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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 19b-4

Proposed Rules

By

Public Company Accounting Oversight Board

In accordance with Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of the Proposed Rule

(a) Pursuant to the provisions of Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") is filing with the Securities and Exchange Commission ("SEC" or "Commission") proposed rules, Auditing Standard No. 3, "Audit Documentation," and an amendment to interim auditing standards. The proposed rules consist of an auditing standard, and a related amendment to the interim auditing standards, applicable to engagements conducted pursuant to the standards of the PCAOB, and one appendix and one addendum. The proposed rules are attached as Exhibit A to this rule filing.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Board

(a) The Board approved these proposed rules, and authorized them for filing with the SEC, at its Open Meeting on June 9, 2004. No other action by the Board is necessary for the filing of these proposed rules.

(b) Questions regarding this rule filing may be directed to Gordon Seymour, Deputy General Counsel (202-207-9034; seymourg@pcaobus.org), Kathleen Peters, Assistant General Counsel (202/207-9190; petersk@pcaobus.org), or Greg Scates, Associate Chief Auditor (202-207-9114; scatesg@pcaobus.org).

3. Board's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules

(a) Purpose

Section 103(a)(1) of the Act authorizes the PCAOB to establish, by rule, auditing standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by the Act. PCAOB Rule 3100, "Compliance with Auditing and Related Professional Practice Standards," requires auditors to comply with all applicable auditing and related professional practice standards established by the PCAOB. The Board has adopted as interim standards, on an initial, transitional basis, the generally accepted auditing standards described in the American Institute of Certified Public Accountants' ("AICPA") Auditing Standards Board's Statement on Auditing Standards No. 95, *Generally Accepted Auditing Standards*, as in existence on April 16, 2003 (the "interim standards").

Section 103(a)(2)(A)(i) of the Act expressly directs the Board to establish auditing standards that require registered public accounting firms to prepare, and maintain for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. These proposed rules are the standards referred to in Section 103(a)(2)(A)(i) of the Act.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

4. Board's Statement on Burden on Competition

The Board does not believe that the proposed rules will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the

Act. Pursuant to the Act and PCAOB Rule 3100, auditing and related professional practice standards established by the PCAOB must be complied with by all registered public accounting firms.

5. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed Auditing Standard for public comment on November 21, 2003. See Exhibit 2(a)(A). The Board received 38 written comment letters relating to its proposal. See Exhibits 2(a)(B) and 2(a)(C).

The Board has carefully considered all comments it has received. In response to the written comments received, the Board has clarified and modified certain aspects of the proposed rules. The Board's response to the comments it received and the changes made to the rules in response to these comments are summarized in Exhibit 3 to this filing.

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rules Based on Rules of Another Board or of the Commission

The proposed rules are not based on the rules of another board or of the Commission.

9. Exhibits

- Exhibit A – Text of the Proposed Rules
- Exhibit 1 – Form of Notice of Proposed Rules for Publication in the Federal Register
- Exhibit 2(a)(A) – PCAOB Release No. 2003-023 (November 21, 2003)
- Exhibit 2(a)(B) – Alphabetical List of Comments
- Exhibit 2(a)(C) – Written comments on the rules proposed in PCAOB Release No. 2003-023
- Exhibit 3 – PCAOB Release No. 2004-006 (June 9, 2004)

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

BY: _____
William J. McDonough, Chairman

Date: June 18, 2004

EXHIBIT A —Text of the Proposed Rules

Auditing Standard No. 2 – Audit Documentation

Introduction

1. This standard establishes general requirements for documentation the auditor should prepare and retain in connection with engagements conducted pursuant to the standards of the Public Company Accounting Oversight Board ("PCAOB"). Such engagements include an audit of financial statements, an audit of internal control over financial reporting, and a review of interim financial information. This standard does not replace specific documentation requirements of other standards of the PCAOB.

Objectives of Audit Documentation

2. Audit documentation is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as work papers or working papers.

Note: An auditor's representations to a company's board of directors or audit committee, stockholders, investors, or other interested parties are usually included in the auditor's report accompanying the financial statements of the company. The auditor also might make oral representations to the company or others, either on a voluntary basis or if necessary to comply with professional standards, including in connection with an engagement for which an auditor's report is not issued. For example, although an auditor might not issue a report in connection with an engagement to review interim financial information, he or she ordinarily would make oral representations about the results of the review.

3. Audit documentation is reviewed by members of the engagement team performing the work and might be reviewed by others. Reviewers might include, for example:

- a. Auditors who are new to an engagement and review the prior year's documentation to understand the work performed as an aid in planning and performing the current engagement.

- b. Supervisory personnel who review documentation prepared by assistants on the engagement.
- c. Engagement supervisors and engagement quality reviewers who review documentation to understand how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions.
- d. A successor auditor who reviews a predecessor auditor's audit documentation.
- e. Internal and external inspection teams that review documentation to assess audit quality and compliance with auditing and related professional practice standards; applicable laws, rules, and regulations; and the auditor's own quality control policies.
- f. Others, including advisors engaged by the audit committee or representatives of a party to an acquisition.

Audit Documentation Requirement

4. The auditor must prepare audit documentation in connection with each engagement conducted pursuant to the standards of the PCAOB. Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. Also, the documentation should be appropriately organized to provide a clear link to the significant findings or issues.^{1/} Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files, or other media.

5. Because audit documentation is the written record that provides the support for the representations in the auditor's report, it should:

- a. Demonstrate that the engagement complied with the standards of the PCAOB,
- b. Support the basis for the auditor's conclusions concerning every relevant financial statement assertion, and

^{1/} See paragraph 12 of this standard for a description of significant findings or issues.

- c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.

6. The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.^{2/} Audit documentation must clearly demonstrate that the work was in fact performed. This documentation requirement applies to the work of all those who participate in the engagement as well as to the work of specialists the auditor uses as evidential matter in evaluating relevant financial statement assertions. Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.

Note: An *experienced auditor* has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

7. In determining the nature and extent of the documentation for a financial statement assertion, the auditor should consider the following factors:

- Nature of the auditing procedure;
- Risk of material misstatement associated with the assertion;
- Extent of judgment required in performing the work and evaluating the results, for example, accounting estimates require greater judgment and commensurately more extensive documentation;
- Significance of the evidence obtained to the assertion being tested; and
- Responsibility to document a conclusion not readily determinable from the documentation of the procedures performed or evidence obtained.

^{2/} Relevant financial statement assertions are described in paragraphs 68-70 of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements.*

Application of these factors determines whether the nature and extent of audit documentation is adequate.

8. In addition to the documentation necessary to support the auditor's final conclusions, audit documentation must include information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions. The relevant records to be retained include, but are not limited to, procedures performed in response to the information, and records documenting consultations on, or resolutions of, differences in professional judgment among members of the engagement team or between the engagement team and others consulted.

9. If, after the documentation completion date (defined in paragraph 15), the auditor becomes aware, as a result of a lack of documentation or otherwise, that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must determine, and if so demonstrate, that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. To accomplish this, the auditor must have persuasive other evidence. Oral explanation alone does not constitute persuasive other evidence, but it may be used to clarify other written evidence.

- If the auditor determines and demonstrates that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached, but that documentation thereof is not adequate, then the auditor should consider what additional documentation is needed. In preparing additional documentation, the auditor should refer to paragraph 16.
- If the auditor cannot determine or demonstrate that sufficient procedures were performed, sufficient evidence was obtained, or appropriate conclusions were reached, the auditor should comply with the provisions of AU sec. 390, *Consideration of Omitted Procedures After the Report Date*.

Documentation of Specific Matters

10. Documentation of auditing procedures that involve the inspection of documents or confirmation, including tests of details, tests of operating effectiveness of controls, and walkthroughs, should include identification of the items inspected. Documentation of auditing procedures related to the inspection of significant contracts or agreements should include abstracts or copies of the documents.

Note: The identification of the items inspected may be satisfied by indicating the source from which the items were selected and the specific selection criteria, for example:

- If an audit sample is selected from a population of documents, the documentation should include identifying characteristics (for example, the specific check numbers of the items included in the sample).
- If all items over a specific dollar amount are selected from a population of documents, the documentation need describe only the scope and the identification of the population (for example, all checks over \$10,000 from the October disbursements journal).
- If a systematic sample is selected from a population of documents, the documentation need only provide an identification of the source of the documents and an indication of the starting point and the sampling interval (for example, a systematic sample of sales invoices was selected from the sales journal for the period from October 1 to December 31, starting with invoice number 452 and selecting every 40th invoice).

