



February 27, 2023

Ms. Phoebe W. Brown  
Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006-2803

**Re: Proposed Auditing Standard, Public Company Accounting Oversight Board; The Auditor's Use of Confirmation and Other Proposed Amendments to PCAOB Standards; PCAOB Release No. 2022-009; PCAOB Rulemaking Docket Matter No. 028 (December 20, 2022)**

Dear Ms. Brown:

The Center for Capital Markets Competitiveness ("CCMC") appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB" or the "Board") Exposure Draft on *The Auditor's Use of Confirmation and Other Proposed Amendments to PCAOB Standards* (the "Exposure Draft" or "Proposal").

The PCAOB's existing confirmation standard was promulgated by the American Institute of Certified Public Accountants ("AICPA") before the Sarbanes-Oxley Act of 2002 ("SOX").<sup>1</sup> In 2009, the Board issued a concept release on confirmations and, in 2010, the Board proposed a standard on confirmations, which was not acted upon.<sup>2,3</sup>

The proposal is now part of an aggressive effort by the Board to overhaul standards in a condensed timeframe. For example, the PCAOB is engaged in actively working to update more than twenty-five standards within eight standard-setting projects and apparently "is just getting started."<sup>4</sup>

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<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") added broker-dealer audits to the PCAOB's oversight responsibilities.

<sup>2</sup> See the *Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations* (April 14, 2009) and the *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* (July 13, 2010).

<sup>3</sup> The CCMC provided comments on the standard proposed in 2010. See the letter to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* dated September 13, 2010.

<sup>4</sup> See "PCAOB Chair Williams Remarks on 20<sup>th</sup> Anniversary of Sarbanes-Oxley Act and Establishment of the PCAOB" (July 28, 2022).

While CCMC supports the PCAOB's goal to update its Auditing Standards,<sup>5</sup> It is important that those projects are undertaken with appropriate due process and informed deliberation to achieve the right outcome. CCMC encourages the Board to focus on crafting well-informed, balanced, cost-effective standards that will improve audit quality and stand the test of time, rather than simply "rushing to revise."

We appreciate that the Proposal intends to expressly integrate the use of confirmations into the PCAOB's risk assessment standards. We support principles-based auditing standards and a risk-based approach to the audit process.

CCMC acknowledges that the Proposal is scaled back from the 2010 proposal. While we believe this is the right approach, we are concerned that the Proposal continues to be overly prescriptive and assumes that confirmations represent "first best" audit evidence, regardless of the facts and circumstances.

We are also concerned that the Proposal is not sufficiently "forward looking." Thus, we question whether the proposed requirements will allow for audits in the future to incorporate advances in technology and innovations to obtain audit evidence from third parties.

Our concerns are discussed in more detail below. We also provide some recommendations to help address these concerns.

### *Discussion*

The Proposal includes a number of prescriptive requirements. For example, the Proposal includes a new requirement to confirm cash; requires that auditors must consider confirming other financial relationships with third parties sent cash confirmations;<sup>6</sup> maintains the requirement to confirm accounts receivable;<sup>7</sup> and specifies, for complex transactions and significant unusual transactions associated with significant risks of material misstatement, that auditors must consider confirming terms of the transactions with counterparties.<sup>8</sup>

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<sup>5</sup> For example, see the letters to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB Concept Release on *Potential Approach to Revisions to PCAOB Quality Control Standards* dated March 16, 2020; the PCAOB Request for Comment on *Advisory Groups – Draft Governance Frameworks* dated February 28, 2022; and the PCAOB Request for Comment on the *Draft 2022-2026 Strategic Plan* dated August 16, 2022.

<sup>6</sup> PCAOB requirements that the auditor "must" consider also invoke requirements for auditors to document that consideration and the conclusion reached (Exposure Draft, pages 21 and 22).

<sup>7</sup> Accounts receivable are defined as those arising from the transfer of goods or services to a customer and a financial institution's loans (Exposure Draft, page A1-3).

<sup>8</sup> As previously noted, these requirements "to consider" likewise involve documentation requirements.

Further, the Proposal provides requirements for assessing the reliability of confirmation responses and the performance of alternative procedures; includes requirements limiting the use of negative confirmation requests, along with limitations on the use of internal auditors in the confirmation process; and adds requirements for audit committee communications and documentation.<sup>9</sup>

These prescriptive requirements appear premised on an assumption that third party confirmations represent “first best” audit evidence. For example, the Proposal states that “evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources.”<sup>10</sup> However, this statement fails to include essential context. The overarching point is that the reliability of audit evidence depends on the nature and source of the evidence and on the circumstances under which it is obtained.<sup>11</sup>

The Exposure Draft states “we [the Board and staff] continue to believe that confirmation procedures would generally provide more persuasive audit evidence than other procedures (without confirmation) for cash and accounts receivable.”<sup>12</sup> Unfortunately, this assertion does not sufficiently appreciate the realities faced by auditors in using confirmations and third parties in responding to confirmations.

