,
13 do we have the same terms? And C, I would go as far
14 as saying if it's a zero-sum game -- I lose \$10
15 million, you make \$10 million -- we ought to confirm
16 that that's actually at least within ballpark that
17 we're dealing with the same numbers so that they are
18 the mirror image of us.

19 I know that may be way beyond the scope of
20 this, but I think the board actually ought to very
21 seriously consider the need for this in light of all
22 these types of transactions and the troubles that

1 we've had in the last year or two.

2 DEE MIRANDO-GOULD: Thank you.

3 Gaylen Hansen?

4 GAYLEN HANSEN: I would agree. A lot of
5 this is based on judgment. And as you point out,
6 Harold, I mean, there might be some situations where
7 it might be very straightforward to do the
8 confirmation. On the other hand, you have an
9 agreement. Sometimes I wonder whether why don't we
10 just attach the agreement to the confirmation, mail it
11 to the client or the confirming party, and say, "Do
12 you agree with this?"

13 And you've got a written agreement signed by
14 both parties in the file. So how much are you going
15 to get into this definition of what is unusual and the
16 terms and so forth? And I think you have to go back
17 to judgment. So I don't know that you can standardize
18 that.

19 DEE MIRANDO-GOULD: Thank you.

20 Paul Sobel?

21 PAUL SOBEL: I think I'm just going to add
22 on pretty much to what's been said before. One other

1 thing to consider here, and I like Doug's suggestion
2 about providing guidance on when confirmations are
3 useful versus less so, and also Gaylen's last
4 suggestion. If you think about it, an accounts
5 receivable balance is quite simple to confirm. You
6 can have almost a clerical person -- I suspect this
7 happens frequently. Somebody in the clerical capacity
8 looks up in the system at a point in time what was the
9 balance. Yes, that's right. Confirms back.

10 When you get into more complicated
11 arrangements, I'd be concerned that, again, absent
12 attaching the contract, you may get confirmation that,
13 yes, those terms exist. There may be other terms that
14 have some very significant impact on the accounting
15 that, for whatever reason, you've failed to put in the
16 confirmation and then would not be confirmed as such.

17 So, again, I think there is value to the
18 confirmation, but it's -- I don't think it should be
19 required because you're not always certain who is
20 responding to that. Again, if a clerical person is
21 responding on a very complex, again, even credit
22 default swap, do they understand the underlying

1 economics and the accounting implications of that
2 credit default swap? Or are they just going to go
3 tick, tick, tick, yes, I found those in a contract.
4 Good enough.

5 DEE MIRANDO-GOULD: Thank you.

6 Joe Carcello?

7 JOSEPH CARCELLO: Let me respond to what
8 Doug said earlier because I think you have language in
9 the standard now that allows for that in terms of not
10 sending confirmations.

11 If you look at footnote 7 on page 4,
12 starting with the second paragraph, "The auditor can
13 overcome the presumption to request confirmation if
14 accounts receivable are immaterial or the auditor's
15 combined assessed level of inherent and control risk
16 is low and the assessed level in conjunction with
17 other evidence is sufficient to reduce audit risk to
18 an acceptably low level."

19 So I think the standard that exists already
20 contemplates not needing to send confirmations. I
21 also think it would be dicey to have a PCAOB standard
22 that would at least be viewed in the eyes of outsiders

1 as a lower level of performance than an ASB standard.
2 And as long as the ASB requires confirmation, I think
3 it puts the PCAOB in a tough position.

4 I also would agree with, I think, Harold
5 said earlier, considering expanding the use of
6 confirmations. I don't know if I would require it.
7 Requiring it is always a bit dicey. But encouraging,
8 particularly as it relates to confirming terms of
9 material revenue transactions near year end, the
10 amount, the order date, the receipt date, to get a cut
11 off -- cut off is a big issue with revenue -- and
12 right of return provisions, particularly oral, which
13 are very problematic, as we've seen in many frauds.

14 Again, the focus that I'm coming from here
15 is I think if you talk to most investors, they would
16 say what they care about is fraud, errors that result
17 in material restatements, and clean opinions before a
18 company shortly thereafter goes belly up. We'll talk
19 about growing concern this afternoon.

20 And a lot of these frauds, I don't think
21 typical management wakes up early in the year and says
22 today is a good day to start a fraud. It happens

1 toward the end of the year when it's obvious they're
2 not going to hit the targets that the analysts have
3 set, and some managements give into pressure. And we
4 know that in terms of fraud, revenue recognition is
5 the override -- by far the most common means of
6 committing fraud.

7 So if you look at transactions close to year
8 end that involve material revenue transactions and at
9 least consider confirming them, that would probably be
10 a prudent course of action in many cases.

11 DEE MIRANDO-GOULD: Thanks, Joe. And you're
12 correct. I mean, the standard right now does have the
13 presumption for accounts receivable, and it has the
14 "should consider" language about unusual and complex
15 transactions.

16 Gary Kabureck?

17 GARY KABURECK: This is going to probably be
18 building somewhat on some of the other comments about
19 confirming unusual transactions and arrangements and
20 stuff like that. The way I think it would work in
21 most big companies, I mean, clerical people are going
22 to give the dollars and cents. But they're probably

1 not going to actually having the contract.

2 I mean, that's probably somebody in the
3 legal department or the business development
4 department or the controller's department. So the
5 clerks are not going to be able to confirm these
6 things. They pay bills as they come in, or they
7 collect cash as it comes in, as the case may be.

8 But you're going to be dealing with an
9 entirely different level of management if you want to
10 start getting into confirming the salient terms of
11 deals. And if all of a sudden, if an audit
12 requirement came out where the middle management core,
13 the general counsel's core of the country has all of a
14 sudden got an extra million confirmations coming out a
15 year, that's a workload issue, and it's going to be
16 challenged I would think as far as necessity.

