



29 May 2009

Mr. J. Gordon Seymour
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/SH

Dear Mr. Seymour,

Re: FEE Comments on PCAOB Release No. 2009-002, Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations

- (1) FEE is pleased to provide you below with its comments on the Public Company Accounting Oversight Board (PCAOB) Concept Release on Possible Revisions to the PCAOB's Standard on Audit Confirmations (the Concept Release).
- (2) 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 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.
- (3) 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.

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

For over ten years, FEE has been advocating the use of the (clarified) ISAs in the European Union (EU). The worldwide use of the ISAs has steadily expanded over the last few years, making them the global benchmark auditing standards. We support the clarified ISAs, have commented on each of them, and support further convergence.

Therefore, we welcome this Concept Release and 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 both capital market entities and other entities.

In an environment of convergence of accounting standards, the globalisation of auditing standards will facilitate consistency in the auditing of financial statements. The alternative is cumbersome questionnaires covering differences in auditing standards that detract from an efficient and effective audit.

We recognise that, currently, the PCAOB issues standards which differ from those of the International Auditing and Assurance Standards Board (IAASB) because the PCAOB standards need to take into account U.S. securities law and U.S. Securities and Exchange Commission (SEC) and other PCAOB rulemaking on these laws. Additionally, because the PCAOB has chosen an integrated audit approach on both the financial statements and the internal controls of an entity, this leads to differences between the PCAOB auditing standards and the (clarified) ISAs.

However, we believe that it is not conducive to international convergence of auditing standards for the PCAOB to write auditing standards that differ from the (clarified) ISAs at a technical level for other reasons: the (clarified) ISAs are the product of an intensively overseen and thorough due process involving considerable consultation at an international level.

In relation to the Concept Release for a standard on audit confirmations, it is particularly relevant to note the following:

- Although the PCAOB has recently proposed auditing standards related to the auditor's assessment of and response to risk, the many questions in the Concept Release as to whether auditors should be required to perform specific procedures appear to diverge from a risk-based approach;
- This usually encourages a rules-based and mechanical and procedural approach to auditing standards;
- For external audit confirmations, the PCAOB appears to retain its presumptively mandatory requirement for external audit confirmations of accounts receivable, but possibly extending the scope of this presumption. In contrast, the IAASB refers to the risk assessment to determine when external audit confirmation ought to be performed: The auditor is responsible to design and implement overall responses to address the assessed risks of material misstatements at the financial statement level. Therefore,

the auditor designs and performs substantive procedures for each material class of transactions, account balance and disclosure and requesting external audit confirmations as substantive procedures can form part of this;

- This more rules-based approach 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.

It might therefore be useful to emphasise that external audit confirmation should not be conducted routinely for the sake of it and to put additional focus on alternative audit procedures, as adequate responses of third parties to all external audit confirmation can currently not be taken for granted.

Question 1

Should the objective of the confirmation standard be for the auditor to design and perform confirmation procedures to obtain sufficient, competent audit evidence from knowledgeable third parties outside the company in response to identified risks?

As noted above, the PCAOB appears to want to stick to its presumptively mandatory requirement for external audit confirmations. Subsequently, the objective as proposed is worded as one which would lead to a requirement to use confirmations to respond to all relevant identified risks.

We are of the opinion that auditors should be allowed to use professional judgment to determine whether to use external audit confirmations as an audit procedure in an individual engagement. Therefore, we support the objective as that set forth in ISA 505 (Revised and Redrafted): "The objective of the auditor, **when using** external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence."

We invite the PCAOB to reword its objective accordingly.

Question 2

Should the definition of confirmation allow for responses other than traditional mailed responses, such as oral confirmation, facsimile, email, responses processed through third-party service providers, and direct on-line access to information held by a third party? Why or why not?

Yes, we agree that confirmation procedures should be expanded and, in doing so, that the "new" situation facing auditors due to advances in technology which facilitate direct confirmation with a third party needs to be dealt with.

However, one cannot assume that 'other' responses are any more inherently reliable than traditional mailed responses. They may be more unreliable, and there may be less high quality documentation to support them, depending on circumstances.

Question 3

What direction should the standard include regarding the use of electronic confirmations and third-party service providers?

The control objectives relevant to electronic confirmations and third-party service providers are the same as those relevant to more traditional methods; mainly completeness, existence and accuracy, including reliability. The overarching control procedures within the control environment implemented to achieve those objectives are also similar. The differences arise at a lower level.

If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further evidence to resolve those doubts. Responses received electronically, for example, 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.

Reference is made to the requirements in paragraphs 10 and 11 of ISA 505 and the Application Material applicable to these paragraphs, especially A12 and A13.

