

NOTICE: This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on October 14, 2009 that related to the Board's concept release on possible revisions to the PCAOB's standard on audit confirmations. The other topics discussed during the October 14, 2009 meeting are not included in this transcript excerpt.

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD
(PCAOB)

STANDING ADVISORY GROUP MEETING

9:03 a.m.

Wednesday, October 14, 2009

National Association of Home Builders
1201 15th Street, N.W.
Washington, D.C.

1 input. And Damon, thanks also for the commentary on
2 fraud.

3 Let's move along to the second topic where we
4 have issued a concept release on confirmations, and Dee
5 Mirando-Gould is going to give you a summary of the
6 comments received there.

7 Thanks, Dee.

8 DEE MIRANDO-GOULD: Thank you, Marty.

9 So, as you are aware, we spoke with the SAG
10 last April regarding confirmations, and we released a
11 concept release in the middle of April. The comment
12 period ended May 29th, and we received 24 comments.
13 The majority of those comments again are from firms or
14 associations of accountants, and then there is a
15 smattering of academics, issuers, other standard
16 setters, other organizations, and the like in those
17 comments.

18 And similar to Keith's comments, I just want
19 to go through some discussion of some key themes with
20 those comments. Generally, commenters were supportive
21 of the PCAOB considering revising its standard on
22 confirmations, and that was mostly because of changes

1 in technology that didn't exist at the time the
2 original standard was put in place.

3 A number of commenters, a lot of auditors
4 referred us to the IAASB standard ISA 505, which deals
5 with confirmations, and the ASB's proposed statement on
6 auditing standards, which came out at the end of May of
7 this year, to look to try to align with those standards
8 and also be more principles based in our approach. So
9 not include a lot of additional requirements in the
10 standard is what was recommended to us.

11 We were also recommended to focus on risk,
12 make the standard be based on -- the use of
13 confirmations be based on an auditor's risk assessment.

14 And then, as a general comment, we received a
15 lot of support for revising the definition of
16 confirmation. In the concept release, we asked the
17 question whether or not confirmation should be revised
18 and should include direct access to information held by
19 a third party on behalf of a confirming party? And
20 overwhelmingly, the commenters supported us revising
21 the definition incorporating direct access as a
22 confirmation.

22 MARTIN BAUMANN: Good. Thanks, Joe, for that

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1 The other thing that came out of that,
 2 though, surprised us a little, was that the majority of
 3 commenters who did comment in this area also suggested
 4 that oral confirmation should not be -- oral responses
 5 should not be a confirmation.
 6 Other areas we asked questions was regarding
 7 the requirement to confirm. So we asked whether or not
 8 the standard or revised standard should include
 9 additional presumptions to confirm certain accounts,
 10 transactions, the like. And there were divergent views
 11 on this.
 12 Auditors generally were not supportive of
 13 expanding the presumption beyond confirming accounts
 14 receivable, and a number of other groups -- the
 15 academics, some of the issuers, some of the individual
 16 investors -- supported adding additional requirements,
 17 making the requirement to confirm cover additional
 18 areas, especially risky areas, was the general comment
 19 we got there.
 20 We also asked about disclaimers and
 21 restrictive language. That is showing up in a lot more
 22 confirmation responses. And we asked if that a new

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1 standard should include something around that
 2 requirements for the auditor to evaluate the language
 3 that's there, specific procedures. Generally, the
 4 commenters who commented here suggested that we clarify
 5 the auditor's responsibility to consider these -- this
 6 language and also provide perhaps some more guidance
 7 around what language creates a problem, what language
 8 doesn't create a problem.
 9 One other area we addressed was with regard
 10 to negative confirmations. We asked the question of
 11 whether or not we should keep negative confirmations as
 12 a form of confirmation and allow it in the standard.
 13 And the individuals who did respond -- virtually
 14 everybody who responded on this question suggested that
 15 we do continue to allow negative confirmations,
 16 although it was recommended that we limit when they can
 17 be used.
 18 So those are some general. There were other
 19 questions we asked in the concept release, but these
 20 were some general ones that we just wanted to highlight
 21 for you. And I'd be happy to get any input from anyone
 22 on the area of confirmations, any concerns that people