17 I think judgment is the right way to do it.
18 I mean, certainly confirming complex and strange
19 arrangements has its place in auditing. But I think
20 to be required, I think, is going one step beyond
21 where it needs to be.

22 DEE MIRANDO-GOULD: Thank you.

1 Doug Anderson?

2 DOUGLAS ANDERSON: Just to follow up on my
3 conversation, kind of respond to Joe's thoughts. In
4 all consideration of what's in footnote 7, I think
5 it's upside down when the reliance on judgment and
6 focus on risk is buried in footnote 7, and the narrow
7 prescriptive standard is put up in the front. I think
8 the right order of it is focus the auditor on risk,
9 focus the auditor on persuasiveness of audit evidence,
10 and explain how confirmations work.

11 If we want to put in footnote 7 that
12 receivables is a great place to confirm, go ahead.
13 But I would not put in footnote 7 use your judgment
14 and then put in the primary standard we're assuming
15 you're going to confirm receivables. That seems
16 upside down.

17 And if the ASB and the AICPA has a different
18 standard, that's fine. I still think the PCAOB should
19 take the best approach and convince the ASB to change
20 theirs.

21 DEE MIRANDO-GOULD: Thank you.

22 Any other comments?

1 [No Response.]

2 DEE MIRANDO-GOULD: Okay, let's move to the
3 next question in this area. Should there be a
4 requirement that the auditor should consider
5 requesting confirmation of other items? If so, which
6 items should be included in this requirement?

7 Gaylen Hansen?

8 GAYLEN HANSEN: I'll jump in here. I think
9 whenever you can focus in on a KPI, a key performance
10 indicator, that involves nonfinancial measures, and in
11 my part of the world, that might be tons in the mining
12 industry or barrels produced. I like to see those
13 things confirmed, and then it ties back into the
14 financial records.

15 So I mean, I don't know that that's part of
16 the standard, but I think it's just sort of common
17 sense, and a lot of times you can get to a quicker
18 answer and a more logical and practical answer if
19 you're confirming some of those sorts of metrics.

20 DEE MIRANDO-GOULD: So, Gaylen, would you be
21 saying a "should consider" type of requirements
22 appropriate?

1 GAYLEN HANSEN: Yes. Absolutely. Maybe
2 it's patient days. It could be any number of things,
3 and they would be all over the board depending on what
4 industry you're dealing with, but more of an
5 understanding of the business and the industry type of
6 approach.

7 DEE MIRANDO-GOULD: Thank you.

8 Tom Tefft?

9 THOMAS TEFFT: I wouldn't object to this
10 requirement. However, I would think that in most
11 situations today, auditors are already considering
12 using confirmations as part of the audit process and
13 thus would question whether it even needs to be an
14 explicit requirement.

15 DEE MIRANDO-GOULD: Thank you.

16 Hal Schroeder?

17 HAROLD SCHROEDER: More of a question. You
18 use the term here "investments." Why would you not be
19 using more of the "financial instruments" term,
20 terminology from the accounting standards?

21 DEE MIRANDO-GOULD: It's a good question. I
22 mean, we were thinking broadly. "Investments" was a

1 term we picked, but we could say "financial
2 instruments." There is no reason why it couldn't be
3 that.

4 Wayne Kolins?

5 WAYNE KOLINS: I think rather getting into
6 the particulars of which accounts or areas should be
7 considered specifically, I think the auditor needs to
8 address the assertions that he's interested in, he or
9 she is interested in, and what is the persuasive means
10 of obtaining evidence to corroborate the assertions?
11 And if confirmation is the persuasive evidence, then
12 that's what the auditor should use. And certainly
13 areas that are quite often confirmed on audits are
14 certainly cash, marketable securities, accounts
15 payable.

16 And I think maybe firms have gotten away
17 from that, but since there's such an acceleration of
18 the filing deadlines to rely on subsequent
19 disbursements to verify accounts payable, perhaps the
20 actual confirmation is a quicker way of getting to the
21 answer in addition to assessing the quality of the
22 internal control system.

1 DEE MIRANDO-GOULD: Thank you.

2 Bob Dacey?

3 ROBERT DACEY: Yes, I'd just like to offer
4 that I think, in our view, there shouldn't be absolute
5 requirements, even "should considers," because of the
6 variability that we've all talked about here today.

7 One of the discussion points we had, too, is
8 that if confirmation is perceived to be of a
9 particular value, that perhaps it ought to be -- the
10 use of confirmations ought to be discussed in your
11 auditor's response to risk of material misstatement
12 and focus this standard on what the confirmation
13 process is, if you decide to use confirmations.

14 DEE MIRANDO-GOULD: Thank you.

15 Sam Ranzilla?

16 SAM RANZILLA: Excuse me. I agree with Bob.
17 A requirement to "should consider" basically drives
18 the auditor to document all the things they thought
19 about and didn't do. And it seems to me what we ought
20 to be focused on is the risk assessment and what you
21 did do in documenting your risk and how you responded
22 to that risk.

1 So I would not be favor of a requirement to
2 "should consider" because it just, again, leads to
3 documentation around what you decided you didn't need
4 to do.

5 DEE MIRANDO-GOULD: Thank you.

6 Any other comments? Jeff Mahoney?

7 JEFF MAHONEY: Thank you.

8 I think I'd like the requirement in that I
9 think we've had some recent events where the cash that
10 the company had said existed did not exist or the
11 investments the company said they had did not exist.
12 So I think there is some expectation out there that
13 one efficient way to get some audit evidence about the
14 existence of those cash balance and investments is
15 through a confirmation.

16 So I think there is some expectation by some
17 investors that confirmations are being sent out in
18 those areas. So I think I would support the
19 requirement.

20 DEE MIRANDO-GOULD: Thank you.

21 Any other comments?

22 [No Response.]