11. Certain matters, such as auditor independence, staff training and proficiency and client acceptance and retention, may be documented in a central repository for the public accounting firm ("firm") or in the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should include a reference to the central repository. Documentation of matters specific to a particular engagement should be included in the audit documentation of the pertinent engagement.

12. The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached in connection with each engagement. *Significant findings or issues* are substantive matters that are important to the procedures performed, evidence obtained, or conclusions reached, and include, but are not limited to, the following:

- a. Significant matters involving the selection, application, and consistency of accounting principles, including related disclosures. Significant matters include, but are not limited to, accounting for complex or unusual transactions, accounting estimates, and uncertainties as well as related management assumptions.
- b. Results of auditing procedures that indicate a need for significant modification of planned auditing procedures, the existence of material misstatements, omissions in the financial statements, the existence of

significant deficiencies, or material weaknesses in internal control over financial reporting.

- c. Audit adjustments. For purposes of this standard, an *audit adjustment* is a correction of a misstatement of the financial statements that was or should have been proposed by the auditor, whether or not recorded by management, that could, either individually or when aggregated with other misstatements, have a material effect on the company's financial statements.
- d. Disagreements among members of the engagement team or with others consulted on the engagement about final conclusions reached on significant accounting or auditing matters.
- e. Circumstances that cause significant difficulty in applying auditing procedures.
- f. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.
- g. Any matters that could result in modification of the auditor's report.

13. The auditor must identify all significant findings or issues in an *engagement completion document*. This document may include either all information necessary to understand the significant findings, issues or cross-references, as appropriate, to other available supporting audit documentation. This document, along with any documents cross-referenced, should collectively be as specific as necessary in the circumstances for a reviewer to gain a thorough understanding of the significant findings or issues.

Note: The engagement completion document prepared in connection with the annual audit should include documentation of significant findings or issues identified during the review of interim financial information.

Retention of and Subsequent Changes to Audit Documentation

14. The auditor must retain audit documentation for seven years from the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements (*report release date*), unless a longer period of time is required by law. If a report is not issued in connection with an engagement, then the audit documentation must be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the audit documentation must be retained for seven years from the date the engagement ceased.

15. Prior to the report release date, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (documentation completion date). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 45 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased.

16. Circumstances may require additions to audit documentation after the report release date. Audit documentation must not be deleted or discarded after the documentation completion date, however, information may be added. Any documentation added must indicate the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it.

17. Other standards require the auditor to perform procedures subsequent to the report release date in certain circumstances. For example, in accordance with AU sec. 711, *Filings Under Federal Securities Statutes*, auditors are required to perform certain procedures up to the effective date of a registration statement.^{3/} The auditor must identify and document any additions to audit documentation as a result of these procedures consistent with the previous paragraph.

18. The office of the firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the requirements of paragraphs 4-13 of this standard is prepared and retained. Audit documentation supporting the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms), must be retained by or be accessible to the office issuing the auditor's report.^{4/}

19. In addition, the office issuing the auditor's report must obtain, and review and retain, prior to the report release date, the following documentation related to the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms):

^{3/} Section 11 of the Securities Act of 1933 makes specific mention of the auditor's responsibility as an expert when the auditor's report is included in a registration statement under the 1933 Act.

^{4/} Section 106(b) of the Sarbanes-Oxley Act of 2002 imposes certain requirements concerning production of the work papers of a foreign public accounting firm on whose opinion or services the auditor relies. Compliance with this standard does not substitute for compliance with Section 106(b) or any other applicable law.

- a. An engagement completion document consistent with paragraphs 12 and 13.

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

- b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures.
- c. Sufficient information relating to any significant findings or issues that are inconsistent with or contradict the final conclusions, as described in paragraph 8.
- d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.
- e. Sufficient information to enable the office issuing the auditor's report to agree or to reconcile the financial statement amounts audited by the other auditor to the information underlying the consolidated financial statements.
- f. A schedule of audit adjustments, including a description of the nature and cause of each misstatement.
- g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.
- h. Letters of representations from management.
- i. All matters to be communicated to the audit committee.

If the auditor decides to make reference in his or her report to the audit of the other auditor, however, the auditor issuing the report need not perform the procedures in this paragraph and, instead, should refer to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*.

20. The auditor also might be required to maintain documentation in addition to that required by this standard.^{5/}

^{5/} For example, the SEC requires auditors to retain, in addition to documentation required by this standard, memoranda, correspondence, communications (for example, electronic mail), other documents, and records (in the form of paper, electronic, or other media) that are created, sent, or received in connection with an engagement conducted in accordance with auditing and related professional practice standards and that contain conclusions, opinions, analyses, or

Effective Date

21. This standard is effective for audits of financial statements, which may include an audit of internal control over financial reporting, with respect to fiscal years ending on or after [the later of November 15, 2004, or 30 days after the date of approval of this standard by the SEC]. For other engagements conducted pursuant to the standards of the PCAOB, including reviews of interim financial information, this standard takes effect beginning with the first quarter ending after the first financial statement audit covered by this standard.

data related to the engagement. (*Retention of Audit and Review Records*, 17 CFR §210.2-06, effective for audits or reviews completed on or after October 31, 2003.)

APPENDIX ABackground and Basis for Conclusions

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Introduction

A1. This appendix summarizes considerations that the Public Company Accounting Oversight Board ("PCAOB" or "Board") deemed significant in developing this standard. This appendix includes reasons for accepting certain views and rejecting others.

A2. Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act") directs the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. Accordingly, the Board has made audit documentation a priority.

Background

A3. Auditors support the conclusions in their reports with a work product called *audit documentation*, also referred to as *working papers* or *work papers*. Audit documentation supports the basis for the conclusions in the auditor's report. Audit documentation also facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files, or other media.

A4. The Board's standard on audit documentation is one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest. The Board believes that the quality and integrity of an audit depends, in large part, on the existence of a complete and understandable record of the work the auditor performed, the conclusions the auditor reached, and the evidence the auditor obtained that supports those conclusions. Meaningful reviews, whether by the Board in the context of its inspections or through other reviews, such as internal quality control reviews, would be difficult or impossible without adequate documentation. Clear and comprehensive audit documentation is essential to enhance the quality of the audit and, at the same time, to allow the Board to fulfill its mandate to inspect registered public accounting firms to assess the degree of compliance of those firms with applicable standards and laws.

A5. The Board began a standards-development project on audit documentation by convening a public roundtable discussion on September 29, 2003, to discuss issues and hear views on the subject. Participants at the roundtable included representatives from public companies, public accounting firms, investor groups, and regulatory organizations.

A6. Prior to this roundtable discussion, the Board prepared and released a briefing paper on audit documentation that posed several questions to help identify the

objectives – and the appropriate scope and form – of audit documentation. In addition, the Board asked participants to address specific issues in practice relating to, among other things, changes in audit documentation after release of the audit report, essential elements and the appropriate amount of detail of audit documentation, the effect on audit documentation of a principal auditor's decision to use the work of other auditors, and retention of audit documentation. Based on comments made at the roundtable, advice from the Board's staff, and other input the Board received, the Board determined that the pre-existing standard on audit documentation, Statement on Auditing Standards ("SAS") No. 96, *Audit Documentation*, was insufficient for the Board to discharge appropriately its standard-setting obligations under Section 103(a) of the Act. In response, the Board developed and issued for comment, on November 17, 2003, a proposed auditing standard titled, *Audit Documentation*.

A7. The Board received 38 comment letters from a variety of interested parties, including auditors, regulators, professional associations, government agencies, and others. Those comments led to some changes in the requirements of the standard. Also, other changes made the requirements easier to understand. The following sections summarize significant views expressed in those comment letters and the Board's responses to those comments.

Objective of This Standard

A8. The objective of this standard is to improve audit quality and enhance public confidence in the quality of auditing. Good audit documentation improves the quality of the work performed in many ways, including, for example:

- Providing a record of actual work performed, which provides assurance that the auditor accomplishes the planned objectives.
- Facilitating the reviews performed by supervisors, managers, engagement partners, engagement quality reviewers,^{1/} and PCAOB inspectors.
- Improving effectiveness and efficiency by reducing time-consuming, and sometimes inaccurate, oral explanations of what was done (or not done).

^{1/} The engagement quality reviewer is referred to as the concurring partner reviewer in the membership requirements of the AICPA SEC Practice Section. The Board adopted certain of these membership requirements as they existed on April 16, 2003. Some firms also may refer to this designated reviewer as the second partner reviewer.

A9. The documentation requirements in this standard should result in more effective and efficient oversight of registered public accounting firms and associated persons, thereby improving audit quality and enhancing investor confidence.

