

Public Company Accounting Oversight Board  
c/o Office of the Secretary  
1666 K Street, N.W.  
Washington, D.C. 20006-2803  
USA

By E-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)

September 13, 2010

Dear Sir(s):

**Re.: PCAOB Rulemaking Docket Matter No. 028  
PCAOB Release No. 2010-003  
Proposed Auditing Standard related to Confirmation and Related  
Amendments to PCAOB Standards**

The Institut der Wirtschaftsprüfer in Deutschland [Institute of Public Auditors in Germany], the professional organization representing public auditors in Germany, appreciates the opportunity to comment on the above-mentioned Proposed Auditing Standard.

We have submitted comments previously to the PCAOB on Rulemaking Docket Matter No. 028 in a letter dated May 29, 2009 in respect of the PCAOB's related Concept Release. We subsequently include references to that letter, rather than repeating any of its content verbatim. In this letter, we discuss particular matters that we consider to be of specific concern, and also respond to selected questions posed in the Release in the accompanying Appendix.

*Alignment of the PCAOB's Auditing Standards with corresponding ISAs*

We are pleased to note that the PCAOB appreciates that "Several commenters encouraged the Board to more closely align a revised confirmation standard with ISA 505." (page 6 of the Release). This reflects our firmly held view, which we have repeatedly commented to the PCAOB in previous correspondence,

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that, in the interests of global comparability, differences of substance between the PCAOB's auditing standards and those of the IAASB should be minimised where possible, deriving solely from U.S.-specific legal requirements.

The PCAOB also needs to bear in mind that its standards do not apply exclusively to audits performed in the United States, such that whilst its standards need to be robust, they must also be capable of application in many different jurisdictions and many different industries around the world. Indeed, in a number of past letters to the PCAOB we have expressed concern that the standards issued by the PCAOB are overly rules-based (i.e., our concern is that the exercise of professional judgement by an auditor is increasingly restricted, leading auditors to adopt a "checklist" approach rather than use the "thinking mentality" essential in exercising appropriate professional judgment and thus potentially detrimental to audit quality). This approach causes the PCAOB's standards to differ from those of the IAASB, which generally follow a more principles-based approach.

Whilst we recognize that the Proposed Auditing Standard does reflect the objective and requirements of ISA 505 in many major respects, our comments in this letter reflect the fact that we are not convinced that alignment has been achieved to the maximum extent possible, nor does the Proposed Auditing Standard itself contain guidance and other explanatory material sufficient to facilitate consistent application of the requirements in all cases. We therefore urge the Board to make further progress in these respects before finalizing its Standard.

#### *Proposed Retention of the Presumption in the Board's Interim Standards*

While, for the reasons previously detailed in our above-mentioned letter, we remain concerned about the retention of the presumption that the auditor's confirmation procedures will apply to accounts receivable – and proposed expansion thereof – our concerns have intensified, as the PCAOB is now proposing not to carry forward the exceptions for not confirming receivables (page 12 of the Release). Also of concern is the fact that the proposal to disallow exceptions was not mentioned in the earlier Concept Release, such that commenters' views have not yet been solicited on this aspect. We discuss this aspect of the proposal further in the subsequent section of this letter.

Although we appreciate that in the vast majority of audit circumstances confirmations may well be the most effective audit procedure, and their extensive use would be common in many jurisdictions and in many industries, our concern is

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that in proposing a rule without exception the PCAOB not only fosters the checklist approach mentioned above, but will also require audit resources to be expended for the sake of compliance without any attaching enhancement of audit quality. Indeed, in addition to the obvious issue of cost, other potential drawbacks may arise as auditors seek to be seen to comply with the letter of the standard rather than performing those alternative procedures that would be the most effective ones in the particular audit circumstances. In our view, this lack of flexibility may be detrimental to audit quality, for the reasons we explain below.

In practical terms, the presumption as currently proposed means that even in those circumstances where an auditor anticipates that confirmation procedures will be ineffective (e.g. when the auditor has had past experience with the audit client encountering especially low response rates, respondent errors including lack of verification, or directional bias in detecting errors – all of which the PCAOB noted as being key barriers to confirmation effectiveness in the Concept Release), confirmation requests will still have to be made (at least twice, and possibly a third time pursuant to paragraph 27 of the Proposed Auditing Standard), without exception.

The two reasons for retaining the presumption the PCAOB has given on pages 11, 12 and A3-3 of the Release (1. audit evidence from third parties is generally more reliable than company generated evidence, and 2. academic research supports effectiveness of confirmations in testing receivables) are not relevant in those audit situations where such key barriers exist. We would like to point out that neither auditor confirmation procedures nor rules-based auditing standards can compel external parties to respond to confirmation requests or to verify the information therein before responding. In this context, we refer to our aforementioned previous letter as to the potential for legislative or regulatory measures to improve cooperation by external parties. In our view the fact that such barriers may, in some cases, indeed preclude the auditor from obtaining effective confirmation indicates that there is a clear case for allowing exceptions in certain particular limited circumstances.