1 DEE MIRANDO-GOULD: Okay. Now we'll talk
2 about reliability of confirmation responses. The
3 standard requires the auditor to evaluate the
4 reliability of confirmation responses and alternative
5 procedures as part of the auditor's overall evaluation
6 of confirmation procedures.

7 The standard acknowledges that there may be
8 situations in which the confirming party responds to a
9 confirmation request other than in written
10 communication mailed to the auditor. When these
11 responses are received, additional evidence may be
12 required to support the validity. For example, a
13 facsimile response involves risk because of the
14 difficulty of ascertaining the source of the response.

15 As discussed previously, banks and other
16 businesses may hire third parties to respond to
17 confirmation requests on their behalf. If a system or
18 process that facilitates confirmation between the
19 auditor and the confirming party is in place and if
20 the auditor plans to rely on that system or process,
21 another auditor's report on that system or process may
22 assist the auditor in assessing the design and

1 operating effectiveness of the electronic and manual
2 controls that address the reliability of the
3 information being confirmed.

4 This leads me to my next question. What
5 factors should the auditor consider when evaluating
6 the reliability of confirmation responses in paper,
7 electronic, or other form?

8 Joe Carcello?

9 JOSEPH CARCELLO: I think we've hit on a lot
10 of this already in some of our earlier discussion.
11 You know, who's responding would certainly be a
12 factor.

13 One of the things that is not in your
14 discussion paper, and again, I'm not even fully
15 convinced it needs to be in a standard, but I want to
16 at least throw it out. One of the things that I think
17 it's important to think about, I know when I cover
18 confirmations in class, is if you get back the
19 confirmation requests, and they're riddled with
20 exceptions, that probably tells you something, if
21 nothing else, about internal control over financial
22 reporting, at least potentially.

1 But the other extreme I think is maybe just
2 as dangerous, right? The other extreme is you send
3 out a lot of confirmation requests, and they all come
4 back perfect. Yes. And so, again, I don't know how
5 you put that in a standard exactly. I'd have to think
6 that through a lot more than I have -- can quickly do
7 here.

8 But I think that's an issue, and I think
9 sometimes in doing audits there is a lot of time
10 pressure. And again, it gets to the overriding
11 importance that can never be emphasized too much of
12 professional skepticism. It just underlies everything
13 auditors do.

14 DEE MIRANDO-GOULD: Thank you.

15 Any other comments?

16 Okay. Oh, Vin?

17 VINCENT COLMAN: Maybe I'll just -- we
18 already have something. I was just wondering what the
19 objective of this is because there is already
20 something in the standard that addresses this. Not to
21 be too, but AU 9330 talks about this already. So I
22 was just wondering what is it we're trying to

1 accomplish here that we don't already have because
2 there's a standard that we need to go through today on
3 this. So I was just trying to understand that better
4 and what problem we're trying to solve.

5 DEE MIRANDO-GOULD: Well, you're right. The
6 standard does have language about assessing the
7 reliability. The question is does there need to be
8 additional information? What factors should be
9 considered?

10 The other thing is AU 9330 technically isn't
11 a PCAOB standard because it was issued after April
12 2003 when we adopted our standards.

13 VINCENT COLMAN: I'm sorry. I didn't catch
14 that nuance. Because it's actually a very good
15 principles-based standard, to Joe's point. It goes
16 through the principles and the thought process you
17 should go through in this instance. So I'd encourage
18 you to consider it. It's pretty well written.

19 DEE MIRANDO-GOULD: We're definitely
20 considering it as we go through the process. But,
21 yes, that's part of it. It addresses some things that
22 the original standard didn't. We haven't adopted it.

1 Any other -- Sam Ranzilla?

2 SAM RANZILLA: I was just going to help Vin
3 out, and I think what he was telling you --

4 VINCENT COLMAN: Well, thanks, Sam.

5 [Laughter.]

6 SAM RANZILLA: Huh? I'm sorry?

7 VINCENT COLMAN: I was thanking you.

8 SAM RANZILLA: I got you. I think the
9 answer to your question is actually you can find some
10 very good evidence and standard setting both at the
11 ASB level and at the IAASB level with respect to this
12 question.

13 DEE MIRANDO-GOULD: Thanks, Sam.

14 Vin, did you have anything else you wanted
15 to -- No, you're --

16 Any other comments?

17 [No Response.]

18 DEE MIRANDO-GOULD: Okay, now let's talk
19 about situations when management requests that the
20 auditor not confirm certain accounts. The standard
21 does not specifically address such situations or
22 procedures that the auditor might perform when faced

1 with these situations. Therefore, what procedure
2 should the auditor be required to perform to address
3 situations in which management requests that the
4 auditor not confirm accounts?

5 Gaylen Hansen?

6 GAYLEN HANSEN: I think the existing
7 guidance, as was just mentioned. I think there's a
8 lot of information already there that there's
9 heightened -- there should be heightened skepticism in
10 this situation, and you start with discussing with the
11 officers of the company as to the rational reasons and
12 evaluate the legitimacy of those reasons.

13 However, and depending on the significance
14 and the materiality, I would think that this might be
15 one of those instances where consideration of the
16 discussion with an audit committee chair, used
17 sparingly, but this is one of those times when I think
18 you might want to exercise that option.

19 DEE MIRANDO-GOULD: Thank you.

20 Shelley Stein?

21 SHELLEY STEIN: As an auditor, I think this
22 is one of those situations where my first reaction

1 would be to run like the wind. We talk about the
2 quality of audits. We talk about documentation. Now
3 we've got management saying please, please don't
4 confirm this.

5 So my skepticism is going straight up
6 immediately with the request, and there are very
7 limited circumstances that I can imagine where that
8 would happen. And I think that you've got to be very
9 careful about that. It doesn't mean there might not
10 be a legitimate one somewhere, but, boy, that ought to
11 be a rare situation.

