



13 September 2010

Office of the Secretary
Public Company Accounting Oversight
Board
1666 K Street, NW
Washington DC 20006-2803
USA

Email: comments@pcaobus.org

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

Dear Sir or Madam,

Re: FEE Comments on PCAOB Release No. 2010-003, PCAOB Rulemaking Docket Matter No. 028 on Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards

FEE is pleased to provide you below with its comments on the Public Company Accounting Oversight Board (PCAOB) Release No. 2010-003, Rulemaking Docket Matter No. 028 on Proposed Auditing Standard Related to Confirmation And Related Amendments to PCAOB standards.

Our main comments as well as our responses to the questions included in the proposed auditing standard on confirmations are enclosed below.

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

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.

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.

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

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 as well as enhancing confidence in the reliability, comparability and consistency of financial statements.

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 other items like national U.S. securities law, U.S. Securities and Exchange Commission (SEC) laws or regulations and other PCAOB rulemaking, for instance resulting from 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 of 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 widely accepted benchmark of high quality auditing standards.

FEE main comments

FEE commented to the Concept Release 2009-002 on Possible Revisions to the PCAOB's standard on Audit Confirmations in its letter from May 2009² and we are pleased to see that the PCAOB has followed our recommendations to align with the international requirements to some extent, especially regarding the objective of the standard, negative confirmations and management requests not to confirm.

However, considering the proposed auditing standard on confirmation, we believe that the response to requests for further guidance and explanations has resulted in additional rules and requirements instead of explanatory material. It is therefore relevant to reiterate our key comments which were the following:

- Although the PCAOB has recently published auditing standards related to the auditor's assessment of and response to risk, the many questions in the proposed standard as to whether auditors should be required to perform specific procedures appear to diverge from a risk-based approach. Such divergence encourages a rules-based and mechanical and procedural approach to auditing standards;
- It might be useful to emphasise that external audit confirmation should not be conducted routinely without the use of professional judgement and to put additional focus on alternative audit procedures, as adequate responses of third parties to all external audit confirmation cannot be taken for granted.

In addition to the above mentioned points, one of the main comments made in response to the previous Concept Release related to the presumed mandatory requirement for external

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<http://www.fee.be/fileupload/upload/Seymour%20090529%20Possible%20Revisions%20to%20PCAOBs%20Standards%20on%20Audit%20Confirmations256200911853.pdf>

audit confirmations. The PCAOB is proposing to retain, indeed even extend, this presumed mandatory requirement in this exposure draft. In addition, the proposed standard does not carry forward the current exceptions for not confirming receivables; in total a solution about which FEE has serious concerns. In contrast, the IAASB refers to the risk assessment to determine when external audit confirmation ought to be performed. The more rules-based approach chosen by the PCAOB might discourage the use of professional judgement, which may, in comparison with an effective application of a truly risk-based approach, have an adverse affect on audit quality.

Please find hereunder our comments on the main part of the questions raised in the proposal. Please note that we have no further comments on questions 4, 7, 10, 14, 16, 18, 23 and 26.

Question 1

Are the definitions included in the proposed standard sufficiently clear and appropriate? If not, what changes should the Board make to the definitions?

The definitions related to confirmations in the PCAOB proposed auditing standard on confirmations and the ISA on this subject matter, ISA 505³, are clearly comparable and broadly similar. The differences that exist, mainly regarding positive confirmation requests, external confirmations and exceptions, appear to be limited and insignificant with no difference of substance. We appreciate that the PCAOB's and the IAASB's definition of a negative confirmation request are identical.

However, we would like to raise two minor points regarding the definitions:

- The definition of Confirmation Response appears to have to be read in conjunction with the definition of Direct Access, as it is not apparent how information the auditor obtains using direct access, interrelates with the confirmation response unless these definitions of Direct Access and of Confirmation Response are read in conjunction with each other;
- As this section of the proposed auditing standard deals solely with definitions and not requirements, the definitions may be clearer were the phrases "*...is audit evidence, but...*" within the definition of Confirmation Response and "*Rather that information constituted other audit evidence*" within the definition of Direct Access not included.

Question 2

Is the objective of the proposed standard clear and appropriate? If not, what changes should the Board make to the objective?

And

Question 3

What other matters, if any, should the objective include?

³ ISA 505, External Confirmations

The objective according to paragraph 3 of the proposed standard is for the auditor to obtain relevant and reliable audit evidence. We support this objective as a clear and appropriate objective, which is similar to the objective of ISA 505.

We are pleased to see that the PCAOB has followed our recommendations to align the objective of the proposed standard with ISA 505 mentioned in our previous letter commenting on the Concept Release.

However, as noted earlier, the PCAOB appears to retain its presumptively mandatory requirement for external audit confirmations, although this is not explicit in the proposed objective.

