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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
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PCAOB Release No. 2022-009: *The Auditor's Use of Confirmation, and Other Proposed Amendments to PCAOB Standards*

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board:

CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment and provide our perspectives on the Public Company Accounting Oversight Board ("PCAOB" or "Board") Proposed Auditing Standards, *The Auditor's Use Of Confirmation, and Other Proposed Amendments to PCAOB Standards* ("Proposed Standard" or "Proposed Confirmation Standard").

CFA Institute has a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. We are providing comments consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures and the related audits provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

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1 With offices in Charlottesville, New York, Washington, DC, Brussels, Hong Kong, Mumbai, Beijing, Shanghai, Abu Dhabi and London, CFA Institute is a global, not-for-profit professional association of more than 190,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program.

2 The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

OVERARCHING OBSERVATIONS

Modernization of Interim Standards

In a letter to the new PCAOB Board Members in early 2022, we noted the following with respect to the need to update legacy standards:

> ***Modernize Interim Auditing, Attestation, Quality Control, Ethics and Independence Standards***
> *The PCAOB adopted the compendium of the profession's legacy auditing, attestation, quality control, and ethics standards (i.e., AICPA standards) in 2003. The PCAOB has not updated many of the legacy standards, and the latest standard-setting agenda does not indicate the timing or whether there will be any future consideration of whether the legacy standards in effect remain fit-for-purpose. The PCAOB should prioritize a project, with public input, on whether the standards remain fit-for-purpose and the nature and extent of whether any modernization is necessary.*

We recognize this Proposed Confirmation Standard is a movement in this direction and laud the PCAOB for its efforts in this regard.

Communication of Effects of the Standard to Investors

In that same letter, we noted (see excerpt below) the need for the PCAOB to communicate differently with investors to obtain the useful feedback they need, and which investors can provide – if they are communicated to in an investor friendly manner. Investors need information summarized in a contextualized, effects-based communication which is stripped of audit jargon and focused on the changes in the standard and the impact of such changes on the audit and its quality. The PCAOB must always be mindful that investors see nothing of the audit – other than the standard audit opinion supplemented by a critical audit matter (CAM) or two. As such, expecting investors to provide feedback on proposed auditing standards without translation is not realistic.

> ***Investor Outreach Must Be Effects, Not Audit Language Focused***
> *Because investors and auditors speak different languages and the investor (consumer of audit services) gets little insight into the quality of the good, when developing or creating new auditing standards the audit regulator must conduct outreach that explains the nature of the change being proposed and its effects on investors in a language other than auditing-ease. Without such translation, the input the PCAOB will receive will not be as useful as it otherwise could be. Investors are smart. They are not confused (i.e., a common refrain used by other stakeholders to forgo change) by accounting and audit standards when they are communicated in terms of their effects on the audit, the accounting, and the economics of the companies in which they invest. It is always important to remember that investors – not management, the audit committee, the auditors, or the audit regulators – are the one's putting money at risk. Investors simply need the jargon of the audit profession to be translated into the effects on auditors, audits and financial statements. With that translation, you will find investors are able to provide rich and useful feedback to the PCAOB.*

We think the PCAOB has room to improve in this regard. With the release of this Proposed Confirmation Standard and the Proposed Standard on Quality Control, *A Firm's System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, investors were left with nearly 500 pages of overlapping standard-setting proposals over the holiday period – as well as the earnings release period – that included streams of technical audit jargon and lacked a consideration of the effects of the proposals on the audit[3]. This is a challenging ask of investors and reduces the likelihood of obtaining investor feedback, which may be PCAOB's Achilles heel. As former SEC Commissioner Kathleen Casey noted, *"While there are many other important stakeholders that rely on financial statement reporting, investors' interests must remain paramount."*

While the Board has acted to enhance the standard-setting process, including through a reconstituted Investor Advisory Group (IAG) and the appointment of the PCAOB's first investor advocate, we believe that the PCAOB should complement these changes and enhance investor feedback by making the material digestible in the manner described above.

Further, we believe the PCAOB needs to perform direct investor education and outreach on its proposed standards to ensure investors – including the Investor Advisory Group – understand the proposals and to obtain not only formal input through comment letters but input through discussions with investors. In this way, investors can communicate with the PCAOB without extensive study of dense consultations in a short timeframe in a parlance that may not be familiar to them[4].