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1 think we need to consider.
 2 Paul?
 3 PAUL BESWICK: And this will be very brief.
 4 It seems to me the divergent views on expanding the
 5 presumption beyond accounts receivable would be
 6 contrary to the previous slide, where you say it should
 7 be risk based. If it's risk based, they will determine
 8 when they need to do something beyond accounts
 9 receivable.
 10 So I can't quite understand why the academics
 11 would be arguing to do more because of risk if it's
 12 already covered on the previous slide?
 13 DEE MIRANDO-GOULD: If I can just answer
 14 that? I think the issue there was that there are
 15 certain areas, like investments and certain revenue
 16 transactions and the like, that individual commenters
 17 thought were riskier areas in the first place so that
 18 the auditor should confirm those types of things
 19 because they are higher risk, and that would go along
 20 the lines of the risk focus.
 21 But I take your point. I understand the
 22 confusion there.

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1 Any other comments, thoughts?
 2 Yes, Liz?
 3 ELIZABETH GANTNIER: It seems that all the
 4 themes I'm hearing today are auditors don't understand
 5 how to evaluate the risk of fraud. Auditors don't know
 6 how to evaluate when the risk is great enough that a
 7 third-party independent confirmation is required.
 8 Auditors don't understand, and we'll get later to how
 9 to evaluate fair value properly or related party
 10 transactions properly.
 11 And I guess I'm waiting for a conversation
 12 about how we're going to train auditors in these
 13 processes, and yet all I'm hearing is so let's just
 14 default to a standard that requires or presumes certain
 15 risk assessments, which goes against pretty much
 16 everything that I know about auditing is that you're
 17 supposed to be capable of evaluating risk and employing
 18 your time and resource properly to these items.
 19 And I wish there was a place in all of this
 20 where we said we don't have to answer every failure by
 21 an auditor with a standard that requires a presumption
 22 that something is, therefore, high risk. We had to

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<p>1 redo Audit Standard 2 because it was so prescriptive, 2 and it had so much "If you have this, then it is a 3 material weakness." And we backed off of that and 4 said, for example, these are examples of what might be 5 a material weakness. But we got rid of the "always" 6 and "never" type of language. 7 And so, again, I just wish there was a place 8 in all this where students were better trained in risk 9 assessment and audit technique and theory and less 10 about presumption in the standards about you have to 11 confirm something. That ought to be left to us to 12 decide. 13 And if you're telling us we don't know how to 14 decide that, then there is another failure here. But 15 it's not necessarily always going to be resolved with 16 or by a standard. 17 KEITH WILSON: Can I just react to that a 18 little bit? At least from the standpoint of risk 19 assessment, I take your point about a large number of 20 presumptions. Certainly I think one of the things that 21 we tried to do with the risk assessment standards in 22 making -- in the foundational principles is to set</p>	<p>1 on that. 2 So we'll take those -- we're taking all of 3 those comments into consideration, and we do think that 4 the comments certainly supported amending the standard. 5 But we'll take the other comments into consideration as 6 to how we do that. And again, our target on that, 7 according to our plan, is to get a proposed standard 8 with public comment during the first quarter. 9 DEE MIRANDO-GOULD: Sam, did you want to? 10 SAM RANZILLA: If the chairman will recognize 11 me? 12 MARTIN BAUMANN: Sam Ranzilla. 13 [Laughter.] 14 SAM RANZILLA: Well, Marty -- I thought he 15 was just trying to cut me off. So I at least wanted to 16 give you the chance to do that formally. 17 [Laughter.] 18 MARTIN BAUMANN: Fair enough. 19 SAM RANZILLA: I think Liz brings up some 20 excellent points, and we'll get to that as we go 21 through each of the three projects. And let me say up 22 front, my comment has nothing to do with audit</p>
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<p>1 forth a process that allows the auditor to demonstrate 2 that they have a reasonable basis for those risk 3 assessments, okay, and then they can develop -- and how 4 they can develop responses that are commensurate with 5 the risk. 6 So I think that is an approach that we're 7 trying to follow. But for purposes of standard-setting 8 and discussion, I think sometimes it's helpful to just 9 lay out these points for discussion and say have these 10 risen to the point where they're important enough often 11 enough that there ought to be a presumption here? 12 It's a point of discussion. It doesn't 13 necessarily mean that that's the intention, okay? So 14 -- 15 MARTIN BAUMANN: And the last comment, I'd 16 like to make is that -- 17 DEE MIRANDO-GOULD: Sam? 18 MARTIN BAUMANN: -- of course, Dee was 19 putting up some of the responses we got back and not 20 necessarily how we're going to deal with those 21 responses. But there were some mixed views with 22 respect to the presumptions. She was just commenting</p>	<p>1 confirmations. 2 But I agree with Liz that there is a theme 3 running through the papers later this afternoon and 4 tomorrow to adding requirements and very prescriptive 5 set of standards, and I think you ought to think very 6 long and hard about going down a path that is very 7 prescriptive. And I also warn you about the 8 presumptive nature that to just presume something is a 9 risk factor or is a bad thing and, therefore, you go to 10 an extended audit response to it. 11 But you can avoid that by documenting in some 12 level of detail why you overcame that presumption. 13 Human behavior will just accept that it's whatever it 14 is you presumed it was in the standard because the risk 15 of trying to get second-guessed by either me, as an 16 internal inspector, or the external inspector. And 17 quite frankly, it might be more efficient to actually 18 just go do unnecessary work than it would be to 19 document why you don't need to do unnecessary work. 20 I just think going down a presumptive path is 21 something that is, in my mind, a very significant 22 decision that the Board will be making and one that you</p>