In our opinion, the application of this objective allows, and does not prohibit, the auditor to use professional judgment to determine whether to use external audit confirmations as an audit procedure in an individual engagement.

Question 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?

In respect of confirmations of cash and other relationships with financial institutions the PCAOB proposes to extend as well as retain its presumptively mandatory requirement for external audit confirmations as paragraph 9 of the proposed auditing standard states that the auditor should perform confirmation procedures for cash with financial institutions. We refer to our main comments above, in which we express concerns at the presumed mandatory requirement for confirmations.

We acknowledge that the fourth sentence recognises the use of professional judgement by stating that the auditor should assess the risk of misstatement due to error or fraud, which is clearly in accordance with the objective in paragraph 3 of the proposed standard.

However, we would recommend that it is made clearer in paragraph 9 whether the external confirmations for cash and other relationships are intended to be mandatory in all cases. This clarification could be within the first sentence of paragraph 9 giving this specific point more prominence in this quite extensive paragraph.

Question 6

Does the proposed standard appropriately address the risk of material misstatement by requiring confirmation procedures in response to significant risks that relate to the relevant assertions that can be adequately addressed by confirmation procedures? If not, what changes should the Board make?

The requirements of proposed paragraph 10 essentially achieve the same objective as material in ISA 330⁴. There is a difference in approach, as the IAASB standards are

⁴ ISA 330, The Auditor's Responses To Assessed Risks

drafted in line with principles, rather than a rules-based approach, which is, in our view, preferable.

Question 8

Is the description in the proposed standard of other risks sufficiently clear and appropriate? If not, what changes should the Board make?

Paragraph 11 of the proposed auditing standard would be more appropriate, and consistent, if it were aligned with the approach adopted by the IAASB in ISA 330, where this aspect is a possible, but not mandatory, use of confirmation procedures. In this way, the standard would make it clear that the auditor should use his professional judgement in determining what might be an appropriate response to obtaining audit evidence. This could be clarified in paragraph 11.

Question 9

Are the requirements in the proposed standard for maintaining control over the confirmation process sufficiently clear and appropriate? If not, what changes should the Board make?

The requirements for maintaining control over the confirmation process are clear. However, we consider them inappropriate, because they are far too prescriptive and rules-based without the potential to significantly increase the quality of the audit. The excessive attention to detail will result in auditors focussing on compliance with detailed requirements of the standard instead of its ultimate objective, which is for auditors to use their judgement in designing and performing confirmation procedures to obtain relevant and reliable audit evidence.

Question 11

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

The list of factors for designing confirmation requests in paragraph 16 is very similar to the list in paragraph A4 of ISA 505. FEE appreciates the alignment with the international requirement in this regard. In addition, the part of paragraph 17 of the proposed auditing standard that relates to negative confirmations are almost identical with the requirements on this in paragraph 15 of ISA 505, except for the last two bullet points.

Paragraph 16 of the proposed auditing standard includes a reference to local customs that might influence confirmation responses, such as responding without verifying the information. In our view this comment constitutes guidance, rather than a requirement, and could be included as a footnote to paragraph 16 instead of a requirement. The use of professional judgement is crucial in assessing whether confirmation requests, also under local customs, are an effective and efficient manner of obtaining audit evidence rather than merely stating the fact that such a situation can occur in practice.

When considering negative confirmations in paragraph 17 of the proposed auditing standard, the PCAOB appears to expect that the auditor will be able to overcome anticipated ineffectiveness of confirmations by adjusting the design of confirmation

requests. In some specific industries and cultures, we believe this might not be the case, as, for instance, where companies have a clear policy never to respond to confirmations.

The second sentence of paragraph 17 of the proposed auditing standard reads “*A positive confirmation request provides audit evidence only when a response is received directly by the auditor from the confirming party.*” The sentence appears superfluous as requirements and the definition of positive confirmation covers the issue when stating “*...the confirming party respond directly to the auditor ...*”.

We refer to question 22 regarding our comments related to intermediaries.

Question 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?

The part of paragraph 17 of the proposed auditing standard that addresses negative confirmations is almost identical with paragraph 15 of ISA 505, and as mentioned above we appreciate the alignment with the international approach as well as that the PCAOB has followed our recommended approach to this issue in our previous letter from May 2009 on the Concept Release.

The main difference between the proposed auditing standard and ISA 505 is the inclusion of the last sentence of paragraph 17 that requires additional substantive procedures to supplement the use of negative confirmation requests, as it is the view of the PCAOB that even when all factors as set out in the bullet points are fulfilled, the audit evidence obtained remains limited.

