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21 May 2010

Ref.: AUD/HvD/HB/LA/SH

Dear Sir or Madam,

Re: FEE Comments on the PCAOB Release No. 2010-001 Rulemaking Docket Matter No. 030: Proposed Auditing Standard Related to Communications with Audit Committees

FEE (the Federation of European Accountants) is pleased to provide you with its comments on the PCAOB Proposed Auditing Standard related to Communications with Audit Committees (the Proposed PCAOB Standard).

FEE welcomes the PCAOB initiative to set a standard for auditors' communication with audit committees. It is an important part of the work of an auditor of public interest entities to have fruitful two-way dialogue with the entities audited and especially with those charged with governance of the audited entity. Guidelines for auditors on how to communicate in an effective way should therefore be beneficial for auditors in practice. However, FEE is concerned that the Proposed Standard's objective, together with the required procedures, may not serve to foster the effective two-way communication that may help to enhance the work an auditor performs.

FEE is supportive of the intention of the PCAOB to set a standard for US public companies on communication with audit committees that is based on the international approach and on a thorough analysis of the differences between PCAOB standards and the International Standards on Auditing (ISAs). As a result of increased global acceptance of ISAs, they have become the global benchmark for auditing standards. Devoting efforts to quality standards and convergence in such a significant area in audit as communication with those charged with governance of the audited entity will therefore be beneficial to all stakeholders.

FEE's comments on significant aspects related to some of the questions raised by the PCAOB in the consultation document of the Proposed PCAOB Standard are set out below. Solely for ease of reference they follow the order of the Proposed PCAOB Standard. However this does not reflect FEE's view as to their relative importance in any way.

1. Convergence

The benchmark auditing standards are the clarified International Standards on Auditing (ISAs)

FEE has been advocating the use of the (clarified) ISAs in the European Union (EU) for over ten years. In addition, the worldwide use of the ISAs has steadily expanded over the last few years, making ISAs the global benchmark auditing standards. In 2009, FEE has reconfirmed its support for ISAs in Europe in the FEE Policy Statement on International Standards on Auditing (ISAs)¹.

FEE fully supports the adoption of ISAs as the use of harmonised international auditing standards will serve to increase audit quality and enhance confidence in the reliability, comparability and consistency of financial statements.

In general, FEE believes that uniformity in auditing standards worldwide, to the maximum degree possible, is beneficial for capital market participants with cross-border interests and global activities and enhances the quality of audits based on globally accepted auditing standards at national level, including the acceptance of audit reports beyond home jurisdictions.

Therefore, FEE welcomes the PCAOB's initiative to align its standards with the clarified ISAs as a step towards the ultimate worldwide application of one set of auditing standards for capital market entities and also other entities.

Towards globally accepted auditing standards or convergence?

We acknowledge that the PCAOB issues standards separately from, and different to, those of the IAASB because the PCAOB standards need to take into account national U.S. securities law and U.S. Securities and Exchange Commission (SEC) and other PCAOB rulemaking on these laws that the PCAOB has chosen for an integrated audit approach. Therefore, some differences between PCAOB standards and ISAs are inevitable.

However, we believe that it is not conducive to international convergence in auditing standards for the PCAOB to issue auditing standards that differ from the (clarified) ISAs at a technical level for other than these US legal reasons. The (clarified) ISAs reflect the product of an intensively overseen and thorough due process involving extensive consultation at an international level, including input from regulators, such as the PCAOB. Consequently, at an international level the ISAs are the most widely accepted benchmark of high quality auditing standards.

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<http://www.fee.be/fileupload/upload/Auditing%20and%20Assurance%20PS%20I%20International%20Standards%20on%20Auditing%20%28ISAs%29%201%20090430145200923149.pdf>

FEE would encourage the PCAOB to more clearly indicate and explain the differences between the PCAOB standards and the ISAs. Such explanations would be particularly helpful for non-US practitioners, who use ISAs as their standard audit approach, but sometimes are required to conduct audits in accordance with PCAOB standards. This is not only relevant for enhancing the efficiency and effectiveness of those audits, but also for educational and quality assurance reasons.

It would also be helpful if the PCAOB were to explain in more detail how the benefits of retaining the differences in the proposed standards exceed the costs of their retention. This would facilitate the IAASB to appropriately include the PCAOB in their due process when the relevant ISAs are being considered for revision in the future.