Confirmations involve difficulties, including the absence of any obligation for third parties to respond to such requests and the absence of any standards of due diligence or inquiry imposed on responding third parties. As CCMC has previously noted, whatever requirements the PCAOB imposes on auditors to confirm accounts and transactions, they cannot overcome these difficulties. Confirmations are also subject to delay, error, or lack of response by third parties. Moreover, third-party confirmations may produce misleading information, such as in cases of collusive fraud.<sup>13</sup>

Adding to these longstanding difficulties, third-party incentives to respond to audit confirmation requests have significantly declined.<sup>14</sup> There has been an explosion of nefarious activities by bad actors – whether using email, U.S. mail, or phone – that mimic otherwise legitimate sources. Thus, a natural response by third parties is to distrust and ignore most external requests for internal (private) information

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<sup>9</sup> For example, see the Exposure Draft, pages 5, 21, 25, 62, and Appendix 1.

<sup>10</sup> See the Exposure Draft, pages 5 and A1-2.

<sup>11</sup> See AS 1105.08 on *Audit Evidence*.

<sup>12</sup> See the Exposure Draft, page 19.

<sup>13</sup> See the letter to the PCAOB from the U.S. Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB *Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards* dated September 13, 2010.

<sup>14</sup> The Exposure Draft notes that anecdotal evidence and some research suggest confirmation response rates are declining (page 52).

CCMC acknowledges the Proposal provides that the auditor may overcome the presumption to confirm accounts receivable, if the auditor determines that other substantive audit procedures would provide audit evidence that is at least as persuasive as that from confirmations.<sup>15</sup> However, the Proposal also requires that this determination be communicated to the audit committee and that both the determination and audit committee communication must be documented.<sup>16</sup> Further, as judgments, these determinations are prone to second-guessing, including through the PCAOB inspection process. Thus, regardless of the intent of the Proposal,<sup>17</sup> it is likely auditors will generally decide to simply use confirmations, even when other audit evidence would be at least as persuasive.

CCMC recognizes that the PCAOB has engaged in efforts to understand audit firm methodologies, audit tools and technologies, and the role of intermediaries (facilitators<sup>18</sup>) in obtaining audit evidence via confirmations.<sup>19</sup> However, we remain concerned that the Proposal is not sufficiently forward looking to allow future developments in technology, tools, and innovation to be integrated into the audit process for obtaining audit evidence from third parties.

This concern is exacerbated by the Proposal's prescriptive requirements for confirmations and presumption that confirmations represent "first best" audit evidence. For example, in the current environment under some circumstances, auditors can obtain direct access to information in a third party's information system concerning that party's transactions or balances with a company under audit. Yet, the PCAOB does not consider direct access to fall under its definition of "confirmation."<sup>20</sup> Thus, to comply with the proposed requirements, audit evidence using confirmations would still have to be obtained for cash and accounts receivable (and considered for complex and significant unusual transactions) even in circumstances of direct access.

## Recommendations

To help address our concerns, CCMC recommends that the PCAOB extend its outreach to stakeholders, particularly to businesses. Discussions with representatives of the business community would help the PCAOB better understand the context, conditions, and limitations that third parties face in responding to confirmation requests from external auditors.

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<sup>15</sup> See the Exposure Draft, page A1-3.

<sup>16</sup> See the Exposure Draft, page A1-4.

<sup>17</sup> See the Exposure Draft, page 66.

<sup>18</sup> See the Exposure Draft, page 35.

<sup>19</sup> See the Exposure Draft, pages 47 to 51.

<sup>20</sup> See the Exposure Draft, page 46.

Further, the CCMC encourages the PCAOB to use its current initiative to “modernize auditing standards” as an opportunity to consider new and different mechanisms to engage with stakeholders. These new mechanisms could help inform the PCAOB, educate stakeholders, and facilitate feedback as the PCAOB develops and proposes auditing standards. Using roundtables that include preparers and (pre-implementation) field-testing with audit firms are just two suggestions. The key is for the PCAOB to go beyond its current approaches that rely on inspection and oversight,<sup>21</sup> notice and comment (with limited participation because of stakeholder constraints, including time and resources), and advisory groups with limited membership.

Finally, we recommend that the Board extend the effective date to two years after approval of any final standard by the Securities and Exchange Commission. PCAOB-registered audit firms need ample time to update and integrate new confirmation requirements, including documentation requirements, into their quality control systems (including methodologies, tools, and training) and audit engagements.

### Concluding Remarks

CCMC hopes that the Board will heed our recommendations on the Exposure Draft. Thank you for your consideration. We stand ready to discuss these matters with you further.

Sincerely,

A handwritten signature in black ink, appearing to read 'TK' with a long, sweeping flourish extending to the right.

Tom Quaadman  
Executive Vice President  
Center for Capital Markets Competitiveness  
U.S. Chamber of Commerce

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<sup>21</sup> The Proposal was developed relying on the PCAOB’s inspection and oversight (Exposure Draft, page 47).