



Federation of European Accountants
Fédération des Experts comptables Européens

Office of the Secretary
PCAOB
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USA

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2 March 2010

Ref.: AUD/HvD/LA/SH

Dear Sir or Madam,

Re: FEE Comments on the PCAOB Release No. 2009-007: Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards

FEE (the Federation of European Accountants) is pleased to provide you with its comments on PCAOB Proposed Auditing Standards related to The Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards.

FEE welcomes an improved set of proposed standards and the decision by the PCAOB to re-expose them. FEE also appreciates the approach to setting standards on audit risk in the US that is based on an international approach and the improved statement 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 audit risk will therefore be beneficial to all stakeholders.

FEE's comments on significant aspects of the proposed audit risk standards are set out below.

1. Convergence

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

As mentioned in the FEE comment letter dated 18 February 2009 to the PCAOB Release No. 2008-006: Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards, FEE has been advocating for 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 harmonized 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 world-wide, 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.

Aligning PCAOB auditing standards to ISAs

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.

We also reiterate our support for the update of the PCAOB's audit risk standards, reflecting the importance the PCAOB attaches, and is right to attach, to the new risk approach (i.e. risk assessment and responding to identified risk) to an audit which is already embedded in the ISAs.

The improved draft standards support to a greater extent than before further global convergence. In an environment of convergence to international accounting standards, the globalisation of auditing standards is also expected to facilitate consistency in the audit of financial statements. The alternative is cumbersome reconciliations covering differences in auditing standards that detract from an efficient and effective audit.

Towards globally accepted auditing standards or convergence?

We recognise that the PCAOB issues standards separately and different from those of the IAASB because the PCAOB standards need to take into account U.S. securities law and

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

U.S. Securities and Exchange Commission (SEC) and other PCAOB rulemaking on these laws and the PCAOB has chosen for an integrated audit approach. Therefore we acknowledge that 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, the ISAs are the most widely accepted benchmark of high quality auditing standards at an international level.

The differences as described in Appendix 10² go beyond additional US legal requirements. Although appendix 10 is helpful, in the light of convergence, FEE recommends that this appendix also articulates why the additional requirements are considered necessary and in particular whether the differences are necessary to address specific US requirements.

Considering this issue, FEE believes that deviations from ISAs should be limited to meeting the US legal requirements which would undoubtedly also result in a significant amount of unnecessary minor differences being eliminated.

Enhanced transparency on the remaining differences between PCAOB auditing standards and ISAs is desirable

FEE would encourage the PCAOB to more clearly indicate and explain where their standards are not based on ISAs. Such explanations would be very 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 when reporting to US group auditors. This is not only the case for enhancing the efficiency and effectiveness of their audits, but also for educational and quality assurance reasons.

Therefore, FEE strongly encourages the PCAOB to consider these additional steps towards convergence before finalising these standards.

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 are exceeding the costs of their retention. This would also enable the IAASB to appropriately include the PCAOB in their due process when the relevant ISAs are being considered for revision in the future.

2. Professional judgement and rigorousness of PCAOB standards

The PCAOB audit risk standards refer to professional due care and professional scepticism, which is specifically addressed in the proposed Auditing Standard No. 5 “*The*

² PCAOB exposure draft Appendix 10: Comparison of the Objectives and Requirements of Proposed Auditing Standards to the Analogous Standards of the International Auditing and Assurance Standards Board and the Auditing Standards Board of the American Institute of Certified Public Accountants

Auditor's Response to Risks of Material Misstatement", where it is highlighted that *"Due professional care requires the auditor to exercise professional scepticism³."*

The term *"professional judgement"* is not used in the proposed PCAOB standards. The discussion in PCAOB Appendix A9 and analysis of further amendments to the standards demonstrate that the PCAOB does not consider *"professional judgement"* as relevant to include which is highlighted by the following comments⁴.

"As under the existing PCAOB standards, auditors would need to exercise judgment in fulfilling the requirements of the new proposed standards in the particular circumstances. Making references to judgment in selected portions of the standards, however, could be misinterpreted as indicating that judgment is required only in certain aspects of the audit. Instead of referring to judgment selectively, the new proposed standards set forth the principles necessary for meeting the requirements of the new proposed standards, and allow the auditor to determine the most appropriate way to comply with the requirements in the circumstances."

FEE considers that the use of professional judgement when conducting audits is highly relevant. The requirements related to professional scepticism in the proposed PCAOB audit risk standards seem to be quite prescriptive and, therefore, may limit the auditor's ability to exercise professional judgement in assessing and responding to risk. FEE supports a more principles-based approach to audit risk, consistent with the ISAs, by applying the concept of professional judgement than the one currently promulgated in the proposed PCAOB audit risk standards.

3. Fraud

FEE would like to reiterate its comments on fraud made in the FEE comment letter dated 18 February 2009 to the PCAOB Release No. 2008-006: Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards, as no additional guidance on fraud seems to have been included in the re-exposed standards. FEE pointed out that the lack of application material in connection with the fraud requirements could be a risk related to the efficiency of the audit.