A10. Inadequate audit documentation diminishes audit quality on many levels. First, if audit documentation does not exist for a particular procedure or conclusion related to a significant matter, it casts doubt as to whether the necessary work was done. If the work was not documented, then it becomes difficult for the engagement team, and others, to know what was done, what conclusions were reached, and how those conclusions were reached. In addition, good audit documentation is very important in an environment in which engagement staff changes or rotates. Due to engagement staff turnover, knowledgeable staff on an engagement may not be available for the next engagement.

Audit Programs

A11. Several commenters suggested that audit documentation should include audit programs. Audit programs were specifically mentioned in SAS No. 96 as a form of audit documentation.

A12. The Board accepted this recommendation, and paragraph 4 in the final standard includes audit programs as an example of documentation. Audit programs may provide evidence of audit planning as well as limited evidence of the execution of audit procedures, but the Board believes that signed-off audit programs should generally not be used as the sole documentation that a procedure was performed, evidence was obtained, or a conclusion was reached. An audit program aids in the conduct and supervision of an engagement, but completed and initialed audit program steps should be supported with proper documentation in the working papers.

Reviewability Standard

A13. The proposed standard would have adapted a standard of reviewability from the U.S. General Accounting Office's ("GAO") documentation standard for government and other audits conducted in accordance with generally accepted government auditing standards ("GAGAS"). The GAO standard provides that "Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions."^{2/} This requirement has been important in the

^{2/} U.S. General Accounting Office, *Government Auditing Standards*, "Field Work Standards for Financial Audits" (2003 Revision), paragraph 4.22.

field of government auditing because government audits have long been reviewed by GAO auditors who, although experienced in auditing, do not participate in the actual audits. Moreover, the Panel on Audit Effectiveness recommended that sufficient, specific requirements for audit documentation be established to enable public accounting firms' internal inspection teams as well as others, including reviewers outside of the firms, to assess the quality of engagement performance.^{3/} Audits and reviews of issuers' financial statements will now, under the Act, be subject to review by PCAOB inspectors. Therefore, a documentation standard that enables an inspector to understand the work that was performed in an audit or review is appropriate.

A14. Accordingly, the Board's proposed standard would have required that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, the name of the person(s) who performed it, the date it was completed, and the conclusions reached. This experienced auditor also should have been able to determine who reviewed the work and the date of such review.

A15. Some commenters suggested that the final standard more specifically describe the qualifications of an experienced auditor. These commenters took the position that only an engagement partner with significant years of experience would have the experience necessary to be able to understand all the work that was performed and the conclusions that were reached. One commenter suggested that an auditor who is reviewing audit documentation should have experience and knowledge consistent with the experience and knowledge that the auditor performing the audit would be required to possess, including knowledge of the current accounting, auditing, and financial reporting issues of the company's industry. Another said that the characteristics defining an experienced auditor should be consistent with those expected of the auditor with final responsibility for the engagement.

A16. After considering these comments, the Board has provided additional specificity about the meaning of the term, *experienced auditor*. The standard now describes an experienced auditor as one who has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

A17. Some commenters also suggested that the standard, as proposed, did not allow for the use of professional judgment. These commenters pointed to the omission of a statement about professional judgment found in paragraph 4.23 of GAGAS that states,

^{3/} Panel on Audit Effectiveness, *Report and Recommendations* (Stamford, Ct: Public Oversight Board, August 31, 2000).

"The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment." A nearly identical statement was found in the interim auditing standard, SAS No. 96, *Audit Documentation*.

A18. Auditors exercise professional judgment in nearly every aspect of planning, performing, and reporting on an audit. Auditors also exercise professional judgment in the documentation of an audit and other engagements. An objective of this standard is to ensure that auditors give proper consideration to the need to document procedures performed, evidence obtained, and conclusions reached in light of time and cost considerations in completing an engagement.

A19. Nothing in the standard precludes auditors from exercising their professional judgment. Moreover, because professional judgment might relate to any aspect of an audit, the Board does not believe that an explicit reference to professional judgment is necessary every time the use of professional judgment may be appropriate.

Audit Documentation Must Demonstrate That the Work was Done

A20. A guiding principle of the proposed standard was that auditors must document procedures performed, evidence obtained, and conclusions reached. This principle is not new and was found in the interim standard, SAS No. 96, *Audit Documentation*, which this standard supersedes. Audit documentation also should demonstrate compliance with the standards of the PCAOB and include justification for any departures.

A21. The proposed standard would have adapted a provision in the California Business and Professions Code which provides that if documentation does not exist, then there is a rebuttable presumption that the work had not been done.

A22. The objections to this proposal fell into two general categories: the effect of the rebuttable presumption on legal proceedings and the perceived impracticality of documenting every conversation or conclusion that affected the engagement. Discussion of these issues follows.

Rebuttable Presumption

A23. Commenters expressed concern about the effects of the proposed language on regulatory or legal proceedings outside the context of the PCAOB's oversight. They argued that the rebuttable presumption might be understood to establish evidentiary rules for use in judicial and administrative proceedings in other jurisdictions.

A24. Some commenters also had concerns that oral explanation alone would not constitute persuasive other evidence that work was done, absent any documentation. Those commenters argued that not allowing oral explanations when there was no documentation would essentially make the presumption "irrebuttable." Moreover, those commenters argued that it was inappropriate for a professional standard to predetermine for a court the relative value of evidence.

A25. The Board believes that complete audit documentation is necessary for a quality audit or other engagement. The Board intends the standard to require auditors to document procedures performed, evidence obtained, and conclusions reached to improve the quality of audits. The Board also intends that a deficiency in documentation is a departure from the Board's standards. Thus, although the Board removed the phrase *rebuttable presumption*, the Board continues to stress, in paragraph 9 of the standard, that the auditor must have persuasive other evidence that the procedures were performed, evidence was obtained, and appropriate conclusions were reached with respect to relevant financial statement assertions.

A26. The term *should* (presumptively mandatory responsibility) was changed to *must* (unconditional responsibility) in paragraph 6 to establish a higher threshold for the auditor. Auditors have an unconditional requirement to document their work. Failure to discharge an unconditional responsibility is a violation of the standard and Rule 3100, which requires all registered public accounting firms to adhere to the Board's auditing and related professional practice standards in connection with an audit or review of an issuer's financial statements.

A27. The Board also added two new paragraphs to the final standard to explain the importance and associated responsibility of performing the work and adequately documenting all work that was performed. Paragraph 7 provides a list of factors the auditor should consider in determining the nature and extent of documentation. These factors should be considered by both the auditor in preparing the documentation and the reviewer in evaluating the documentation.

A28. In paragraph 9 of this standard, if, after the documentation completion date, as a result of a lack of documentation or otherwise, it appears that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must determine, and if so demonstrate, that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. In those circumstances, for example, during an inspection by the Board or during the firm's internal quality control review, the auditor is required to demonstrate with persuasive other evidence that the procedures were performed, the evidence was obtained, and appropriate conclusions were reached. In

this and similar contexts, oral explanation alone does not constitute persuasive other evidence. However, oral evidence may be used to clarify other written evidence.

A29. In addition, more reliable, objective evidence may be required depending on the nature of the test and the objective the auditor is trying to achieve. For example, if there is a high risk of a material misstatement with respect to a particular assertion, then the auditor should obtain and document sufficient procedures for the auditor to conclude on the fairness of the assertion.

Impracticality

A30. Some commenters expressed concern that the proposed standard could be construed or interpreted to require the auditor to document every conversation held with company management or among the engagement team members. Some commenters also argued that they should not be required to document every conclusion, including preliminary conclusions that were part of a thought process that may have led them to a different conclusion, on the ground that this would result in needless and costly work performed by the auditor. Commenters also expressed concern that an unqualified requirement to document procedures performed, evidence obtained, and conclusions reached without allowing the use of auditor judgment would increase the volume of documentation but not the quality. They stated that it would be unnecessary, time-consuming, and potentially counterproductive to require the auditor to make a written record of everything he or she did.

A31. The Board's standard distinguishes between (1) an audit procedure that must be documented and (2) a conversation with company management or among the members of the engagement team. Inquiries with management should be documented when an inquiry is important to a particular procedure. The inquiry could take place during planning, performance, or reporting. The auditor need not document each conversation that occurred.

A32. A final conclusion is an integral part of a working paper, unless the working paper is only for informational purposes, such as documentation of a discussion or a process. This standard does not require that the auditor document each interim conclusion reached in arriving at the risk assessments or final conclusions. Conclusions reached early on during an audit may be based on incomplete information or an incorrect understanding. Nevertheless, auditors should document a final conclusion for every audit procedure performed, if that conclusion is not readily apparent based on documented results of the procedures.