Question 4

What procedures should the auditor be required to perform to address the risk that the information is not from a proper source and the risk that the integrity of the data has been compromised?

Reference is made to our response to Question 3 and to paragraphs 10 and 11 of ISA 505 and the Application Material applicable to these paragraphs.

Question 5

Should the Board expand the presumptively mandatory requirement to request confirmation of accounts receivable in AU sec. 330 to include confirmation of the significant terms of complex or unusual agreements or transactions, including complex or unusual revenue transactions? Why or why not?

No, the objective ought to be the same as that in ISA 505: to design and perform the confirmation procedures, *when used*, to obtain relevant and reliable audit evidence.

The auditor is responsible for designing and implementing overall responses to address the assessed risks of material misstatements at the financial statement level. Therefore, the auditor designs and performs substantive procedures for each material class of transactions, account balance and disclosure and requesting external audit confirmations as substantive procedures can form part of this.

Including confirmation of significant terms of complex or unusual agreements or transactions are not necessarily associated with heightened risk (as noted on page 11 of the Concept Release).

Reference is also made to paragraph 3 of ISA 505.

Question 6

Should the Board require that the auditor consider confirming other items? If so, which items should be included in this requirement?

No, external audit confirmations should not be required. However, external audit confirmation procedures are *frequently* performed to confirm or request information regarding account balances and their elements. They *may also be used* to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a “side agreement”.

Reference is made to paragraph A1 of ISA 505.

Question 7

Should the Board require the auditor to perform specific procedures when evaluating whether confirmation of accounts receivable would be ineffective? If so, what should those procedures include?

No, as noted above we do not support retention of the extant presumption. In our view, the auditor should assess the relevant risks of material misstatement and design audit procedures accordingly. If the auditor concludes that the confirmation of accounts receivable is likely to be ineffective, the auditor should perform alternative audit procedures to obtain the audit evidence he requires. Specific procedures are not necessary and are likely to enable auditors to hide behind them rather than justify their decisions.

Guidance might be useful in this respect in which it could be explained that the auditor *may*, for accounts receivable balances, be able to examine specific subsequent cash receipts, shipping documentation, and sales near the period-end as such alternative audit procedures, depending on the engagement circumstances. The main point is that the auditor needs, irrespective of the procedures applied, to obtain sufficient appropriate audit evidence.

Question 8

Should the Board include direction in the standard on what constitutes “unusual” or “complex” agreements or transactions, including revenue transactions? If so, what should that direction include?

No, auditors should be allowed to use a risk based approach to unusual or complex agreements, and thus be able to use their judgement to determine what is unusual or complex without direction or requirements in this area.

Question 9

Is additional direction needed with regard to designing confirmation requests and, if so, what direction would be helpful for auditors?

No, although the design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses, the benefit of such standardisation derives from recipients being a homogenous group subject to regulation, for instance financial institutions or insurance companies. This is not the case with recipients of requests for confirmation of accounts receivable.

Guidance would be useful in this respect as provided in paragraph A4 of ISA 505, which includes factors to consider when designing confirmation requests.

Question 10

Should the standard include the requirement for the auditor to test some or all of the addresses of confirming parties to determine whether confirmation requests are directed to the intended recipients? Why or why not?

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 request before they are sent out.

Question 11

What additional direction should the standard include with regard to maintaining control over confirmation requests and responses?

No direction is needed in the form of requirements, although guidance in this respect might be useful. The auditor *may* send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. Reference is made to paragraph A7 of ISA 505.

Question 12

What direction is necessary in the standard regarding maintaining control over confirmations in electronic form?

We believe that any additional direction should be kept to a minimum. ISA 505 does not include requirements related to maintaining control over confirmations in electronic form. However, it includes guidance in paragraph A12 where reference is made to reliability of electronic confirmations because proof of origin and authority of the respondent may be difficult to establish and alterations may be difficult to detect.

Question 13

What changes should be made to the standard regarding the auditor's responsibility for evaluating the reliability of confirmation responses and alternative procedures?

In line with the risk-based approach and the application of professional scepticism, we believe that a general requirement as in paragraph 10 of ISA 505 is useful that, *if* the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts.

Further guidance would be useful in this respect as provided in paragraph A14 of ISA 505, which specifies that the auditor may choose to verify the source and contents of a

response to a confirmation request by electronic mail, the auditor may telephone the confirming party to determine whether the confirming party did, in fact, send the response.

Question 14

When an auditor uses direct on-line access to a third-party database or a third-party service provider, what procedures should the auditor be required to perform to assess that the information included in the third-party database or provided by the third-party service provider is reliable?