The Proposed Auditing Standard also requires the auditor perform alternative procedures in response to ineffective confirmation. This means that when confirmation is expected to be ineffective the auditor has to double-count procedures, i.e., sending confirmation requests and follow-up requests would be essentially a “wasted” effort. In the best case, this could lead to auditors “going through the motions” in sending confirmation requests to comply with the Standard which would neither enhance audit quality, nor be justified from a cost efficiency perspective. However, in the worst case, should the auditor fail to recog-

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nize the full extent of respondents' behaviour e.g., neglecting to verify the information, or incorrectly gauge the significance thereof to the audit, the receipt of positive confirmations would allow the auditor to appear to have complied with the requirements, when other procedures would have been more effective in the particular circumstances.

#### *Introduction of a Proposal Not to Carry Forward Hitherto Recognized Exceptions*

As mentioned above, the proposed removal of exceptions to the presumption was not discussed in the earlier Concept Release. Furthermore none of the 27 questions posed by the PCAOB in this Release relate directly to this aspect. We regard this as an important issue worthy of full discussion with the PCAOB's constituents during the standard setting process, and we were disappointed that the PCAOB has not sought specific comment on this aspect of the proposal.

The arguments put forth by the PCAOB in favor of its proposal to eliminate the exception currently permitted, contend that auditors can look for ways to improve the effectiveness of confirmation procedures (e.g., rather than seeking confirmation of a specific balance requesting confirmation of the individual transactions that make up that balance, or where the local custom is to respond without verifying information to use a positive confirmation request that does not state the balance or amount or certain other information). In our opinion, such measures will not result in satisfactory confirmation in all cases, since as discussed above, neither auditor confirmation procedures nor rules-based auditing standards can compel cooperation by external parties.

#### *Confirmation Procedures Prescribed as a Response to Significant Risks*

The proposed requirement relating to significant risks is a further example of the adoption of a rules-based approach on the part of the PCAOB. Paragraph 10 of the Proposed Auditing Standard specifically requires the auditor to "...perform confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures". In contrast, the ISAs adopt a principles-based approach, as the corresponding requirements of ISA 330.19, in conjunction with ISA 330.21 read together with accompanying application and other explanatory material in paragraphs A48-A51 and A53 of ISA 330 require the auditor to perform substantive procedures specifically responsive to a significant risk, and to consider the appropriateness of confirmation as a possible such substantive procedure.

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The PCAOB's approach requires the auditor perform confirmation procedures whenever an assertion is, in theory, capable of being adequately addressed by confirmation procedures – irrespective of whether the auditor expects that they will prove effective or not. This limitation on the auditor's exercise of professional judgement will prevent auditors from considering whether a procedure other than confirmation procedures might be more effective or otherwise preferable and, for the same reasons as explained above, may not be conducive to fostering audit quality.

*Comparison of the Requirements of the Proposed Auditing Standard and Analogous Standards – Appendix 3*

We note that the detailed comparison of objectives and requirements of the Proposed Auditing Standard and the analogous standards of the IAASB and the AICPA's Auditing Standards Board set forth in Appendix 3 of the Release reveals a number of proposed requirements having [apparently] no equivalent requirement in ISAs.

In part these differences arise as ISAs take a more principles-based approach to arrive at, what is, essentially a common objective. In certain other cases, statements to the effect that there are no similar requirements may simply be misleading. For example, in respect of paragraph 10 of the Proposed Auditing Standard, the text under the heading *IAASB and ASB* on page A3-6 states: "ISA 505 and the ASB's proposed SAS do not contain similar requirements." As far as ISA 505 is concerned this is true; such requirements are not found in ISA 505. However, as noted above, the requirements of ISA 330.19, in conjunction with ISA 330.21 read together with accompanying application and other explanatory material in paragraphs A48-A51 and A53 of ISA 330 effectively require the auditor to consider the appropriateness of confirmation as a substantive procedure in response to a significant risk. In this instance, we consider the impression portrayed unfortunate.

*Effective Date*

As confirmation procedures may be used during the period subject to audit or to confirm period end balances and transactions, we are concerned that the proposed effective date may be overly tight, given that the standard has yet to be finalized, approved by the PCAOB and approved by the SEC. For periods ending December 31, 2011 auditors will plan and perform procedures from early 2011 onwards.