A33. The Board also believes the reference to *specialists* is an important element of paragraph 6. Specialists play a vital role in audit engagements. For example,

appraisers, actuaries, and environmental consultants provide valuable data concerning asset values, calculation assumptions, and loss reserves. When using the work of a specialist, the auditor must ensure that the specialist's work, as it relates to the audit objectives, also is adequately documented. For example, if the auditor relies on the work of an appraiser in obtaining the fair value of commercial property available for sale, then the auditor must ensure the appraisal report is adequately documented. Moreover, the term *specialist* in this standard is intended to include any specialist the auditor relies on in conducting the work, including those employed or retained by the auditor or by the company.

Audit Adjustments

A34. Several commenters recommended that the definition of *audit adjustments* in this proposed standard should be consistent with the definition contained in AU sec. 380, *Communication with Audit Committees*.

A35. Although the Board recognizes potential benefits of having a uniform definition of the term *audit adjustments*, the Board does not believe that the definition in AU sec. 380 is appropriate for this documentation standard because that definition was intended for communication with audit committees. The Board believes that the definition should be broader so that the engagement partner, engagement quality reviewer, and others can be aware of all proposed corrections of misstatements, whether or not recorded by the entity, of which the auditor is aware, that were or should have been proposed based on the audit evidence.

A36. Adjustments that should have been proposed based on known audit evidence are material misstatements that the auditor identified but did not propose to management. Examples include situations in which (1) the auditor identifies a material error but does not propose an adjustment and (2) the auditor proposes an adjustment in the working papers, but fails to note the adjustment in the summary or schedule of proposed adjustments.

Information That Is Inconsistent with or Contradicts the Auditor's Final Conclusions

A37. Paragraph .25 of AU sec. 326, *Evidential Matter*, states: "In developing his or her opinion, the auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements." Thus, during the conduct of an audit, the auditor should consider all relevant evidential matter even though it might contradict or be inconsistent with other conclusions. Audit documentation must contain information or data relating to significant findings or issues that are inconsistent with the auditor's final conclusions on the relevant matter.

A38. Also, information that initially appears to be inconsistent or contradictory, but is found to be incorrect or based on incomplete information, need not be included in the final audit documentation, provided that the apparent inconsistencies or contradictions were satisfactorily resolved by obtaining complete and correct information. In addition, with respect to differences in professional judgment, auditors need not include in audit documentation preliminary views based on incomplete information or data.

Retention of Audit Documentation

A39. The proposed standard would have required an auditor to retain audit documentation for seven years after completion of the engagement, which is the minimum period permitted under Section 103(a)(2)(A)(i) of the Act. In addition, the proposed standard would have added a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after the auditor's report is released. Such reasonable period of time should not exceed 45 days.

A40. In general, those commenting on this documentation retention requirement did not have concerns with the time period of 45 days to assemble the working papers. However, some commenters suggested the Board tie this 45-day requirement to the filing date of the company's financial statements with the SEC. One commenter recommended that the standard refer to the same trigger date for initiating both the time period during which the auditor should complete work paper assembly and the beginning of the seven-year retention period.

A41. For consistency and practical implications, the Board agreed that the standard should have the same date for the auditor to start assembling the audit documentation and initiating the seven-year retention period. The Board decided that the seven-year retention period begins on the *report release date*, which is defined as the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. In addition, auditors will have 45 days to assemble the complete and final set of audit documentation, beginning on the report release date. The Board believes that using the report release date is preferable to using the filing date of the company's financial statements, since the auditor has ultimate control over granting permission to use his or her report. If an auditor's report is not issued, then the audit documentation is to be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the seven-year period begins when the work on the engagement ceased.

Section 802 of Sarbanes-Oxley and the SEC's Implementing Rule

A42. Many commenters had concerns about the similarity in language between the proposed standard and the SEC final rule (issued in January 2003) on record retention, *Retention of Records Relevant to Audits and Reviews*.^{4/} Some commenters recommended that the PCAOB undertake a project to identify and resolve all differences between the proposed standard and the SEC's final rule. These commenters also suggested that the Board include similar language from the SEC final rule, Rule 2-06 of Regulation S-X, which limits the requirement to retain some items.

Differences between Section 802 and This Standard

A43. The objective of the Board's standard is different from the objective of the SEC's rule on record retention. The objective of the Board's standard is to require auditors to *create* certain documentation to enhance the quality of audit documentation, thereby improving the quality of audits and other related engagements. The records retention section of this standard, mandated by Section 103 of the Act, requires registered public accounting firms to "prepare and maintain for a period of not less than 7 years, *audit work papers, and other information related to any audit report*, in sufficient detail to support the conclusions reached in such report." (emphasis added)

A44. In contrast, the focus of the SEC rule is to require auditors to *retain* documents that the auditor does create, in order that those documents will be available in the event of a regulatory investigation or other proceeding. As stated in the release accompanying the SEC's final rule (SEC Release No. 33-8180):

Section 802 of the Sarbanes-Oxley Act is intended to address the destruction or fabrication of evidence and the preservation of "financial and audit records." We are directed under that section to promulgate rules related to the retention of records relevant to the audits and reviews of financial statements that companies file with the Commission.

A45. The SEC release further states, "New rule 2-06 ... addresses the retention of documents relevant to enforcement of the securities laws, Commission rules, and criminal laws."

A46. Despite their different objectives, the proposed standard and SEC Rule 2-06 use similar language in describing documentation generated during an audit or review. Paragraph 4 of the proposed standard stated that, "Audit documentation ordinarily consists of *memoranda, correspondence, schedules, and other documents created or obtained in connection with* the engagement and may be in the form of paper, electronic

^{4/} SEC Regulation S-X, 17 C.F.R. § 210.2-06 (SEC Release No. 33-8180, January 2003). (The final rule was effective in March 2003.)

files, or other media." Paragraph (a) of SEC Rule 2-06 describes "records relevant to the audit or review" that must be retained as, (1) "workpapers and other documents that form the basis of the audit or review and (2) memoranda, correspondence, communications, other documents, and records (including electronic records), which: [a]re created, sent or received in connection with the audit or review and [c]ontain conclusions, opinions, analyses, or financial data related to the audit or review. ..." (numbering and emphasis added).

A47. The SEC makes a distinction between the objectives of categories (1) and (2). Category (1) includes audit documentation. Documentation to be retained according to the Board's standard clearly falls within category (1). Items in category (2) include "desk files" which are more than "what traditionally has been thought of as auditor's 'workpapers'." The SEC's rule requiring auditors to retain items in category (2) have the principal purpose of facilitating enforcement of securities laws, SEC rules, and criminal laws. This is not an objective of the Board's standard. According to SEC Rule 2-06, items in category (2) are limited to those which: (a) are created, sent or received in connection with the audit or review, and (b) contain conclusions, opinions, analyses, or financial data related to the audit or review. The limitations, (a) and (b), do not apply to category (1).

A48. Paragraph 4 of the final standard deletes the reference in the proposed standard to "other documents created or obtained in connection with the engagement." The Board decided to keep "correspondence" in the standard because correspondence can be valid audit evidence. Paragraph 20 of the standard reminds the auditor that he or she may be required to maintain documentation in addition to that required by this standard.

Significant Matters and Significant Findings or Issues

A49. Some commenters asked how the term *significant matters*, in Rule 2-06, relates to the term *significant findings or issues* in the Board's standard. The SEC's release accompanying its final Rule 2-06 states that "... *significant matters* is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer. ..." This is very similar to the term *significant findings or issues* contained in paragraph 12 of the Board's standard which requires auditors to document *significant findings or issues*, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. Examples of significant findings or issues are provided in the standard.

A50. Based on the explanation in the SEC's final rule and accompanying release, the Board believes that *significant matters* are included in the meaning of *significant findings or issues* in the Board's standard. The Board is of the view that *significant*

findings or issues is more comprehensive and provides more clarity than significant matters and, therefore, has not changed the wording in the final standard.

Changes to Audit Documentation

A51. The proposed standard would have required that any changes to the working papers after completion of the engagement be documented without deleting or discarding the original documents. Such documentation must indicate the date the information was added, by whom it was added, and the reason for adding it.

A52. One commenter recommended that the Board provide examples of auditing procedures that should be performed before the report release date and procedures that may be performed after the report release date. Some commenters also requested clarification about the treatment of changes to documentation that occurred after the completion of the engagement but before the report release date. Many commenters recommended that the Board more specifically describe post-issuance procedures. The Board generally agreed with these comments.