We have read the public statements of the Board members and find the remarks of Board member Kara Stein[5] particularly helpful in enabling investors to understand why they should care about the Proposed Confirmation Standard and why the revisions have been proposed. More of this contextualization is necessary to effectively get investors interested in the important work of the PCAOB.

3 While we note the PCAOB Staff's comparison of the prior, revised and internal standards on confirmations , the document is simply a side-by-side comparison of paragraphs, not an analysis or synthesis of the changes. We believe the PCAOB can enhance the quality and timeliness of feedback by preparing a summary document for investors which explains the changes being proposed and why they are being proposed, including the expected effects, in a manner which is investor friendly.

4 This is also particularly important given it has been twelve years since the last public consultation on the Proposed Confirmation Standard and the fact that the PCAOB does not undergo a public due process where documents are discussed, and revisions debated, in public over time.

5 PCOAB Board Member Kara Stein, *Collecting Better Evidence: Proposal to Strengthen an Auditor's Use of Confirmation* (https://pcaobus.org/news-events/speeches/speech-detail/collecting-better-evidence-proposal-to-strengthen-an-auditor-s-use-of-confirmation).

We also note that Chair Williams statement highlights the origin of the use of confirmations. (https://pcaobus.org/news-events/speeches/speech-detail/pcaob-chair-williams-statement-on-proposed-new-standard-for-the-auditor-s-use-of-confirmation)

CONSIDERATION OF SPECIFIC PROVISIONS

We generally support the key provisions of the Proposed Confirmation Standard, with a few additional recommendations, as noted below:

- ***Confirmation with Third Parties Provides Better Quality Evidence*** – We support use of confirmations on significant accounts, balances or transactions as we believe they provide higher quality audit evidence given they are obtained directly from independent third parties – rather than evidence provided internally by management and employees of the company. Board member Stein's statement includes several vivid illustrations of where confirmations would have, if used, provided better quality evidence.
- ***Application to All Confirmations*** – We believe that the principles set forth within the Proposed Standard should apply to all confirmations, whether done in a paper-based or electronic communication format.
- ***Confirmation of Cash and Accounts Receivable*** – Positive confirmation of cash and accounts and loans receivable is necessary to provide the auditor with persuasive, sufficient and competent evidence for the level of assurance that the auditor's opinion provides to investors.
- ***When Auditor Overcomes Presumption of Confirmation: Communication with Audit Committee and Investors is Essential***– We are concerned that the Proposed Confirmation Standard provides significant leeway to overcome a presumption that positive confirmations will be used *". . . if the auditor determines that those other procedures would provide audit evidence that is at least as persuasive as the evidence the auditor might expect to obtain through confirmation."*

  It should be difficult to overcome the presumption that it is necessary to carry out generally accepted auditing standards; however, the proposal's language includes an equivalence threshold. We believe that any exception to confirmations can only be when other audit procedures would result in more persuasive or greater accumulated evidence over what could be obtained through confirmations. We are concerned the Board's proposal may unintentionally suggest equivalence of substitution. Moreover, the Board should describe the factors that an auditor should consider when making such a determination.

  We believe this provision of the Proposed Confirmation Standard should be revised such that the auditor can overcome the presumption if, and only if, they:
  (1) document the evidence and basis for their conclusion, and
  (2) have communicated the conclusion to the: (a) audit committee and (b) investors.

Due to the importance of confirmation of cash and cash equivalents and accounts and loans receivable – and the ability to confirm the existence of these balances directly with a third-party – if an auditor decides not to use positive confirmations as prescribed by the Proposed Standard, we agree the auditor should communicate this to the audit committee responsible for overseeing the audit.

Furthermore, we believe the final standard must require that this decision also be communicated to investors. In our view, the overall confidence of investors in the quality and utility of the audit has diminished because of a number of highly publicized failures to carry out confirmations.

As a result, the final rule must reinstate the historical obligation to disclose to investors any decision by the auditor not to use positive confirmation. We suggest that this disclosure be made as a critical audit matter (CAM[6]) – as it appears that when an auditor's judgment results in procedures other than mandatory confirmation, the auditor has also simultaneously made a determination that a critical audit matter exists. An override of confirmations suggests that the auditor has inherently also determined a CAM exists as such determination either: (1) related to material accounts or disclosures, (2) involved especially challenging, subjective, or complex judgments, and (3) were or are required to be communicated to the audit committee (as we note above).