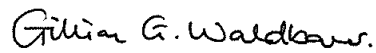
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We hope that our comments are useful for the Board's further deliberations. Should you have any questions about our comments, we would be pleased to be of assistance.

Yours very truly,



Klaus-Peter Feld  
Executive Director



Gillian G. Waldbauer  
Technical Manager

## Appendix

### Responses to specific questions in the Release

#### **5. Is the requirement in the proposed standard to confirm cash and other relationships with financial institutions sufficiently clear and appropriate? If not, what changes should the Board make?**

The wording of the second and fourth sentences of paragraph 9 appears to infer that requesting confirmation of a sample of cash accounts and other relationships with financial institutions might be appropriate. This seems to us to be in direct conflict with the last three sentences of that paragraph. In our view, further clarification of this aspect of the PCAOB's requirement would be useful. For example, does the PCAOB intend the second and fourth sentences to mean that in preparing confirmation requests it would be acceptable for the auditor to leave out particular financial institutions altogether as potentially not material or not posing a significant risk, or alternatively might the auditor specifically exclude certain specific accounts or relationships from requests for these reasons.

The German auditing standard promulgated by the IDW "IDW Auditing Standard 302: External Confirmations" requires bank confirmations be obtained in respect of all types of business relations between the entity and credit and financial services institutions (or their branches) as well as for all business relations with financial enterprises as defined by § [Article] 1 (3) KWG ["Kreditwesengesetz": German Banking Act]. In our opinion, the confirmation of such information is, certainly in Germany, less likely to be ineffective than may be the case for other receivables, thus whilst we would generally see less of a necessity to foresee possible exceptions in respect of confirmation requests to credit institutions, we refer to our comments in the attached letter relating to the presumptive requirement and the proposal not to carry forward exceptions, as the PCAOB should recognize that in some circumstances or cultures it may be conceivable that even these types of confirmations may prove ineffective.

#### **11. Are the factors for designing confirmation requests in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make?**

As discussed in our attached letter, we are concerned at the PCAOB's apparent expectation that the auditor will essentially be able to overcome anticipated ineffectiveness of confirmations by adjusting the design of confirmation requests. In

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some specific industries and cultures, we believe this expectation to be unrealistic.

In any case, to the extent that conformation requests for individual items rather than for an account balance are considered an “alternative”, there may be a need for additional procedures e.g., to address the completeness assertion, or cut off. This aspect needs to be addressed in the Standard more clearly.

We further suggest the PCAOB expand the material relating to designated intermediaries, as this is one aspect in which the auditor may not retain full control of the confirmation process, which, whilst not common, nevertheless may be encountered in practice.

**12. Are the requirements in the proposed standard regarding the use of negative confirmation requests sufficiently clear and appropriate? If not, how should the Board change these requirements?**

No, in our opinion, the requirements are not entirely appropriate.

As we have previously stated, we agree that the use of negative form requests should not be forbidden, but instead used only under certain conditions.

We therefore question whether supplementary substantive procedures as required by the last sentence of paragraph 17 would be necessary in every case where negative confirmations are used, and even though each and every of the four required criteria are fulfilled. In this context, the ISAs require the auditor to obtain more persuasive audit evidence the higher the auditor’s assessment of risk (ISA 330.07(d) together with supporting application material) and also to conclude whether sufficient appropriate audit evidence has been obtained (ISA 330.26 and ISA 200.17 together with supporting application material). The IASSB recognized that there may be some circumstances in which the auditor judges that, provided certain criteria (similar to those required by the PCAOB) are fulfilled, negative confirmations can provide appropriate sufficient audit evidence. We suggest the PCAOB take a similar risk-based approach in drafting paragraph 17.

In addition, we do not agree that requiring the auditor to “reasonably believe that recipients of negative confirmation requests will give such requests consideration” sets an appropriate threshold. The corresponding text in ISA 505.15(d) states “the auditor is not aware of circumstances or conditions that would cause the recipients of negative conformation requests to disregard such requests”, which, in our opinion, sets a more practicable threshold.



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**13. Are the procedures the auditor should perform to determine the validity of the addresses on confirmation requests sufficiently clear and appropriate? If not, what changes should the Board make to the proposed procedures?**

We had previously commented that given the technological advances that facilitate direct confirmation with a third party, the auditor will need to perform procedures directed at ensuring the security and integrity of the auditor's direct interaction with that third party, i.e., procedures to determine whether the third party supplied link is secure and cannot be subject to manipulation and whether access granted by that third party does indeed relate to all the information requested.

We do not believe the procedures are sufficiently clear in the Proposed Auditing Standard to cover all circumstances auditors may face in practice, and suggest, once again, that the PCAOB include additional material to assist the auditor in addressing such validity issues, especially in cases where responders grant direct access rather than providing a specific response. For example, this issue is not discussed in paragraphs 19-21 where an auditor may wish to use electronic or other medium to request a confirmation. We also refer to our responses to questions 21, 22 and 24.