A53. The final standard includes two important dates for the preparation of audit documentation: (1) the report release date and (2) the documentation completion date.

- Prior to the report release date, the auditor must have completed all necessary auditing procedures, including clearing review notes and providing support for all final conclusions. In addition, the auditor must have obtained sufficient evidence to support the representations in the auditor's reports before the report release date.
- After the report release date and prior to the documentation completion date, the auditor has 45 calendar days in which to assemble the documentation.

A54. During the audit, audit documentation may be superseded for various reasons. Often, during the review process, reviewers annotate the documentation with clarifications, questions, and edits. The completion process often involves revising the documentation electronically and generating a new copy. The SEC's final rule on record retention, *Retention of Records Relevant to Audits and Reviews*,^{5/} explains that the SEC rule does not require that the following documents generally need to be retained: superseded drafts of memoranda, financial statements or regulatory filings; notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking; previous copies of workpapers that have been

^{5/} See footnote 4.

corrected for typographical errors or errors due to training of new employees; and duplicates of documents. This standard also does not require auditors to retain such documents as a general matter.

A55. Any documents, however, that reflect information that is either inconsistent with or contradictory to the conclusions contained in the final working papers may not be discarded. Any documents added must indicate the date they were added, the name of the person who prepared them, and the reason for adding them.

A56. If the auditor obtains and documents evidence after the report release date, the auditor should refer to the interim auditing standards, AU sec. 390, *Consideration of Omitted Procedures After the Report Date* and AU sec. 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*. Auditors should not discard any previously existing documentation in connection with obtaining and documenting evidence after the report release date.

A57. The auditor may perform certain procedures subsequent to the report release date. For example, pursuant to AU sec. 711, *Filings Under Federal Securities Statutes*, auditors are required to perform certain procedures up to the effective date of a registration statement. The auditor should identify and document any additions to audit documentation as a result of these procedures. No audit documentation should be discarded after the documentation completion date, even if it is superseded in connection with any procedures performed, including those performed pursuant to AU sec. 711.

A58. Additions to the working papers may take the form of memoranda that explain the work performed, evidence obtained, and conclusions reached. Documentation added to the working papers must indicate the date the information was added, the name of the person adding it, and the reason for adding it. All previous working papers must remain intact and not be discarded.

A59. Documentation added to the working papers well after completion of the audit or other engagement is likely to be of a lesser quality than that produced contemporaneously when the procedures were performed. It is very difficult to reconstruct activities months, and perhaps years, after the work was actually performed. The turnover of both firm and company staff can cause difficulty in reconstructing conversations, meetings, data, or other evidence. Also, with the passage of time memories fade. Oral explanation can help confirm that procedures were performed during an audit, but oral explanation alone does not constitute persuasive other evidence. The primary source of evidence should be documented at the time the procedures are performed, and oral explanation should not be the primary source of evidence. Furthermore, any oral explanation should not contradict the documented

evidence, and appropriate consideration should be given to the credibility of the individual providing the oral explanation.

Multi-Location Audits and Using the Work of Other Auditors

A60. The proposed standard would have required the principal auditor to maintain specific audit documentation when he or she decided not to make reference to the work of another auditor.

A61. The Board also proposed an amendment to AU sec. 543 concurrently with the proposed audit documentation standard. The proposed amendment would have required the principal auditor to review the documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed.

A62. Commenters expressed concerns that these proposals could present conflicts with certain non-U.S. laws. Those commenters also expressed concern about the costs associated with the requirement for the other auditor to ship their audit documentation to the principal auditor. In addition, the commenters also objected to the requirement that principal auditors review the work of other auditors as if they were the principal auditor's staff.

Audit Documentation Must be Accessible to the Office Issuing the Auditor's Report

A63. After considering these comments, the Board decided that it could achieve one of the objectives of the proposed standard (that is, to require that the issuing office have access to those working papers on which it placed reliance) without requiring that the working papers be shipped to the issuing office. Further, given the potential difficulties of shipping audit documentation from various non-U.S. locations, the Board decided to modify the proposed standard to require that audit documentation either be retained by or be accessible to the issuing office.

A64. In addition, instead of requiring that all of the working papers be shipped to the issuing office, the Board decided to require that the issuing office obtain, review, and retain certain summary documentation. Thus, the public accounting firm issuing an audit report on consolidated financial statements of a multinational company may not release that report without the documentation described in paragraph 19 of the standard.

A65. The auditor must obtain and review and retain, prior to the report release date, documentation described in paragraph 19 of the standard, in connection with work performed by other offices of the public accounting firm or other auditors, including

affiliated or non-affiliated firms, that participated in the audit. For example, an auditor that uses the work of another of its offices or other affiliated or non-affiliated public accounting firms to audit a subsidiary that is material to a company's consolidated financial statements must obtain the documentation described in paragraph 19 of the standard, prior to the report release date. On the other hand, an auditor that uses the work of another of its offices or other affiliated or non-affiliated firms, to perform selected procedures, such as observing the physical inventories of a company, may not be required to obtain the documentation specified in paragraph 19 of the standard. However, this does not reduce the need for the auditor to obtain equivalent documentation prepared by the other auditor when those instances described in paragraph 19 of the standard are applicable.

Amendment to AU Sec. 543, *Part of Audit Performed by Other Independent Auditors*

A66. Some commenters also objected to the proposed requirement in the amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, that the principal auditor review another auditor's audit documentation. They objected because they were of the opinion such a review would impose an unnecessary cost and burden given that the other auditor will have already reviewed the documentation in accordance with the standards established by the principal auditor. The commenters also indicated that any review by the principal auditor would add excessive time to the SEC reporting process, causing even more difficulties as the SEC Form 10-K reporting deadlines have become shorter recently and will continue to shorten next year.

A67. The Board accepted the recommendation to modify the proposed amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*. Thus, in the final amendment, the Board imposes the same unconditional responsibility on the principal auditor to obtain certain audit documentation from the other auditor prior to the report release date. The final amendment also provides that the principal auditor should consider performing one or more of the following procedures:

- Visit the other auditors and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditors. In some cases, it may be appropriate to issue instructions to the other auditors as to the scope of the audit work.
- Review additional audit documentation of the other auditors relating to significant findings or issues in the engagement completion document.

Effective Date

A68. The Board proposed that the standard and related amendment would be effective for engagements completed on or after June 15, 2004. Many commenters were concerned that the effective date was too early. They pointed out that some audits, already begun as of the proposed effective date, would be affected and that it could be difficult to retroactively apply the standard. Some commenters also recommended delaying the effective date to give auditors adequate time to develop and implement processes and provide training with respect to several aspects of the standard.

A69. After considering the comments, the Board has delayed the effective date. However, the Board also believes that a delay beyond 2004 is not in the public interest.

A70. The Board concluded that the implementation date of this standard should coincide with that of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, because of the documentation issues prevalent in PCAOB Auditing Standard No. 2. Therefore, the Board has decided that the standard will be effective for audits of financial statements with respect to fiscal years ending on or after [the later of November 15, 2004, or 30 days after the date of approval of this standard by the SEC]. The effective date for reviews of interim financial information and other engagements, conducted pursuant to the standards of the PCAOB, would occur beginning with the first quarter ending after the first financial statement audit covered by this standard.

Reference to Audit Documentation As the Property of the Auditor

A71. Several commenters noted that SAS No. 96, *Audit Documentation*, the interim auditing standard on audit documentation, referred to audit documentation as the property of the auditor. This was not included in the proposed standard because the Board did not believe ascribing property rights would have furthered this standard's purpose to enhance the quality of audit documentation.

Confidential Client Information

A72. SAS No. 96, *Audit Documentation*, also stated that, "the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information," and referenced Rule 301, *Confidential Client Information*, of the AICPA's Code of Professional Conduct. Again, the Board's proposed standard on audit documentation did not include this provision. In adopting certain interim standards and rules as of April 16, 2003, the Board did not adopt Rule 301 of the AICPA's Code of Professional Conduct. In this standard on audit documentation, the Board seeks neither

to establish confidentiality standards nor to modify or detract from any existing applicable confidentiality requirements.

ADDENDUM

This addendum is not a part of PCAOB Auditing Standard No. 3.

Additional Documentation Requirements of SEC Rule 2-06

B1. Auditors should be aware of the additional record retention requirements in SEC Rule 2-06 of Regulation S-X ("Rule 2-06"). The Board is providing additional information below to remind auditors of the SEC requirements. This addendum is not an interpretation of Rule 2-06. Instead, this addendum provides excerpts from the SEC release accompanying the final rule which provides the SEC's interpretation of the rule's requirements, particularly paragraphs (a) and (c) of Rule 2-06.