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1 should not take without a great deal of soul searching.

2 MARTIN BAUMANN: Good. Thanks for that
3 input, Sam.

4 Randy Fletchall?

5 RANDY FLETCHALL: Gosh, after that, I hate to
6 go back to confirmations, Sam.

7 [Laughter.]

8 RANDY FLETCHALL: But you mention there about
9 disclaimers and restrictive language, and we've talked
10 about that stuff at the last meeting in terms of seeing
11 more of that and how to evaluate whether that was to
12 such extent that you really couldn't treat it as audit
13 evidence.

14 I guess the other thing is also we've seen
15 increasing is where companies just won't respond. And
16 whether that's kind of a misinterpretation of Section
17 303 of Sarbanes-Oxley or not, I guess I would make
18 sure, as you write your standard, not only deal with
19 disclaimers and restrictions, but where you just
20 recognize you're using confirmations more often and yet
21 maybe respondents are not required to send them back to
22 you.

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1 And I don't have a solution here because, you
2 know, public companies, nonpublic, individuals -- it's
3 not like there's any one group that can dictate that
4 people have to respond. But I would encourage you in
5 the standard itself or covering releases to recognize
6 that as you talk about it is good evidence, try to use
7 it more often, that you're going to have to deal with
8 situations where you are unable to get a response and
9 have to do alternative work to satisfy the evidential
10 matters.

11 DEE MIRANDO-GOULD: Thank you, Randy.

12 As you may be aware, in the comments we've
13 received, we certainly received a lot of suggestions
14 that we consider response rates and we consider
15 disclaimers and consider whether or not there's
16 anything we can do, as a group, to help improve that.
17 So it's certainly something that we haven't forgotten
18 and we are considering in the whole process as we go
19 down this path.

20 Yes. We appreciate it.

21 MARTIN BAUMANN: Thanks for your comments on
22 that.

Meeting of the Standing Advisory Group

October 14, 2009

9:00 a.m. – 2:30 p.m.

Update on Proposed Standards and Concept Release Issued

Keith Wilson, Dee Mirando-Gould, and
Bella Rivshin

Associate Chief Auditors, Office of the Chief Auditor

Update on Proposed Standards and Concept Releases

- Proposed standards on risk assessment
- Audit confirmations concept release
- Signing the auditor's report concept release

Audit Confirmations Concept Release

□ Comment Letters Received

■ Firms and association of accountants	15
■ Academics and associations of academics	1
■ Issuers, business groups, and internal auditors	1
■ Investor representatives	1
■ Other standards-setters	1
■ Other organizations	2
■ Other individuals	<u>3</u>
Total	24

Audit Confirmations Concept Release

- Key Themes of Comment Letters
 - Support for a revised standard
 - Standard should be principles-based
 - Confirmation should be a function of risk assessment
 - Support alignment with ISA 505 and the ASB's Proposed Statement on Auditing Standards
 - Support for revising definition of confirmation to include direct online access and exclude oral responses

Audit Confirmations Concept Release

- Key Themes of Comment Letters (cont'd)
 - Requirement to request confirmation
 - Divergent views on expanding the presumption beyond accounts receivable
 - Disclaimers and restrictive language
 - Clarify auditor's responsibility to evaluate
 - Provide more guidance on how language affects audit evidence
 - Negative confirmations should be permitted as audit evidence