As noted in the Proposed Confirmation Standard, this communication would be entirely consistent with historical practice:

> *SAP No. 1 required confirmation of accounts receivable by direct communication with customers in all independent audits of financial statements, subject to the auditor's ability to overcome the presumption to confirm accounts receivable for certain reasons. <u>Following the adoption of SAP No. 1, the accounting profession also adopted a requirement in 1942, which remained in effect until the early 1970s, that auditors should disclose in the auditor's report when confirmation of accounts receivable was not performed</u>.*

Still further, such a disclosure would enhance the transparency of the quality of an audit for investors and provide an appropriate incentive to use confirmations.

- ***Expansion of Positive Confirmations*** – We agree with the comments of the PCAOB Investors Advisory Group that the use of positive confirmations should be expanded, given the nature of business transactions today, to provide for the use of positive confirmations for the following additional transactions:

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6 We note, in passing, that the Japanese authorities' recent requirement to oblige the formatting of CAMs in Inline XBRL format greatly increases their utility to investors. We would suggest that: (a) the audit firms themselves should be obliged to complete this markup, and (b) that exceptions to ordinary procedures, such as a decision not to use positive confirmations procedures, should be tagged using Boolean measures or similar mechanisms that maximise the ability of investors to rapidly highlight these exceptions using machine analytics.

- Those with ***unusual terms and conditions and/or the terms of agreements that may have a material effect on the fair presentation*** of financial reports, including the disclosures.
- Those with ***related parties***, including the assessment of the nature, the substance of such transactions and the completeness of the disclosures.
- Those where the auditor has a ***concern about whether or not side agreements may exist.***
- Those where ***financing is obtained, including bank debt or supplier provided financing***.[7]
- Those involving ***certain sales practices*** such as the terms of bill and hold arrangements, supplier discounts or concessions.
- Those involving ***certain oral arrangements or guarantees***.
- Those ***involving sales, lending, and liability for custodianship of digital assets***, especially considering losses investors have recently suffered.[8]

We believe that including such transactions ensures a final standard includes some of the most important areas where external third-party confirmation is necessary.

- ***Negative Confirmations Are Not Sufficient Alone*** – Negative confirmations provide low quality, if any, audit evidence and will always need to be supplemented by other audit procedures that will result in the same level of persuasive evidence a positive confirmation would provide.
- ***Auditor Must Control Entire Confirmation Process*** – The auditor must maintain control over the confirmations, including over the transmission and receipt of the confirmation directly to and from the third party.
- ***Exceptions Must Be Resolved*** – When a positive confirmation results in an exception, such as when it is not returned, or the recipient returns it with differences from information the auditor received from the company, the auditor ***must*** perform audit procedures to resolve any inconsistencies in evidence, including examining other third party evidence such as purchase orders. The PCAOB should limit the auditors ability to assess non-responses as "isolated exceptions."
- ***Internal Audit Should Have Limited Involvement in Confirmations, Especially Resolution of Exceptions*** – Independent auditors rather than internal auditors should perform this important audit step of confirmation. We believe the internal auditor should also be precluded from evaluating the results of the confirmations, as it is the responsibility of the auditor to evaluate the results of the audit procedures performed, not the internal auditor.

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7 *Cf.* Vinicios Andrade et al., Vanished $4 Billion Brings Down Century-Old Retailer in a Week, Bloomberg (Jan. 20, 2023), *available at* https://gulfnews.com/business/markets/vanished-4-billion-brings-down-century-old-retailer-in-a-week-1.1674223102115 ("The company's disclosures imply it misreported numbers tied to financing of debts with suppliers while also wrongly deducting interest paid to lenders from its liabilities.").

8 *See, e.g.,* Francie McKenna, The PCAOB, and the SEC, can do so much more to rein in auditors giving false assurance about crypto, The Dig (Jan. 28, 2023) (on file with MIAG) (Discussing FTX Trading and commenting that "PCAOB Chair Erica Williams has been reluctant to address audits in the crypto industry [and] [s]he does not even mention it in the proposed new confirmation standard!").

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Thank you for your consideration of our views and perspectives. We would welcome the opportunity to meet with you to provide more detail on our letter. If you have any questions or seek further elaboration of our views, please contact me at sandra.peters@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters, CPA, CFA
Senior Head, Global Policy Advocacy
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CC:
Paul Munter, Chief Accountant, U.S. Securities & Exchange Commission