12 DEE MIRANDO-GOULD: Thank you.

13 Damon Silvers?

14 DAMON SILVERS: I'm just curious if members
15 of the group who are -- do this more day-to-day than I
16 do could explain any instances they know of where this
17 kind of request would be legitimate? I mean, I can
18 kind of imagine maybe some circumstances. But I'm
19 just curious if anyone has ever actually had one?

20 DEE MIRANDO-GOULD: So there are a couple of
21 people down there. Hal Schroeder?

22 HAROLD SCHROEDER: In my auditing days, I

1 actually did one involving litigation. It was a
2 sensitive issue, and you already knew it was in
3 litigation or about to go into litigation. We were
4 asked not to confirm and to speak with the attorney.
5 So, yes, I could come up with one or two.

6 DEE MIRANDO-GOULD: No, not at all.

7 DAMON SILVERS: What was the -- I mean, a
8 matter was being litigated, and so you were not -- I'm
9 not sure how you connect the notion that there was
10 litigation with what the nature of the matter was.

11 HAROLD SCHROEDER: They just didn't -- the
12 client, as I recall -- and this is a few years ago.
13 The client was very sensitive to any exchange of
14 information between itself and the other party because
15 it may go into litigation.

16 They just didn't want any more
17 documentation. They had what they wanted, and they
18 were going to litigate it, and they just didn't want
19 to -- they were attempting, if I recall, they were
20 attempting to settle it out of court. But it was very
21 likely to go to court, and so they asked for us not to
22 confirm it.

1 DEE MIRANDO-GOULD: Gaylen, did you have a
2 comment?

3 GAYLEN HANSEN: I was going to say basically
4 the same thing. I've had those instances that I've
5 had to deal with.

6 DEE MIRANDO-GOULD: Hal Schroeder?

7 HAROLD SCHROEDER: I'm sorry. I did have
8 another comment. Very much like Gaylen, I sit on a
9 board of an insurance company, and I'm on the audit
10 committee. If we're not confirming something that
11 would normally be confirmed, I would certainly want to
12 know about it. So I would expect it to be a
13 requirement that they actually communicate that.

14 DEE MIRANDO-GOULD: Thank you.

15 Okay, Ted White?

16 TED WHITE: I like the suggestion that this
17 possibly be a communication back to the audit
18 committee chair. The other thing I was wondering was
19 whether your language could either suggest or require
20 that the auditor reopen their risk assessment and
21 address this issue specifically?

22 I suspect if this is something that they

1 knew up front, that the risk assessment would be quite
2 a bit different going into the audit. And this would
3 materially change that, or should, and that in most
4 instances it's probably something that's going to
5 raise some big red flags. Because what I think you
6 need is a mechanism to ensure that it's dealt with,
7 right?

8 DEE MIRANDO-GOULD: Thank you, Ted.

9 Actually, I believe it's ISA 505 has
10 slightly different wording, but they do encourage the
11 auditor to consider the effect of any requests like
12 that on a risk assessment, including risk of fraud.
13 So that's one of the things we've been discussing.

14 I think Bob Dacey was next.

15 ROBERT DACEY: In answer to the question, we
16 thought the procedures outlined in ISA 505, in fact,
17 which were pretty similar to the ones you have in your
18 document, were appropriate procedures in this
19 circumstance.

20 DEE MIRANDO-GOULD: Thank you.

21 Damon Silvers?

22 DAMON SILVERS: It seems to me that

1 particularly based on the responses I got to my
2 earlier question, that my intuition about this, which
3 is that this is a very unusual phenomenon when this is
4 a legitimate matter. And that even as, for example,
5 in the litigation arena, if there is an account that
6 is subject to litigation, it strikes me that the
7 auditor -- that that's obviously an account where
8 somebody disagrees with what the preparer is -- or how
9 the preparer is characterizing that account.

10 I think that the fact that the preparer is
11 uncomfortable with that with getting -- with a third
12 party like the auditor getting into that is kind of
13 too bad in relation to what the auditor's obligations
14 need to be in that circumstance.

15 I mean, I can imagine a circumstance, for
16 example, where law enforcement is involved where it
17 would clearly be inappropriate to, say, tip off
18 someone that law -- you know, you could be in a
19 situation where that kind of extreme thing might make
20 sense. But it seems extraordinarily rare to me.

21 And I very much support the notion that
22 there ought to be kind of a presumption that when that

1 occurs, that the auditor needs to be talking to the
2 audit committee to make sure that there is really a
3 justification for this and that the PCAOB's guidance
4 and standards in this area need to really kind of
5 ensure that this is a very rarely accepted
6 proposition.

7 I want to go from that, though, to a broader
8 comment about the discussion thus far, which is that
9 it's not clear to me how explicit -- you know, the
10 issue I think Joe Carcello talked about, about
11 professional skepticism. The question of how much you
12 wish to specify and guide professional skepticism in
13 the drafting of your standards, this area or others,
14 is one that it's, I think, a subtle judgment.

15 It strikes me, for example, that when you're
16 talking about different forms of confirmation that
17 there are obviously implications to certain -- toward
18 a prevalence of certain types of forms of
19 confirmation. That there are that there is a sliding
20 scale with faxes -- that some faxes are pretty much no
21 different from a letter, and other faxes are a lot
22 different from a letter. How much do you want to get

1 into that?

2 And I think one of the questions that the
3 board might want to consider is the lessons that it
4 has from its inspections as to whether there is kind
5 of -- whether there is pretty well-established and
6 understood practice in this area, such that that type
7 of guidance is not really necessary, or whether there
8 is not? Or whether there seems to be a willingness
9 within the profession, within the firms that do the
10 predominant amount of public company auditing to kind
11 of just accept anything? To not be skeptical in these
12 areas and whether, therefore, some more detailed
13 guidance needs to be had?