B2. Paragraph (a) of Rule 2-06 requires that:

... the accountant shall retain ... memoranda, correspondence, communications, other documents, and records (including electronic records) which:

(1) Are created, sent or received in connection with the audit or review, and

(2) Contain conclusions, opinions, analyses, or financial data related to the audit or review.

B3. Paragraph (c) of Rule 2-06 states:

Memoranda, correspondence, communications, other documents, and records (including electronic records) described in paragraph (a) of this section shall be retained whether they support the auditor's final conclusions regarding the audit or review, or contain information or data relating to a significant matter, that is inconsistent with the auditor's final conclusions regarding that matter or the audit or review. Significance of a matter shall be determined based on an objective analysis of the facts and circumstances. Such documents and records include, but are not limited to, those documenting a consultation on or resolution of differences in professional judgment.

Other Statements by the SEC

B4. In the excerpt below, from the SEC's release accompanying its final Rule 2-06, the SEC discusses documents that generally are not required to be retained under Rule 2-06.

In the Proposing Release, we stated that non-substantive materials that are not part of the workpapers, such as administrative records, and other documents that do not contain relevant financial data or the auditor's conclusions, opinions or analyses would not meet the second of the criteria in rule 2-06(a) and would not have to be retained. Commentators questioned whether the following documents would be considered substantive and have to be retained:

- Superseded drafts of memoranda, financial statements or regulatory filings,
- Notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking,
- Previous copies of workpapers that have been corrected for typographical errors or errors due to training of new employees,
- Duplicates of documents, or
- Voice-mail messages.

These records generally would not fall within the scope of new rule 2-06 provided they do not contain information or data, relating to a significant matter that is inconsistent with the auditor's final conclusions, opinions or analyses on that matter or the audit or review. For example, rule 2-06 would require the retention of an item in this list if that item documented a consultation or resolution of differences of professional judgment.

B5. The excerpt below, from the SEC's release accompanying its final Rule 2-06, provides further explanation about documents to be retained under Rule 2-06:

In consideration of the comments received, we have revised paragraph (c) of the rule. We have removed the phrase "cast doubt" to reduce the possibility that the rule mistakenly would be interpreted to reach

typographical errors, trivial or "fleeting" matters, or errors due to "on-the-job" training. We continue to believe, however, that records that either support or contain significant information that is inconsistent with the auditor's final conclusions would be relevant to an investigation of possible violations of the securities laws, Commission rules, or criminal laws and should be retained. Paragraph (c), therefore, now provides that the materials described in paragraph (a) shall be retained whether they support the auditor's final conclusions or contain information or data, relating to a significant matter that is inconsistent with the final conclusions of the auditor on that matter or on the audit or review. Paragraph (c) also states that the documents and records to be retained include, but are not limited to, those documenting consultations on or resolutions of differences in professional judgment.

The reference in paragraph (c) to "significant" matters is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer or registered investment company. Rule 2-06(c) requires that the documentation of such matters, once prepared, must be retained even if it does not "support" the auditor's final conclusions, because it may be relevant to an investigation. Similarly, the retention of records regarding a consultation about, and resolution of, differences in professional judgment would be relevant to such an investigation and must be retained. We intend for Rule 2-06 to be incremental to, and not to supersede or otherwise affect, any other legal or procedural requirement related to the retention of records or potential evidence in a legal, administrative, disciplinary, or regulatory proceeding.

Finally, we recognize that audits and reviews of financial statements are interactive processes and views within an accounting firm on accounting, auditing or disclosure issues may evolve as new information or data comes to light during the audit or review. We do not view "differences in professional judgment" within subparagraph (c) to include such changes in preliminary views when those preliminary views are based on what is recognized to be incomplete information or data.

Amendment to Interim Auditing Standards

AU sec. 543.12 is amended as follows:

When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in AU sec. 543.10, the principal auditor must obtain, and review and retain, the following information from the other auditor:

- a. An engagement completion document consistent with paragraphs 12 and 13 of PCAOB Auditing Standard No. 3

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

- b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures.
- c. Sufficient information relating to significant findings or issues that are inconsistent with or contradict the auditor's final conclusions, as described in paragraph 8 of PCAOB Auditing Standard No. 3.
- d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.
- e. Sufficient information to enable the office issuing the auditor's report to agree or reconcile the financial statement amounts audited by the other firm to the information underlying the consolidated financial statements.
- f. A schedule of audit adjustments, including a description of the nature and cause of each misstatement.
- g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.
- h. Letters of representations from management.
- i. All matters to be communicated to the audit committee.

The principal auditor must obtain, and review and retain, such documents prior to the report release date.^{1/} In addition, the principal auditor should consider performing one or more of the following procedures:

- Visit the other auditor and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditor. In some cases, it may be appropriate to issue instructions to the other auditor as to the scope of the audit work.
- Review additional audit documentation of the other auditor relating to significant findings or issues in the engagement completion document.

^{1/} As it relates to the direction in paragraph .19 of AU sec. 324, for the auditor to "give consideration to the guidance in section 543.12," the auditor need not, in this circumstance, obtain the previously enumerated documents.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. PCAOB-2004-05)

[Date]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule on Auditing Standard No. 3, *Audit Documentation*, and an amendment to interim auditing standards.

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on June 18, 2004, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") the proposed rules described in Items I, II, and III below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On June 9, 2004, the Board adopted Auditing Standard No. 3, *Audit Documentation*, and an amendment to interim auditing standards ("the proposed rules").

The text of the proposed rules is as follows:

Auditing Standard No. 2 – *Audit Documentation*

Introduction

1. This standard establishes general requirements for documentation the auditor should prepare and retain in connection with engagements conducted pursuant to the standards of the Public Company Accounting Oversight Board ("PCAOB"). Such engagements include an audit of financial statements, an audit of internal control over financial reporting, and a review of interim financial information. This standard does not replace specific documentation requirements of other standards of the PCAOB.

Objectives of Audit Documentation

2. *Audit documentation* is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

Note: An auditor's representations to a company's board of directors or audit committee, stockholders, investors, or other interested parties are usually included in the auditor's report accompanying the financial statements of the company. The auditor also might make oral representations to the company or others, either on a voluntary basis or if necessary to comply with professional standards, including in connection with an engagement for which an auditor's report is not issued. For example, although an auditor might not issue a report in connection with an engagement to review interim financial information, he or she ordinarily would make oral representations about the results of the review.

3. Audit documentation is reviewed by members of the engagement team performing the work and might be reviewed by others. Reviewers might include, for example:

- a. Auditors who are new to an engagement and review the prior year's documentation to understand the work performed as an aid in planning and performing the current engagement.
- b. Supervisory personnel who review documentation prepared by assistants on the engagement.
- c. Engagement supervisors and engagement quality reviewers who review documentation to understand how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions.
- d. A successor auditor who reviews a predecessor auditor's audit documentation.
- e. Internal and external inspection teams that review documentation to assess audit quality and compliance with auditing and related professional

practice standards; applicable laws, rules, and regulations; and the auditor's own quality control policies.

- f. Others, including advisors engaged by the audit committee or representatives of a party to an acquisition.

Audit Documentation Requirement

4. The auditor must prepare audit documentation in connection with each engagement conducted pursuant to the standards of the PCAOB. Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. Also, the documentation should be appropriately organized to provide a clear link to the significant findings or issues.^{1/} Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files, or other media.

5. Because audit documentation is the written record that provides the support for the representations in the auditor's report, it should:

- a. Demonstrate that the engagement complied with the standards of the PCAOB,
- b. Support the basis for the auditor's conclusions concerning every relevant financial statement assertion, and
- c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.

6. The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.^{2/} Audit documentation must clearly demonstrate that the work was in fact performed. This documentation requirement applies to the work of all those who participate in the engagement as well as to the work of specialists the auditor uses as evidential matter in evaluating relevant financial statement assertions. Audit documentation must contain

^{1/} See paragraph 12 of this standard for a description of significant findings or issues.

^{2/} *Relevant financial statement assertions* are described in paragraphs 68-70 of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*.

sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.

Note: An *experienced auditor* has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

7. In determining the nature and extent of the documentation for a financial statement assertion, the auditor should consider the following factors:

- Nature of the auditing procedure;
- Risk of material misstatement associated with the assertion;
- Extent of judgment required in performing the work and evaluating the results, for example, accounting estimates require greater judgment and commensurately more extensive documentation;
- Significance of the evidence obtained to the assertion being tested; and
- Responsibility to document a conclusion not readily determinable from the documentation of the procedures performed or evidence obtained.