2. The use of professional judgement and rigorosity of PCAOB standards

FEE considers that the use of professional judgement in the conduct of audits is indispensable since it enables the auditor to make informed decisions about the course of action that is appropriate in the circumstances of the audit engagement.

The requirements related to the communication with audit committees in the Proposed PCAOB Standard appear to be quite prescriptive and rules-based and, therefore, may limit the auditor's ability to exercise professional judgement in deciding on the most appropriate and efficient means and content of the communication with the audit committee and those charged with governance. Furthermore, this level of detail may serve to detract from the aim of communications, as both parties seek to comply with the "letter" of the requirements.

FEE supports a more principles-based approach to communication with the audit committee and with those charged with governance, consistent with the ISAs, by embedding the concept of professional judgement in the standard. Therefore, we believe that a number of the detailed requirements within the Proposed PCAOB Standard should be removed from the main text.

Prescriptive and rules-based requirements are particularly apparent in relation to the Proposed PCAOB Standard paragraphs 12 and 13 which we further comment on in sections 5 and 6 below.

3. Objectives

FEE supports the overall objectives of the PCAOB in proposing this new standard as FEE believes in the importance of enhancing the relevance and effectiveness of communications with the audit committee and in the importance of emphasising effective two-way communication to better achieve the objectives of an audit.

The Proposed PCAOB Standard contains four objectives which are similar, but not identical, to the objectives included in ISA 260². The main differences that FEE recommends the PCAOB to reconsider are:

² ISA 260 on Communication with those charged with governance.

- The objective in paragraph 3a requires the auditor to establish a mutual understanding of the terms of the audit. It appears inappropriate to impose the establishment of mutual understanding upon one party – the auditor – as such an understanding requires the involvement of both parties. Therefore, it may not be possible for the auditor to achieve this objective in practice. The same applies to the requirements in paragraph 5 of the Proposed PCAOB Standard.
- Paragraph 3 sections a, b and c, address the exchange of information between the auditor and the audit committee. This paragraph specifies, as part of the objectives, that the auditor should *communicate to* the audit committee and *provide* the audit committee *with* certain information, all of which represents a one-way information flow. Paragraph 3d includes *evaluating the adequacy of the two-way communications* as a separate objective.
- ISA 260 states that one of the auditor's objectives is to *obtain information relevant to the audit from* those charged with governance and further to *promote effective two-way communication*. The ISA 260 objective appears more appropriate as it underlines the two-way communication throughout the audit process instead of a one-way communication from the auditor to the audit committee. The ISA 260 approach also assists the auditor in providing relevant and appropriate information to the audit committee which enables the audit committee to enhance the performance of its role of overseeing the financial reporting process.

Requirements of an auditing standard are designed to enable the auditor to achieve the objectives of a standard. However, there may be particular matters that require the auditor to perform audit procedures in addition to those required by the standard to fulfil the objectives. FEE would encourage the PCAOB to consider whether the objectives stated in the Proposed PCAOB Standard are designed to enable the auditor to achieve an understanding of the requirements instead of merely summarising the requirements.

These comments relate to questions 1 and 2 raised in the PCAOB consultation document.

4. Overview of the Audit Strategy and Timing of the Audit

In obtaining information related to the audit the auditor is required to inquire of the audit committee whether it is aware of matters that may be related to the audit³. FEE notes that according to the preamble of the Proposed PCAOB Standard⁴ the auditor should only inquire in relation to *significant* risks, not regarding all matters related to the audit. FEE would encourage the PCAOB to eliminate such inconsistency in the Proposed PCAOB Standard to reduce the risk of inconsistent or inefficient application by introducing the notion of significance in paragraph 8 of the Proposed PCAOB Standard.

These comments relate to question 5 raised in the PCAOB consultation document.

³ Proposed PCAOB Standard paragraph 8.

⁴ Preamble of the Proposed PCAOB Standard, page 4.

5. Issues Arising from the Audit – Accounting policies, Practices and Estimates

In paragraph 12a of the Proposed PCAOB Standard, a number of matters which the auditor should communicate have been included. All requirements in paragraph 12 of the Proposed PCAOB Standard relate to accounting policies and estimates that the management, rather than the auditor, should initially communicate to the audit committee. This is also highlighted in the “note” at the end of paragraph 12, stating that the auditor should determine whether all matters were adequately described, and, if not, the auditor should communicate any omitted or inadequately described matters to the audit committee.