14 I don't know the answer, but I assume you
15 all might be able to figure that out.

16 DEE MIRANDO-GOULD: Thank you.

17 Jim Cox?

18 JAMES COX: I was just wondering about
19 somewhat more of maybe a formulaic response here and
20 think about this as being in the category of a
21 limitation on the scope of the audit and material.
22 Then the way you normally deal with that question is

1 to see if there are other ways.

2 For example, the litigation situation -- I'm
3 not asking how you handled it. But it had come to my
4 mind that you may want to think about other ways of
5 getting at that, including having conversations that
6 you can with the counsel for the audit client to get
7 some review about what the exposure is there and then
8 figure out what -- but to figure out some way to
9 overcome it.

10 But if you can't overcome it, then I would
11 think that it's appropriate to see this as a
12 limitation on scope and that the implications of that
13 depends on the materiality of the limitation.

14 DEE MIRANDO-GOULD: Thank you.

15 Randy Fletchall?

16 RANDY FLETCHALL: Yes, I was just going to
17 try to add to Damon's question and Hal's response. I
18 think, Professor Cox, to your point, I mean, we look
19 at confirmation in terms of whether it would be
20 effective at getting evidence. And if you went to
21 management and they said, "Don't confirm that account
22 because they may not agree with the balance," I would

1 agree that's a red flag, and I think you'd probably
2 want to direct your attention there.

3 If they said, "This has been in litigation
4 for three years," I think you'd say, "Well, there's no
5 sense mailing a confirmation to the customer."
6 Instead, I think you'd go to the process of confirming
7 and evaluating responses from outside counsel or in-
8 house counsel to decide what that meant from an
9 accounting standpoint and not a confirmation that you
10 just knew was of no value and, in fact, could affect
11 their legal strategy.

12 So I don't think it's a matter of you just
13 don't want to do it because it's a problem, when it's
14 a matter of there's a more effective way to get the
15 answer for something that's in litigation. If they
16 just said, "Don't mail that one. We think they may
17 not agree." I would think that would certainly draw
18 your attention to it.

19 DEE MIRANDO-GOULD: Thank you.

20 Joe Carcello?

21 JOSEPH CARCELLO: I think just about
22 everybody in this room is onboard that except for the

1 litigation situation, there would be very unusual
2 circumstances where a request by management not to
3 send a confirmation when the auditor feels it's
4 appropriate would be honored without it being viewed
5 at least as a scope limitation.

6 But I think the board runs the risk if they
7 are completely silent in this area because,
8 unfortunately, the people in this room are not the
9 ones who are likely to have been involved with
10 problematic behavior or they wouldn't be in the room.

11 We shouldn't lose sight of the fact that Z
12 Best, which was one of the largest frauds certainly at
13 the time it happened, was essentially this issue. The
14 auditors wanted to send confirmation to the building
15 restoration projects, and they were convinced that
16 that was going to be problematic from a client
17 perspective, and they didn't do it.

18 More recently, I would refer interested
19 readers to the Breeden Report on the WorldCom fraud,
20 where, although this wasn't a confirmation issue, the
21 firm, and it was a large firm -- I won't mention it by
22 name -- wanted to do certain work in the United

1 Kingdom and were told that there were reasons why
2 management did not want that done. And a good bit of
3 the fraud was seated in the accounts in that
4 subsidiary.

5 So I think we should not lose sight of those
6 issues.

7 DEE MIRANDO-GOULD: Thanks, Joe.

8 Vin Colman?

9 VINCENT COLMAN: The specific question --
10 again, I just repeat what other people have said. The
11 ISA 505 is a pretty good outline again. So it sounds
12 to me like we're still -- I think we've got the
13 solution here. And a pretty good, again, principles-
14 based procedures that would solve it.

15 I want to go to -- I was going to take a
16 shot at answering Damon's broader question because I'm
17 struck by a similar type of reaction when you go to
18 audit confirmations and it's as if we're having a
19 conversation a little bit in a vacuum. And you know,
20 there is something called a risk assessment. You've
21 got assertions. And audit confirmations is one
22 element of dealing with the assertions in the risk

1 assessment.

2 And just be too prescriptive, and any one of
3 these actually could have an inverse effect. It could
4 actually be a negative. We really should be up a
5 level, as you were just talking about, of what is the
6 risk assessment? What are the assertions? How do you
7 use confirmations at the right time?

8 And there's a time and a place for them.
9 And quite frankly, there are times where this is not
10 the best solution and to be able to have judgment
11 around that, to make sure that we're very outcome
12 driven against those assertions.

13 Similarly, with the audit committee
14 communications, there is -- it's come up a number of
15 times already today -- there is a standard on audit
16 committee communications of what needs to be given to
17 the audit committee, and you would hope that in
18 certain situations like this, if it really raised to
19 that level, it would fit into that standard.

20 And so, you know, it came up this morning
21 while concurring important reviews. It's come up
22 here. You know, there is a standard there. It's

1 actually a pretty good principle standard of what are
2 the types of things that need to go to an audit
3 committee? And instead of putting individually in a
4 standard, if we think that there is something where
5 that could be -- that communication needs to get
6 better, then I'd encourage you to go back and look at
7 that standard of what those communications are and
8 make sure that it is covering, you know, what we
9 believe broadly needs to get to an audit committee.

10 DEE MIRANDO-GOULD: Thanks, Vin. Hal
11 Schroeder?

12 HAROLD SCHROEDER: I just wanted to follow
13 up, Professor. We did handle it through litigation
14 later, so -- and I think Randy was our independent
15 partner that year, so --

16 [Laughter.]

17 HAROLD SCHROEDER: Actually, he may have
18 been. I'm not certain. But I just don't want to go
19 too far down the path of saying if a client -- if the
20 company says, "I don't want you to confirm this and
21 here are the reasons why," then we immediately -- it
22 just throws up all sorts of red flags and it's the end

1 of the world. Maybe I've had a lot of unusual certain
2 situations, but had a shipping company that sent
3 crates over and they wouldn't allow me to confirm it.
4 It went to a hot spot in the world. We knew where the
5 ship went. We knew what was in the crates, and it
6 happened to be an airstrip.