Third party service providers and the use of third-party databases are complex areas. It is essential that the auditor be satisfied with the controls over information delivered to the third party provider or database, the controls applied to the data during processing, and the control of information returned to the entity from such third parties. Given this complexity, confirmation provided by such third party service providers and databases might need to be considered as relatively weak, or less reliable audit evidence. Therefore, in such circumstances confirmations might not be the most efficient approach to obtaining audit evidence and alternative procedures may need to be considered.

Question 15

Are there factors other than those mentioned above that the auditor should consider when evaluating the reliability of electronic confirmations? If so, what are they?

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.

Reference is made to our response to Question 2 indicating that the risk of manipulation and fraud might be greater than with traditional mailed confirmations.

Question 16

Should the standard require the auditor to perform alternative procedures for non-responses to positive confirmation requests? Why or why not?

Yes, as per the requirement in paragraph 10 of ISA 505, where no response is received, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.

It is particularly important to include such requirement in a standard on external audit confirmations as a non-response to a confirmation request may indicate a previously unidentified risk of material misstatement as per paragraph A19 of ISA 505. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level, and modify planned audit procedures. For example, fewer responses to confirmation requests than anticipated, or a greater number of responses than anticipated, may indicate a previously unidentified fraud risk factor that requires evaluation.

Question 17

Should the standard require the auditor to investigate exceptions identified as a result of confirmation responses? Why or why not?

Yes, as per the requirement in paragraph 14 of ISA 505, the auditor shall investigate exceptions to determine whether or not they are indicative of misstatements. As per paragraphs A21 and A22 of ISA 505, exceptions noted in responses to confirmation request may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required to evaluate whether such misstatement is indicative of fraud. However, some exceptions do not represent misstatements.

Question 18

Should there be a requirement for the auditor to consider the possibility of previously unidentified risk of material misstatements including previously unidentified fraud risk factors when performing alternative procedures for non-responses and investigating exceptions on confirmation responses? Why or why not?

Yes, reference is made to our responses to Questions 16 and 17.

Question 19

Should the standard include alternative procedures the auditor should perform for non-responses when the auditor is confirming the significant terms of unusual or complex agreements or transactions? What should those alternative procedures include?

Yes, as per the requirement in paragraph 10 of ISA 505, in the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence.

Question 20

Should the standard include procedures for the auditor to perform to address situations in which management requests the auditor not confirm certain accounts, transactions, agreements, or other items? If so, are the procedures listed above the appropriate procedures for the auditor to perform? What other procedures should the auditor perform to address situations in which management requests that the auditor not confirm accounts, transactions, agreements, or other items?

Yes, as per the requirements in paragraphs 8 and 9 of ISA 505, if management refuses to allow the auditor to send a confirmation request, the auditor shall:

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

The auditor uses his professional judgement to determine whether there are valid reasons for management's request or refusal not to confirm.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance. The auditor also shall determine the implications for the audit and the auditor's opinion.

Question 21

Should the auditor be required to perform specific procedures to evaluate the effect of disclaimers and restrictive language on confirmation responses? If so, what specific procedures should an auditor be required to perform in evaluating such disclaimers or restrictive language?

Disclaimers and restrictive language are increasingly common and are understood to be mainly included for legal reasons. Therefore, they should be *addressed* in a standard on external audit confirmations.

The legal validity or otherwise of confirmations may vary depending on the jurisdiction in which the confirmation response was provided. Currently, in some European jurisdictions, disclaimers and restrictive language are considered to impair the value of the evidence provided. However, this might not be the case in other jurisdictions. As explained in paragraph A16 of ISA 505, restrictive language regarding the use of a response to a confirmation does not necessarily invalidate the reliability of the response as audit evidence.

However, the practical effect of a disclaimer or restrictive language in particular circumstances is likely to require a legal analysis that is not within the auditor's competence.

Question 22

Should auditors be allowed to use negative confirmations and, if so, in what circumstances?

Yes, we agree that the use of negative form requests should not be forbidden, although reference is made to paragraph 15 of ISA 505 which specifies that negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless this risk was assessed to be low and determinate preconditions are fulfilled as stated in the final part of paragraph 15 of ISA 505.

Question 23

Should the standard include the requirement that the auditor perform additional substantive procedures when using negative confirmations? Why or why not?

Yes, reference is made to our response to Question 22 and to paragraphs 15 and A23 of ISA 505.



For further information on this 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,

A handwritten signature in black ink, appearing to be 'Hans van Damme', written over a light blue horizontal line. The signature is stylized and includes a large loop at the beginning.

Hans van Damme
FEE President