FEE questions whether these supplementary substantive procedures would be necessary in every case where of the four required criteria are fulfilled. In this context, the ISAs⁵ require (i) the auditor to obtain more persuasive audit evidence the higher the auditor’s assessment of risk and (ii) the auditor to conclude whether sufficient appropriate audit evidence has been obtained. The IAASB recognised 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. In our opinion such a risk-based approach, inclusive of the use of professional judgement, would lead to higher audit quality compared to using substantive procedures in all cases.

On the two points where the proposed auditing standard differs from ISA 505, we note the following observations:

- The PCAOB has chosen not to apply the seemingly higher threshold of paragraph 15 (c) of ISA 505 in requiring a “*very low exception rate*” as a condition for conducting negative confirmations, rather than the “*low expectation rate*” set out in paragraph 17 on the PCAOB proposed auditing standard. We find the ISA 505 approach of a “*very low expectation rate*” sufficient and appropriate when it comes to negative confirmations.

⁵ ISA 330 paragraphs 7(d) and 26 supplemented by ISA 200 paragraph 17 and relevant application material

- The last bullet of paragraph 17 of the proposed auditing standard states that “...*The auditor reasonably believes that the recipients of negative confirmation requests will give such requests consideration*”. The corresponding paragraph 15 (d) of ISA 505 states that “*The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests*”. In our view, that approach chosen in ISA 505, requiring a negative judgement (...*not aware of ...*) instead of the positive (...*the auditor believes...*) sets a more practicable threshold, and seems appropriate in the context.

Question 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?

In our May 2009 response to the Concept Release we highlighted that, when using external audit confirmation procedures, the auditor should be required to maintain control over external audit confirmation requests, including designing the confirmation request, which also includes determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor.

In line with the risk-based approach, guidance would be useful in this respect as provided in paragraph A6 of ISA 505, which specifies that determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out. In practice, it might very well be the case that IT technology will allow for some direct confirmation with a third party in a way, via secure connections, for instance. This should be kept in mind when designing these principles regarding the validity of addresses.

We remain of this view that it is unnecessary to require substantive tests of all addresses. Therefore, we recommend that it is made clearer in paragraphs 18, 19 and 20 in the proposed auditing standard that the auditor should use professional judgement, in accordance with the objective in paragraph 3, to assess to which level of detail substantive procedures are necessary, having the risk of fraud in mind.

Question 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?

In our May 2009 response to the Concept Release we recommended alignment with material based on paragraphs 8 and 9 of ISA 505 and accompanying application material. We appreciate that the PCAOB has followed our recommendations as set out in the requirements regarding “*Management Requests Not To Confirm*” in paragraphs 23 and 24.

Although paragraphs 23 and 24 the proposed requirements are not identical with the corresponding ISA requirements, we support the underlying attention of the use of professional judgement to determine whether there are valid reasons for management’s request or refusal not to confirm, the audit evidence and the evaluation in relation to fraud

along with the design of alternative audit procedures, which is clearly in accordance with the objective in the proposed paragraph 3.

If the auditor has previously obtained audit evidence as to the appropriateness of management's request not to confirm particular information and has been able to obtain relevant and reliable audit evidence from the alternative procedures required pursuant to sections a and b of that paragraph, then FEE believes that it should be up to the judgement of the auditor whether this needs to be communicated to the audit committee.

In addition, the communication of the request not to confirm to the audit committee and its inclusion in the management representation letter may be more appropriate if it is done on a summary basis in order to avoid overloading the audit committee and management representation letter with excessive or insignificant information. FEE believes that communicating these matters only where the auditor concludes that management's request is unreasonable, in line with paragraph 9 of ISA 505, would be sufficient and also more appropriate than the proposed approach. FEE suggests the proposed standard be amended accordingly.

Question 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?

Paragraph 27 of the proposed standard requires the auditor to follow up a non-response with a second and possibly third request for confirmation.

Audit quality may not necessarily be increased if auditors are required to send audit confirmation requests if 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. Similarly, audit quality may not be increased in cases where expected response rates are very low, based on either policies of the third party or industry or jurisdiction customs and habits.

The auditor could also end up spending excessive time without obtaining any valuable audit evidence if it is known in advance that any responses will include disclaimers that render such responses of limited value as audit evidence.

Instead, the auditor could be required to use professional judgement in applying alternative audit procedures to determine how to achieve effective and efficient audit evidence.

Therefore, we suggest paragraph 27 be reworded in terms of "*the auditor should consider follow up with a second request...*", instead of "*the auditor should follow up with a second request...*". In addition, we do not see a need for including requirements related to considerations with regards to a third request in all cases, as a third request, if considered effective, should be left up to the professional judgement of the auditor and not be regulated.

Question 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 application material in paragraph A21 of ISA 505 if, in investigating exceptions, the auditor identifies a misstatement, the auditor is further required to evaluate whether the misstatement is indicative of fraud. 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 auditing standard 14 is included.

Question 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?