7 No one was going to accept the -- or sign a
8 piece of paper that said "yes" they received a U.S.-
9 grade military airstrip in that region of the world.
10 They just weren't going to say that, and so we had to
11 come back with alternative procedures. And as I look
12 around the table and know what some of your companies
13 do, I've got to envision that you find yourselves
14 quite often in those situations, and you've got
15 processes and procedures to handle that.

16 So I'm concerned that if we write this too
17 restrictive that, you know, the end of the world has
18 come, this is a scope limitation, there are going to
19 be a lot of companies that can't be audited, which
20 will create a whole new set of problems. So I can
21 think of several in my own situation, and just looking
22 around the table I know that there are a few more

1 ideas out there that I just don't want to go too far
2 down that path.

3 DEE MIRANDO-GOULD: Thank you. Sam
4 Ranzilla.

5 SAM RANZILLA: Well, Hal, I can understand
6 why you left Ernst & Young based on that client
7 portfolio --

8 [Laughter.]

9 SAM RANZILLA: -- and the fact that
10 Fletchall is your independent reviewer, because I was
11 getting ready to say at least in my experience what
12 we're talking about here is a very unusual
13 circumstance where management would come and say, "I
14 don't want you to confirm something." At least, my
15 experience -- and I think that I can speak for my firm
16 -- this is not a burning issue.

17 I would agree, though, that when management
18 does come and request it, the ISA505 factors are the
19 things you can -- and in the most extreme
20 circumstance, after you've plowed your way through all
21 the issue, I think there is a possibility that you
22 could find yourself in a scope limitation. But again,

1 that would be a very extreme circumstance, and
2 honestly this is not a prevalent auditing issue, at
3 least from my experience. Now, maybe your inspection
4 results say different, but I think we're talking
5 about, you know, sort of Haley's Comet here.

6 DEE MIRANDO-GOULD: Yeah, I don't believe
7 it's a major issue in inspections, either. So Damon
8 Silvers?

9 DAMON SILVERS: I mean, in a way, this -- as
10 I said earlier -- I find this more interesting as a
11 window into some larger things than perhaps as
12 something that hopefully doesn't happen every day and
13 in every engagement. I'm particularly interested in
14 responding to the comment -- and I'm afraid I -- I
15 think you're -- I don't -- I know your -- the person
16 that was talking about sending airstrips in unmarked
17 containers.

18 [Laughter.]

19 DAMON SILVERS: Which I think opens up a
20 whole different kind of thing. The -- I like -- I'll
21 reiterate this -- to the extent that Haley's Comet
22 comes along, I like the board's solution best because

1 I think it reemphasizes where really the client
2 relationship ought to run, and I think that, you know,
3 there is a -- there is a way in which these kinds of
4 things weighs, you know, really, really large problems
5 are generally kind of surfaced at first by something
6 like the request not to get a confirmation.

7 It's akin -- I think it's the sort of thing
8 like it's an akin to an ethics waiver, thinking back
9 in the long -- back to the early -- back to the
10 distant past of the Enron matter. Right? It's akin
11 to an ethics waiver. There may be reasons to grant
12 ethics waivers, but boy, you know, they often -- the
13 request often signals something and I think that the
14 guide -- that the standard ought to be written with
15 that sort of thing in mind.

16 And I think it will have a salutary effect,
17 meaning a sort of -- a default of going to the board I
18 think will make management think again before asking.
19 I think that's a good idea, because then there's a --
20 then you don't necessarily put so much weight on the
21 manager/auditor relationship that way.

22 But now, I want to turn this business about

1 airstrips, because I think that raises a much broader
2 issue. Auditing is not simp -- there are issues that
3 -- an examination of the accounts can raise other
4 issues. If, for example, you know, I think there was
5 some obligation on the auditor to do something if in
6 the course of confirmations you discover that your
7 client is bribing foreign officials. All right?
8 Which is a violation -- which is a felony in the
9 United States.

10 And I can easily imagine in the course of
11 enterprises like shipping airstrips to hot zones that
12 someone might not want to get a confirmation because,
13 in fact, that would set off a criminal inquiry. And I
14 think that there needs to be some guidance here to --
15 one of the issues I think that's very present right
16 now, and in a way I think is under discussion with the
17 G20 as we meet, is the sort of interaction of the
18 financial reporting and governance system with some of
19 these larger issues.

20 And whether or not our financial reporting
21 public company disclosure and auditing systems
22 adequately capture the range and risks that are in

1 play in businesses, the -- and I, you know, I
2 apologize for harping on this example, but I think
3 that this is a window into the fact that auditors may
4 often be told answers which at one level may be
5 plausible but at another level open up this -- all
6 these other issues that are in fact properly the
7 subject of the audit.

8 All right? Meaning that the financial --
9 meaning that if it's, for example, if a company is
10 engaged in illegal trade in arms, that that might be
11 something that would have to be dealt with in the
12 financial statement in some form or fashion, and if it
13 wasn't, that financial statement might not be
14 accurate. So I think that sort of puts a -- it raises
15 this largest context that's opened up by this Haley's
16 Comet-type issue.

17 DEE MIRANDO-GOULD: Thank you, Damon. Does
18 anybody else want to comment?

19 [No Response.]

20 DEE MIRANDO-GOULD: Okay. Now, our last
21 topic on confirmations involves disclaimers and
22 restrictive language, including on confirmation

1 responses. Examples of such language include that the
2 information is not guaranteed to be accurate nor
3 current and may be a matter of opinion, and the
4 confirming party doesn't accept any responsibilities
5 for errors and omissions.