Application of these factors determines whether the nature and extent of audit documentation is adequate.

8. In addition to the documentation necessary to support the auditor's final conclusions, audit documentation must include information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions. The relevant records to be retained include, but are not limited to, procedures performed in response to the information, and records documenting consultations on, or resolutions of, differences in professional judgment among members of the engagement team or between the engagement team and others consulted.

9. If, after the documentation completion date (defined in paragraph 15), the auditor becomes aware, as a result of a lack of documentation or otherwise, that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must determine, and if so demonstrate, that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. To accomplish this, the auditor must have persuasive other evidence. Oral explanation alone does not constitute persuasive other evidence, but it may be used to clarify other written evidence.

- If the auditor determines and demonstrates that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached, but that documentation thereof is not adequate, then the auditor should consider what additional documentation is needed. In preparing additional documentation, the auditor should refer to paragraph 16.
- If the auditor cannot determine or demonstrate that sufficient procedures were performed, sufficient evidence was obtained, or appropriate conclusions were reached, the auditor should comply with the provisions of AU sec. 390, *Consideration of Omitted Procedures After the Report Date*.

Documentation of Specific Matters

10. Documentation of auditing procedures that involve the inspection of documents or confirmation, including tests of details, tests of operating effectiveness of controls, and walkthroughs, should include identification of the items inspected. Documentation of auditing procedures related to the inspection of significant contracts or agreements should include abstracts or copies of the documents.

Note: The identification of the items inspected may be satisfied by indicating the source from which the items were selected and the specific selection criteria, for example:

- If an audit sample is selected from a population of documents, the documentation should include identifying characteristics (for example, the specific check numbers of the items included in the sample).
- If all items over a specific dollar amount are selected from a population of documents, the documentation need describe only the scope and the identification of the population (for example, all checks over \$10,000 from the October disbursements journal).

- If a systematic sample is selected from a population of documents, the documentation need only provide an identification of the source of the documents and an indication of the starting point and the sampling interval (for example, a systematic sample of sales invoices was selected from the sales journal for the period from October 1 to December 31, starting with invoice number 452 and selecting every 40th invoice).

11. Certain matters, such as auditor independence, staff training and proficiency and client acceptance and retention, may be documented in a central repository for the public accounting firm ("firm") or in the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should include a reference to the central repository. Documentation of matters specific to a particular engagement should be included in the audit documentation of the pertinent engagement.

12. The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached in connection with each engagement. *Significant findings or issues* are substantive matters that are important to the procedures performed, evidence obtained, or conclusions reached, and include, but are not limited to, the following:

- a. Significant matters involving the selection, application, and consistency of accounting principles, including related disclosures. Significant matters include, but are not limited to, accounting for complex or unusual transactions, accounting estimates, and uncertainties as well as related management assumptions.
- b. Results of auditing procedures that indicate a need for significant modification of planned auditing procedures, the existence of material misstatements, omissions in the financial statements, the existence of significant deficiencies, or material weaknesses in internal control over financial reporting.
- c. Audit adjustments. For purposes of this standard, an *audit adjustment* is a correction of a misstatement of the financial statements that was or should have been proposed by the auditor, whether or not recorded by management, that could, either individually or when aggregated with other misstatements, have a material effect on the company's financial statements.

- d. Disagreements among members of the engagement team or with others consulted on the engagement about final conclusions reached on significant accounting or auditing matters.
- e. Circumstances that cause significant difficulty in applying auditing procedures.
- f. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.
- g. Any matters that could result in modification of the auditor's report.

13. The auditor must identify all significant findings or issues in an *engagement completion document*. This document may include either all information necessary to understand the significant findings, issues or cross-references, as appropriate, to other available supporting audit documentation. This document, along with any documents cross-referenced, should collectively be as specific as necessary in the circumstances for a reviewer to gain a thorough understanding of the significant findings or issues.

Note: The engagement completion document prepared in connection with the annual audit should include documentation of significant findings or issues identified during the review of interim financial information.

Retention of and Subsequent Changes to Audit Documentation

14. The auditor must retain audit documentation for seven years from the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements (*report release date*), unless a longer period of time is required by law. If a report is not issued in connection with an engagement, then the audit documentation must be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the audit documentation must be retained for seven years from the date the engagement ceased.

15. Prior to the report release date, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (*documentation completion date*). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 45 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased.

16. Circumstances may require additions to audit documentation after the report release date. Audit documentation must not be deleted or discarded after the documentation completion date, however, information may be added. Any documentation added must indicate the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it.

17. Other standards require the auditor to perform procedures subsequent to the report release date in certain circumstances. For example, in accordance with AU sec. 711, *Filings Under Federal Securities Statutes*, auditors are required to perform certain procedures up to the effective date of a registration statement.^{3/} The auditor must identify and document any additions to audit documentation as a result of these procedures consistent with the previous paragraph.

18. The office of the firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the requirements of paragraphs 4-13 of this standard is prepared and retained. Audit documentation supporting the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms), must be retained by or be accessible to the office issuing the auditor's report.^{4/}

19. In addition, the office issuing the auditor's report must obtain, and review and retain, prior to the report release date, the following documentation related to the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms):

- a. An engagement completion document consistent with paragraphs 12 and 13.

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

- b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures.

^{3/} Section 11 of the Securities Act of 1933 makes specific mention of the auditor's responsibility as an expert when the auditor's report is included in a registration statement under the 1933 Act.

^{4/} Section 106(b) of the Sarbanes-Oxley Act of 2002 imposes certain requirements concerning production of the work papers of a foreign public accounting firm on whose opinion or services the auditor relies. Compliance with this standard does not substitute for compliance with Section 106(b) or any other applicable law.

- c. Sufficient information relating to any significant findings or issues that are inconsistent with or contradict the final conclusions, as described in paragraph 8.
- d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.
- e. Sufficient information to enable the office issuing the auditor's report to agree or to reconcile the financial statement amounts audited by the other auditor to the information underlying the consolidated financial statements.
- f. A schedule of audit adjustments, including a description of the nature and cause of each misstatement.
- g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.
- h. Letters of representations from management.
- i. All matters to be communicated to the audit committee.

If the auditor decides to make reference in his or her report to the audit of the other auditor, however, the auditor issuing the report need not perform the procedures in this paragraph and, instead, should refer to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*.

20. The auditor also might be required to maintain documentation in addition to that required by this standard.^{5/}

Effective Date

21. This standard is effective for audits of financial statements, which may include an audit of internal control over financial reporting, with respect to fiscal years ending on or after [the later of November 15, 2004, or 30 days after the date of approval of this

^{5/} For example, the SEC requires auditors to retain, in addition to documentation required by this standard, memoranda, correspondence, communications (for example, electronic mail), other documents, and records (in the form of paper, electronic, or other media) that are created, sent, or received in connection with an engagement conducted in accordance with auditing and related professional practice standards and that contain conclusions, opinions, analyses, or data related to the engagement. (*Retention of Audit and Review Records*, 17 CFR §210.2-06, effective for audits or reviews completed on or after October 31, 2003.)

standard by the SEC]. For other engagements conducted pursuant to the standards of the PCAOB, including reviews of interim financial information, this standard takes effect beginning with the first quarter ending after the first financial statement audit covered by this standard.

APPENDIX A

Background and Basis for Conclusions

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Introduction

A1. This appendix summarizes considerations that the Public Company Accounting Oversight Board ("PCAOB" or "Board") deemed significant in developing this standard. This appendix includes reasons for accepting certain views and rejecting others.

A2. Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act") directs the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. Accordingly, the Board has made audit documentation a priority.

Background

A3. Auditors support the conclusions in their reports with a work product called *audit documentation*, also referred to as *working papers* or *work papers*. Audit documentation supports the basis for the conclusions in the auditor's report. Audit documentation also facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files, or other media.

A4. The Board's standard on audit documentation is one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest. The Board believes that the quality and integrity of an audit depends, in large part, on the existence of a complete and understandable record of the work the auditor performed, the conclusions the auditor reached, and the evidence the auditor obtained that supports those conclusions. Meaningful reviews, whether by the Board in the context of its inspections or through other reviews, such as internal quality control reviews, would be difficult or impossible without adequate documentation. Clear and comprehensive audit documentation is essential to enhance the quality of the audit and, at the same time, to allow the Board to fulfill its mandate to inspect registered public accounting firms to assess the degree of compliance of those firms with applicable standards and laws.