There could be a risk that the proposed auditing standard sets too high expectations in respect of the auditor's procedures and their capabilities in relation to the reliability of confirmation responses.

Paragraph 10 of ISA 505 requires the auditor to 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. Furthermore, only when the auditor determines that a response is not reliable, then paragraph 11 of ISA 505 requires the auditor to evaluate the implications further.

In contrast, paragraph 31 of the proposed standard states *"The auditor should assess the reliability of confirmation responses"* without qualifying this requirement in any similar manner. 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 that represent the auditor's own findings and determinations. A more principles-based approach could therefore be preferable.

Question 21

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

Responses received electronically involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. The main issue is to mitigate the risk of manipulation and fraud which might be, but not necessarily is, greater than with traditionally mailed confirmations.

However, direct contact with the intended confirming party is not necessarily 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).

In addition, confirming the content of a response directly with that party might not be needed in every case where responses are received by facsimile. This is not required in respect of responses received by any other means, and facsimile does not seem to include higher risk in this respect than other sources.

Therefore, we suggest that the introduction of paragraph 34 be revised as follows:

“Confirmation responses received electronically (e.g. by facsimile, e-mail, through an intermediary, or direct access) may involve additional risks relating to reliability. In such circumstances, in addition to the factors identified in paragraph 31, the auditor should take into account risks that the confirmation process might not be secure or might not be properly controlled.”

Also, we do not agree that fax and e-mail procedures (paragraph 35) should include an automatic requirement to be performed in all cases. They should be expressed in terms of *“the auditor shall consider the need to...”*. The alternate formulation would take account of enhanced security of the electronic confirmation process, for example, the use of encryption.

Question 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?

The risks occurring when using an intermediary is dealt with in the third bullet point of paragraph 35 of the proposed auditing standard.

An issue that is not addressed in the proposed auditing standard is the assurance work related to internal controls of intermediaries. If an intermediary is used, assurance could be provided or required to assure the internal controls of the intermediary. Therefore, the PCAOB could add further explanation as to how it foresees that the auditor might review reports by other auditors (e.g., a similar concept to ISAE 3402⁶ or so-called “SAS 70” engagements). In this context the PCAOB could consider how and whether such engagements should be needed and/or performed.

The third bullet point of paragraph 35 could preferably be structured as follows:

- Firstly to address authorisation of the intermediary to respond;
- Secondly to address the auditor’s understanding of appropriate/relevant control processes at the intermediary;
- Thirdly to address the availability of an independent report on the adequacy of those processes; and
- Completion of these processes would facilitate the auditor’s determination to rely or not on the intermediary’s response.

⁶ ISAE 3402, Assurance Reports on Controls at a Service Organization

The current third sentence of the third bullet point deals with risks related to intermediaries. Risks are already addressed in paragraph 34, and the PCAOB is encouraged to consider whether these two paragraphs should be dealt with in the same paragraph or in two paragraphs. In any case, these requirements related to risk could preferably be given a more prominent place in the paragraph.

Question 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?

As discussed in our response to question 23 direct access is a complex issue. In this respect, the PCAOB could consider including requirements for the auditor to seek similar verification of the system to which direct access is provided. For example, consideration of the process by which the auditor is registered for limited period direct access might be relevant.

Question 25

Should direct access be permitted as a confirmation response only if such response is received from a financial institution? Why or why not?

Allowing direct access to be used would require that the third party has systems that can provide reliable and high quality confirmation responses. If this is not the case the auditor needs to assess the risk of receiving information that is not sufficient as audit evidence and then design alternative audit procedures. We would not think that this would depend on whether the entity is a financial institution or not, as both financial institutions as well as other companies in practice can provide information of higher or lesser quality. Instead, this would depend on whether the entity has adequate internal control systems.

Question 27

Are the requirements in the proposed standard related to evaluating the results of confirmation procedures sufficiently clear and appropriate? If not, what changes should the Board make?

The evaluation of results is described in paragraphs 26-39 of the proposed auditing standard. These paragraphs appear to be very comprehensive, leading to a significant amount of substantive work to be carried out by the auditor.

As such, the requirements appear to be rules-based and clearly not developed having the principles-based objective in paragraph 3 of the proposed standard in mind. We would favour a more principles-based approach in line with paragraph 16 and the application material in paragraphs A24-A25 of ISA 505 as this, in our view, would not lead to reliance on responses that may not be as reliable as alternative procedures in some circumstances. We would like to remind the PCAOB that we suggested this approach in our response to the Concept Release in May 2009 and as set out here, we would like to repeat this recommendation as it in our view would be the most appropriate one.

Overall, it is our view that the approach to use professional judgement to a greater extent would lead to higher quality in the audit evidence compared to the time needed to carry out the procedures set out in paragraphs 26-39 of the proposed auditing standard.

For further information on this FEE⁷ letter, please contact 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
FEE 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.