6 The standard does not specifically address
7 the use of disclaimers and restrictive language by
8 confirming parties, which leads me to my last
9 question. Should the auditor be required to perform
10 procedures to evaluate the effect of disclaimers and
11 restrictive language on confirmation responses? If
12 so, what procedures should an auditor be required to
13 perform in evaluating such disclaimers and restrictive
14 language? Joe Carcello?

15 JOSEPH CARCELLO: I thought your list on
16 Page 8 was a good list, and it certainly T's up the
17 discussion nicely. I guess from my point of view,
18 disclaimers designed to solely limit legal liability
19 from the perspective of who responds -- not from the
20 auditor's perspective, but from the perspective of who
21 responds they're probably okay. And you can't force
22 these parties to respond to confirmations. This is a

1 voluntary action.

2 However, disclaimers that call into question
3 the accuracy of the response to me weakens the audit
4 evidence provided. So to me, if I looked at what you
5 had on Page 8, there were two types there. One was
6 really more of "we're not going to take legal
7 liability by choosing to voluntarily help you." I'm
8 not sure if that is a big issue. On the other hand,
9 the -- some of the others said, "We're not even sure
10 this information is right." That to me is very
11 different.

12 DEE MIRANDO-GOULD: So, Joe, would you be
13 recommending that the auditor just document that
14 thought process? That this disclaimer really doesn't
15 have much of any effect on the audit evidence versus
16 the other type?

17 JOSEPH CARCELLO: Yeah, I'm sensitive to the
18 people who practice every day. And, you know, there's
19 obviously been a lot of concerns raised this morning
20 about excessive documentation burden, so I think
21 that's fair and I think that's valid, but I think a
22 quick -- I think that's something you could document

1 in one or two sentences.

2 DEE MIRANDO-GOULD: Hal Schroeder?

3 HAROLD SCHROEDER: This is more of a
4 question and it may be more addressed to the SEC
5 observers, but if you're dealing with public companies
6 that you're trying to confirm things with, can there
7 be some type of requirement placed upon any SEC
8 register?

9 PAUL BESWICK: I'm not -- I mean, it's an
10 interesting question. I think we need to talk to the
11 lawyers, because for once the SEC doesn't have lawyers
12 present.

13 [Laughter.]

14 PAUL BESWICK: So you're asking two
15 accountants that question. It's something we could
16 take back. It would only -- the problem is, it would
17 only deal with a certain population of the universe.
18 I mean, confirmations go out to nonpublic companies
19 all the time, and so you would be limiting it in that
20 manner. I mean, I think we'd have to think about
21 whether we could bring action under a securities law
22 violation that you've -- I'd -- we need to think

1 through it, and that's something we can certainly ask.

2 HAROLD SCHROEDER: Yeah, but I'm thinking
3 that, A, it would cover the bulk of the assets that
4 are being audited out there, at least the significant
5 assets, and the second point is, is I read through --
6 and I agree these were very good examples, and they
7 look very similar to what I recall seeing in various
8 confirmations, these would be to the professor's
9 comment earlier.

10 To me, these would be scope limitations
11 which, you know, really presents a real problem from
12 an audit perspective. And so, what you do is you
13 start to get more and more of this type of response in
14 your efficiency of auditing, if not the whole audit
15 process, starts to collapse, which to me is an SEC
16 issue.

17 PAUL BESWICK: Agree. And, I mean, I think
18 one thing we'd need to consider, though, is the
19 repercussions to preparers if we now have securities
20 law -- a security law that says, "If you confirm
21 something and it's not accurate, you're going to be
22 held accountable from a legal standpoint." I can

1 imagine what the disclaimers are now going to appear,
2 and we're going to be back in, "Can I rely on this
3 confirmation, because I received a cash confirmation
4 back that has ten pages of disclaimers?"

5 And so, I mean, I think that's something we
6 need to think about, and it's something we can
7 certainly take back to our people.

8 DEE MIRANDO-GOULD: Thanks, Paul, for
9 answering that. Okay. Randy Fletchall?

10 RANDY FLETCHALL: I was just going to add in
11 a similar vein I think Wayne Kolins said earlier, a
12 long time ago, that we are seeing an increase in
13 responses, say, from banks that are just filled with
14 disclaimers. And I think an auditor does have to look
15 at those from a standpoint of, you know, some you can
16 kind of ignore; others look like they might affect the
17 reliability of the evidence, and you can't ignore
18 those.

19 But I think we find ourselves slugging those
20 out one by one, engagement by engagement, with a
21 particular institution, and I think if there was some
22 collective way to deal with this, so whether it's the

1 PCAOB, or Hal suggested the SEC, some way to deal
2 with, you know, what would be an appropriate, you
3 know, caveat or a limiting language and a confirmation
4 will be inappropriate, and try to get these done right
5 the first time, it really would save a lot of time and
6 effort.

7 DEE MIRANDO-GOULD: Thank you. Wayne
8 Kolins?

9 WAYNE KOLINS: On the suggestion that the
10 SEC consider ways to impose a requirement on issuers,
11 it really goes beyond that, too, because you've got,
12 you know, many of these do come from financial
13 institutions that are not issuers. And so, you look
14 at the bank regulators for possibly doing this kind of
15 a thing, and I thought there was something in Sarbanes
16 Oxley or the outgrowth of that which basically made it
17 unlawful to lie to auditors, and I think that's
18 probably the seeds for a lot of what's happening now.
19 So there is an interplay here.

20 DEE MIRANDO-GOULD: Thanks, Wayne. That's
21 my understanding, too. Gary Kabureck?

22 GARY KABURECK: Actually, Wayne hit my

1 point. I think one of the 59 sections of the SOX act
2 there is about misrepresentation to auditors, and when
3 it first came out five or six years, there was a
4 flurry of, you know, the legal community advising
5 their clients, "Don't answer if you don't have to."