FEE recommends that the condition of primary involvement and communication by the management to the audit committee as set out in the guidance, is transposed into the beginning of paragraph 12. This would indicate more clearly that it is only appropriate for the auditor to communicate the inadequacies in relation to these issues to the audit committee. The auditor should not submit descriptive communications to the audit committee if the management has already done so.

This would be consistent with the recent Staff Audit Practice Alert No. 5 on “Auditor Considerations regarding significant unusual transactions”⁵ in which it is highlighted that the auditor should discuss his assessments and judgements with audit committees instead of merely describing the views of the management. In addition, a changed approach would also highlight the separation of the responsibilities between the management and the auditor, respectively, which is only implicitly included in the Proposed PCAOB Standard.

These comments relate to questions 8 and 11 raised in the PCAOB consultation document.

6. Auditor’s Evaluation of the Quality of the Company’s Financial Reporting

The PCAOB has included extensive requirements as to what the auditor should communicate to the audit committee in paragraph 13 of the Proposed PCOAB Standard. Some of these requirements seem to be more significant than others, especially the following:

- Paragraph 13a appears to duplicate part of paragraph 12 as it addresses the same issue from two different angles. In accordance with paragraph 12a the auditor is required to communicate the inadequacies in the accounting policies described by the management. A discussion of the quality, clarity and completeness of the financial statements and the consistency of the disclosures should be carried out in accordance with paragraph 13a which, therefore, also relates to the descriptions made by the management. As both paragraphs address the accounting policies and the descriptions made by the management, FEE would encourage the PCAOB to consider whether merging paragraphs 12 and 13a would make the requirements less confusing for the auditor and avoid duplicative work in practice.

⁵ PCAOB Staff Audit Practice Alert No. 5: “Auditor Considerations regarding significant unusual transactions”, 7 April 2010: http://pcaobus.org/Standards/QandA/04-07-2010_APA_5.pdf

- Paragraph 13c addresses critical accounting estimates. The paragraph appears also to duplicate part of paragraph 12b as both paragraphs require an auditor's assessment on how critical accounting estimates affect the financial statements.

According to paragraph 13c the auditor is required to evaluate the reasonableness of the process for critical accounting estimates used by the management. In this respect, FEE would recommend that the PCAOB carefully considers that the auditor should not appear to be making decisions of behalf of the management, thus impairing the independence of the auditor.

- Paragraph 13e requires that the view of the auditor on alternative accounting treatments is expressed. As mentioned above, FEE would recommend that the PCAOB carefully considers this requirement to ensure that the independence of the auditor is not compromised by imposing management decisions upon the auditor.
- Paragraph 13f requires the auditor to communicate significant accounting matters on which the auditor has consulted outside the engagement team. This requirement appears to address the use of the work of experts which is already dealt with in paragraph 10 of the Proposed PCAOB standard. These two paragraphs appear therefore to be duplicative.

These comments relate to questions 8 and 11 raised in the PCAOB consultation document.

7. Adequacy of the Two-Way Communications

FEE regards the changes introduced by the IAASB in redrafting ISA 260 which are aimed at fostering two-way communication between auditor and those charged with governance as an important improvement which can enhance the effectiveness of the audit. As mentioned above the Proposed PCAOB Standard appears to focus on communication in relation to the completion of the audit, not prior to or during the audit. It is not apparent what kind and what level of communication should take place during the audit. We recognise that the currently *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* requires the auditor to inquire of the audit committee about the risks of material misstatement. However, we are not aware of other required communicative measures aimed at having auditors promote a two-way exchange of information. In our view, effective timely two-way communication may enable the auditor to gather information relevant to the audit which would otherwise not be forthcoming.

As audit committees may have information beyond initial risk assessments, in a risk-based audit approach it seems more appropriate to underline that this two-way communication should take place at appropriate points during the audit. This approach would enable the auditor to perform a more in-depth risk assessment and, where necessary, revise that assessment, which will lead to a more effective audit. Therefore, FEE would encourage the PCAOB to underline the two-way communication during the audit to a greater extent than currently envisioned in the Proposed PCAOB Standard.

These comments relate to question 18 raised in the PCAOB consultation document.

For further information on this FEE⁶ letter, please contact Mrs. Hilde Blomme at +32 2 285 40 77 or via email at hilde.blomme@fee.be or Lotte Andersen at +32 2 285 40 80 or via email at lotte.andersen@fee.be from the FEE Secretariat.

Yours sincerely,



Hans van Damme
President

⁶ FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.