4. Considerations Specific to Small Entities

The PCAOB has included some additional considerations specific to small entities by adding some notes.

FEE recommends that this issue is addressed to an even greater extent in a consistent way similar to the approach taken in the ISAs where all ISAs include a specific section addressing these considerations.

³ PCAOB Appendix 5 Proposed Auditing standard The Auditor's Response to Risks of Material Misstatement, paragraph 7

⁴ PCAOB Appendix A9 – page 4

5. Objectives

Each of the PCAOB audit risk standards include some objectives, but not in a comparable way. Under ISAs the objectives are addressed in two different ways: generally in ISA 200⁵ and in addition each ISA contains objectives for the particular subject matters addressed in that ISA. For example, the wording of the objective on page A5-1 states that the auditor is to address “*the risks of material misstatement*” whereas the requirements of that standard, which FEE supports, relate to “*the assessed risks of material misstatement*”. As a result of this mismatch, an auditor complying fully with the requirements of the standard may not necessarily be in a position to meet the stated objective.

The PCAOB audit risk standards do not include a standard that is comparable to ISA 200. FEE commented on this issue in its comment letter dated 18 February 2009 highlighting that it was not clear whether the objectives included in each PCAOB audit risk standard would be comparable to the objectives in the comparable ISAs. Other respondents to the originally proposed PCAOB audit risk standards expressed similar views. Setting clear objectives in a manner consistent with ISA 200 would be very helpful in applying the proposed standards.

6. Due process

As part of its due process in developing auditing standards, the PCAOB re-exposes or invites again comments on standards previously proposed and commented on by interested parties. FEE welcomes this initiative as it enhances the involvement of stakeholders and significantly contributes to the quality of the final standards. Given the international significance of PCAOB standards, FEE believes that the standards require an adequate transparent due process throughout their development. As an additional step in the due process and depending on the significance of the amendments made based on comments received to this re-exposure, the PCAOB could consider re-exposing the audit risk standards one more time, especially in light of the importance of the issues discussed.

FEE is very supportive of further initiatives to improve the due process and especially its transparency and would encourage the PCAOB to engage in an even more active and transparent dialogue in the development phase of new standards with its stakeholders. This would provide more transparency in the standard setting process which could be achieved by:

- Providing a mark-up of the originally proposed standard to better illustrate the revisions made. This approach is followed by the IAASB;
- Clearer explanations of the further amendments made, which could for instance have been done via cross-referencing from Appendix 9 to the revised proposals;
- Providing a list of the significant changes in practice that are anticipated as a result of the revised standards; and

⁵ ISA 200: Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing

- Providing a discussion as to how the individual comments received have been addressed, and, where not addressed, the reasons for not having addressed them.

7. FEE previous and other comments

The re-exposed audit risk standards do not include an explanation as to how significant comments raised by respondents have been addressed. FEE has therefore not been able to clearly identify how the PCAOB has dealt with its comments made in February 2009 and we would therefore like to reiterate these points as we still believe that the issues addressed are significant when considering the application of standards on audit risk. The detailed comments made by FEE in its comment letter dated 18 February 2009 to the PCAOB Release No. 2008-006 were as follows:

- The distinction between audit procedures on a financial statements level and on an assertion level is not always drawn systematically in the Proposed Auditing Standards like it is done in the clarified ISAs;
- The distinction between requirements pertaining to management as opposed to those charged with governance or the board of directors is not always pronounced clearly in the Proposed Auditing Standards like it is included in the clarified ISAs;
- The introduction in the Proposed Auditing Standards of far reaching requirements to compensate for the lack of an auditing standard on group audits like ISA 600⁶ makes the Proposed Auditing Standards to be less comprehensive and unduly burdensome;
- There are requirements for substantive procedures on *all* significant risks, with little scope for the combination of work on controls and analytical procedures as required by clarified ISAs; this may be onerous. Detailed substantive testing for significant risks is flawed logically; *detailed* checking is not the right response to significant risks;
- There is a great number of presumptively mandatory ‘shoulds’ in the Proposal Auditing Standards (a construction rejected by the IAASB).

The PCAOB is also proposing a number of amendments to its standard AS-3 “Audit Documentation” in addition to those proposed previously. These proposals stem from the results of the PCAOB’s inspections rather than from comments received from respondents.

FEE believes that overly prescriptive documentation requirements, may not be conducive to enhancing audit quality, and indeed may be counterproductive. In this context we refer to our letter dated 20 January 2004 commenting on the then proposed AS-3 “Audit Documentation”, in which we had previously expressed this view.

⁶ ISA 600: Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)

For further information on this FEE⁷ letter, please contact Mrs. Hilde Blomme at +32 2 285 40 77 or via email at hilde.blomme@fee.be from the FEE Secretariat.

Yours sincerely,



Hans van Damme
President

⁷ 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.