6 DEE MIRANDO-GOULD: Wayne Carnall?

7 WAYNE CARNALL: Thank you. Paul and I were
8 actually just chatting. I can't recall the specifics,
9 but there was actually an enforcement case against a
10 company where they actually did lie on their
11 confirmations. I think it was actually a Jap --
12 involving a Japanese subsidiary where there was
13 massive, massive collusion among all these companies
14 all lying on their confirmations, and the commission
15 did actually take action against that company. Yeah,
16 I'll try and find the specifics.

17 DEE MIRANDO-GOULD: Thank you, Wayne. Ian
18 Dingwall?

19 IAN DINGWALL: Yeah, I was just going to
20 say, the confirmations that I see that typically make
21 me a little crazy is the ones that say, "To the best
22 of my knowledge and belief," and you have no idea who

1 signed that thing.

2 DEE MIRANDO-GOULD: They were drafted by a
3 lawyer.

4 [Laughter.]

5 IAN DINGWALL: Yeah. Actually, you're quite
6 right about that, probably a bank of lawyers, but, you
7 know, I've always wondered what to make out of that,
8 and it seemed to me that if I was an auditor getting
9 something that says, "To the best of my knowledge and
10 belief," I'd wonder who that person was and in what
11 capacity was that person signing.

12 And frankly, the other thing that happens
13 oftentimes with these is there's a stamp. It's not
14 even a signature; it's just a stamp. It was stamped
15 by whoever had the stamp that day.

16 DEE MIRANDO-GOULD: Thank you. Gary?

17 GARY KABURECK: Just building on his last
18 comment, "The best of my knowledge and belief," that's
19 in the rep letters today from Page 1. I mean, so
20 you've got the issue elsewhere, and here is from
21 people who actually are supposed to know what's going
22 on inside the accounts in the company. And it's the

1 first paragraph almost of a standard rep letter.

2 DEE MIRANDO-GOULD: Thank you. Any other
3 comments? Oh, Gail Hanson?

4 GAIL HANSON: I just want to be sure we
5 don't lose sight of the fact that responding to
6 confirmations is voluntary, and so we get them in our
7 office and this gentleman was right, who signs them is
8 a big question. Are they -- they come in, and then
9 our mailroom -- think of the expertise here -- has to
10 figure out who they go to. And so, if you don't --
11 and I think it behooves you to ask your client, "Who
12 is the best?"

13 You know, is it written to the accounting
14 department, the legal department? How to best address
15 those confirmations, because when it gets to our
16 mailroom, it's up for grabs.

17 DEE MIRANDO-GOULD: Doug Anderson?

18 DOUGLAS ANDERSON: I was just add a side
19 point, and maybe now is the right time to do it, and I
20 remember -- I don't have the quotes from the past,
21 some past research, that sometimes auditors can put
22 too much reliance on confirmations and they're not

1 always accurate.

2 And I think the guidance, whatever we have,
3 is just to make sure we understand the limitations,
4 whether it's a stamp, whether it's somebody who's in
5 the mailroom signing them, or whatever else it is,
6 they're not as perfect and as reliable as sometimes I
7 think auditors would hope they were.

8 DEE MIRANDO-GOULD: Thank you. Warren
9 Malmquist?

10 WARREN MALMQUIST: I think we've just about
11 killed this one, but I think that from all the
12 comments that you've heard, is that there's not a lot
13 of confidence in the confirmation process itself. Not
14 only is there a low response rate, but then you have
15 those that have been received, confirmations that have
16 been received, that have disclaimers. So I've always
17 been of the belief that the confirmations that you
18 actually do receive and don't have a disclaimer on
19 them, maybe they should have.

20 In other words, they're -- I -- there's not
21 much that you have that you can rely on if you only
22 use the confirmation process, so I -- going back to a

1 previous question, I think that what should be
2 mandatory is the fact that alternative procedures
3 should be in place, audit procedures should be in
4 place, to give the auditor the confidence.

5 And you'll be back to the due professional
6 care and the evident evidential manner that's required
7 to reach a conclusion on those assets, liabilities,
8 whatever it is that you're trying to confirm.

9 DEE MIRANDO-GOULD: Any other comments?

10 [No Response.]

11 DEE MIRANDO-GOULD: Okay. Thank you very
12 much, and I'll turn it back over to Jennifer.

13 JENNIFER RAND: Okay, thanks, Dee. We're
14 going to go ahead and break for lunch. We have just a
15 couple of logistical issues. One, as I had mentioned
16 this morning, we're provide -- we have copies
17 available of what the FASB issued this morning made
18 publicly available, so those are back at the
19 registration desk, so please pick one of those -- pick
20 that up.

21 Also, for lunch, lunch is provided for SAG
22 members, observers, and PCAOB staff, and that'll be in

1 Rooms A, B, and C, which is out here to your right.
2 For other members of the public, you are on your own,
3 but we will be resuming at 1:15. And at that point,
4 we'll start with the discussion of emerging issues.
5 Okay? Thanks.

6 [Recessed at 12:09 p.m.]

7 [Reconvened at 1:20 p.m.]

8 WAYNE CARNALL: Jennifer, could I just
9 actually make a very quick -- I'll call it a
10 "correction" of what I said previously about this one
11 enforcement case I was referring to?

12 The company I was thinking about was Boston
13 Scientific, and unfortunately I probably thought there
14 was a case against the people with the confirmations,
15 because perhaps I thought there should have been at
16 the time, but it involved a Japanese subsidiary.
17 There was 40 people -- 40 employees at the company
18 that were involved.

19 What was surprising was that there was 143
20 independent distributors that participated in the
21 fraud in terms of sending in false confirmations.
22 Anyway, there was a commission enforcement case

1 several years back involving Boston Scientific, but to
2 the best of my knowledge there was no action taken
3 against the people that submitted the false
4 confirmations.

5 JENNIFER RAND: Okay. Thanks, Wayne. All
6 right.