**15. Are the procedures the auditor should perform when management requests the auditor not to confirm certain accounts, balances, or other items sufficiently clear and appropriate? If not, what changes should the Board make to the proposed requirements?**

We had previously commented that we would support the inclusion of material based on paragraphs 8 and 9 of ISA 505 and accompanying application material.

In this context, we question why the PCAOB deems it necessary to perform the procedures listed in sections c. and e. of paragraphs 24 of the Proposed Auditing Standard even in those circumstances where the auditor has both previously obtained audit evidence as to the appropriateness of management's request not to confirm particular information and been able to obtain relevant and reliable audit evidence from the alternative procedures required pursuant to sections a. and b. of that paragraph. This is a further example of the PCAOB adopting a rules-based approach, ultimately leading to the need for auditors having to report all such refusal(s) to the audit committee, and evaluate potential implica-

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tions for the audit report regardless of their validity and significance for the audit. In contrast, ISA 505 requires this communication and a determination of implication for the audit and auditor's opinion only in the case of either unreasonable refusal(s) by management, or of reasonable refusal(s) that have resulted in the auditor being unable to obtain relevant and reliable audit evidence from alternative procedures.

**17. Are the additional procedures that are required when the auditor does not receive a confirmation response for the terms of a significant transaction or agreement appropriate? If not, what changes should the Board make?**

We refer to our attached letter in respect of the appropriateness of retaining the presumption without exception which will result in confirmation requests having to be made (at least twice, and possibly a third time) pursuant to paragraph 27 of the Proposed Auditing Standard. In this context, should the PCAOB reject our suggestions and decide not to allow for exceptions, we suggest that when both past experience and responses to the first confirmation requests indicate that second or third requests are unlikely to lead to an increase in effectiveness of the confirmations, the auditor not be required to follow up with a second and possibly third request.

**19. Is the requirement in the proposed standard for the auditor to investigate all exceptions in confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to the requirement?**

Pursuant to the ISAs if, in investigating exceptions, the auditor identifies a misstatement, the auditor is further required to evaluate whether the misstatement is indicative of fraud (ISA 505.A21). We note that the Proposed Auditing Standard does not mention a similar requirement. This may need to be addressed as the PCAOB completes its risk standards, and a reference to the relevant paragraph in AS-14 included. (Currently AU 316.68 deals with this aspect.)

**20. Are the requirements in the proposed standard related to addressing the reliability of confirmation responses sufficiently clear and appropriate? If not, what changes should the Board make to those requirements?**

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We are concerned that, in comparison to ISA 505, the Proposed Auditing Standard sets overly high expectations in respect of the auditor's procedures in relation to the reliability of conformation responses.

ISA 505.10 requires the auditor obtain further audit evidence to resolve doubts about the reliability of a response to a confirmation request only if the auditor identifies factors that give rise to doubts about the reliability. In the absence of such factors the auditor does not seek to confirm or discount reliability. In contrast, paragraph 31 states "The auditor should assess the reliability of confirmation responses." without qualifying this requirement in any similar manner.

Furthermore, only when the auditor determines that a response is not reliable does ISA 505.11 require the auditor to evaluate the implications further.

The Proposed Auditing Standard sets a far lower threshold in requiring the auditor to obtain additional audit evidence if conditions indicate that a confirmation response might not be reliable.

This may lead to expectations that are impracticable, as the auditor can only react to matters of which the auditor becomes aware, or represent the auditor's own findings and determinations.

**21. Does the proposed standard include adequate requirements regarding electronic confirmation procedures? If not, what additional requirements should the Board include?**

We do not agree that direct contact with the intended confirming party is the only way to verify the source of a response received via facsimile or e-mail (e.g., recourse to directories etc. may be an alternative).

We question whether there is a need to confirm the content of a response directly with that party in every case where responses are received by facsimile – this is not required in respect of responses received by any other means.

**22. Are there risks related to the use of an intermediary that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?**

If an intermediary is used, we are unsure whether the PCAOB foresees that the auditor might review reports by other auditors (e.g., a similar concept to SAS 70 or ISAE 3402 engagements), should such engagements have been performed?

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Further clarification of the PCAOB's expectations as to how the auditor should address the risks would be appropriate.

**24. Are there risks related to the auditor's use of direct access that the proposed standard has not adequately addressed? If so, what are those risks, and how should the standard address them?**

In respect of direct access, the PCAOB has not included requirements for the auditor to seek verification of the source or content. For example, consideration of the process by which the auditor is registered for limited period direct access might be relevant.