A5. The Board began a standards-development project on audit documentation by convening a public roundtable discussion on September 29, 2003, to discuss issues and hear views on the subject. Participants at the roundtable included representatives from public companies, public accounting firms, investor groups, and regulatory organizations.

A6. Prior to this roundtable discussion, the Board prepared and released a briefing paper on audit documentation that posed several questions to help identify the

objectives – and the appropriate scope and form – of audit documentation. In addition, the Board asked participants to address specific issues in practice relating to, among other things, changes in audit documentation after release of the audit report, essential elements and the appropriate amount of detail of audit documentation, the effect on audit documentation of a principal auditor's decision to use the work of other auditors, and retention of audit documentation. Based on comments made at the roundtable, advice from the Board's staff, and other input the Board received, the Board determined that the pre-existing standard on audit documentation, Statement on Auditing Standards ("SAS") No. 96, *Audit Documentation*, was insufficient for the Board to discharge appropriately its standard-setting obligations under Section 103(a) of the Act. In response, the Board developed and issued for comment, on November 17, 2003, a proposed auditing standard titled, *Audit Documentation*.

A7. The Board received 38 comment letters from a variety of interested parties, including auditors, regulators, professional associations, government agencies, and others. Those comments led to some changes in the requirements of the standard. Also, other changes made the requirements easier to understand. The following sections summarize significant views expressed in those comment letters and the Board's responses to those comments.

Objective of This Standard

A8. The objective of this standard is to improve audit quality and enhance public confidence in the quality of auditing. Good audit documentation improves the quality of the work performed in many ways, including, for example:

- Providing a record of actual work performed, which provides assurance that the auditor accomplishes the planned objectives.
- Facilitating the reviews performed by supervisors, managers, engagement partners, engagement quality reviewers,^{1/} and PCAOB inspectors.
- Improving effectiveness and efficiency by reducing time-consuming, and sometimes inaccurate, oral explanations of what was done (or not done).

^{1/} The engagement quality reviewer is referred to as the concurring partner reviewer in the membership requirements of the AICPA SEC Practice Section. The Board adopted certain of these membership requirements as they existed on April 16, 2003. Some firms also may refer to this designated reviewer as the second partner reviewer.

A9. The documentation requirements in this standard should result in more effective and efficient oversight of registered public accounting firms and associated persons, thereby improving audit quality and enhancing investor confidence.

A10. Inadequate audit documentation diminishes audit quality on many levels. First, if audit documentation does not exist for a particular procedure or conclusion related to a significant matter, it casts doubt as to whether the necessary work was done. If the work was not documented, then it becomes difficult for the engagement team, and others, to know what was done, what conclusions were reached, and how those conclusions were reached. In addition, good audit documentation is very important in an environment in which engagement staff changes or rotates. Due to engagement staff turnover, knowledgeable staff on an engagement may not be available for the next engagement.

Audit Programs

A11. Several commenters suggested that audit documentation should include audit programs. Audit programs were specifically mentioned in SAS No. 96 as a form of audit documentation.

A12. The Board accepted this recommendation, and paragraph 4 in the final standard includes audit programs as an example of documentation. Audit programs may provide evidence of audit planning as well as limited evidence of the execution of audit procedures, but the Board believes that signed-off audit programs should generally not be used as the sole documentation that a procedure was performed, evidence was obtained, or a conclusion was reached. An audit program aids in the conduct and supervision of an engagement, but completed and initialed audit program steps should be supported with proper documentation in the working papers.

Reviewability Standard

A13. The proposed standard would have adapted a standard of reviewability from the U.S. General Accounting Office's ("GAO") documentation standard for government and other audits conducted in accordance with generally accepted government auditing standards ("GAGAS"). The GAO standard provides that "Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions."^{2/} This requirement has been important in the

^{2/} U.S. General Accounting Office, *Government Auditing Standards*, "Field Work Standards for Financial Audits" (2003 Revision), paragraph 4.22.

field of government auditing because government audits have long been reviewed by GAO auditors who, although experienced in auditing, do not participate in the actual audits. Moreover, the Panel on Audit Effectiveness recommended that sufficient, specific requirements for audit documentation be established to enable public accounting firms' internal inspection teams as well as others, including reviewers outside of the firms, to assess the quality of engagement performance.^{3/} Audits and reviews of issuers' financial statements will now, under the Act, be subject to review by PCAOB inspectors. Therefore, a documentation standard that enables an inspector to understand the work that was performed in an audit or review is appropriate.

A14. Accordingly, the Board's proposed standard would have required that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, the name of the person(s) who performed it, the date it was completed, and the conclusions reached. This experienced auditor also should have been able to determine who reviewed the work and the date of such review.

A15. Some commenters suggested that the final standard more specifically describe the qualifications of an experienced auditor. These commenters took the position that only an engagement partner with significant years of experience would have the experience necessary to be able to understand all the work that was performed and the conclusions that were reached. One commenter suggested that an auditor who is reviewing audit documentation should have experience and knowledge consistent with the experience and knowledge that the auditor performing the audit would be required to possess, including knowledge of the current accounting, auditing, and financial reporting issues of the company's industry. Another said that the characteristics defining an experienced auditor should be consistent with those expected of the auditor with final responsibility for the engagement.

A16. After considering these comments, the Board has provided additional specificity about the meaning of the term, *experienced auditor*. The standard now describes an experienced auditor as one who has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

A17. Some commenters also suggested that the standard, as proposed, did not allow for the use of professional judgment. These commenters pointed to the omission of a statement about professional judgment found in paragraph 4.23 of GAGAS that states,

^{3/} Panel on Audit Effectiveness, *Report and Recommendations* (Stamford, Ct: Public Oversight Board, August 31, 2000).

"The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment." A nearly identical statement was found in the interim auditing standard, SAS No. 96, *Audit Documentation*.

A18. Auditors exercise professional judgment in nearly every aspect of planning, performing, and reporting on an audit. Auditors also exercise professional judgment in the documentation of an audit and other engagements. An objective of this standard is to ensure that auditors give proper consideration to the need to document procedures performed, evidence obtained, and conclusions reached in light of time and cost considerations in completing an engagement.

A19. Nothing in the standard precludes auditors from exercising their professional judgment. Moreover, because professional judgment might relate to any aspect of an audit, the Board does not believe that an explicit reference to professional judgment is necessary every time the use of professional judgment may be appropriate.

Audit Documentation Must Demonstrate That the Work was Done

A20. A guiding principle of the proposed standard was that auditors must document procedures performed, evidence obtained, and conclusions reached. This principle is not new and was found in the interim standard, SAS No. 96, *Audit Documentation*, which this standard supersedes. Audit documentation also should demonstrate compliance with the standards of the PCAOB and include justification for any departures.

A21. The proposed standard would have adapted a provision in the California Business and Professions Code which provides that if documentation does not exist, then there is a rebuttable presumption that the work had not been done.

A22. The objections to this proposal fell into two general categories: the effect of the rebuttable presumption on legal proceedings and the perceived impracticality of documenting every conversation or conclusion that affected the engagement. Discussion of these issues follows.

Rebuttable Presumption

A23. Commenters expressed concern about the effects of the proposed language on regulatory or legal proceedings outside the context of the PCAOB's oversight. They argued that the rebuttable presumption might be understood to establish evidentiary rules for use in judicial and administrative proceedings in other jurisdictions.

A24. Some commenters also had concerns that oral explanation alone would not constitute persuasive other evidence that work was done, absent any documentation. Those commenters argued that not allowing oral explanations when there was no documentation would essentially make the presumption "irrebuttable." Moreover, those commenters argued that it was inappropriate for a professional standard to predetermine for a court the relative value of evidence.

A25. The Board believes that complete audit documentation is necessary for a quality audit or other engagement. The Board intends the standard to require auditors to document procedures performed, evidence obtained, and conclusions reached to improve the quality of audits. The Board also intends that a deficiency in documentation is a departure from the Board's standards. Thus, although the Board removed the phrase *rebuttable presumption*, the Board continues to stress, in paragraph 9 of the standard, that the auditor must have persuasive other evidence that the procedures were performed, evidence was obtained, and appropriate conclusions were reached with respect to relevant financial statement assertions.

A26. The term *should* (presumptively mandatory responsibility) was changed to *must* (unconditional responsibility) in paragraph 6 to establish a higher threshold for the auditor. Auditors have an unconditional requirement to document their work. Failure to discharge an unconditional responsibility is a violation of the standard and Rule 3100, which requires all registered public accounting firms to adhere to the Board's auditing and related professional practice standards in connection with an audit or review of an issuer's financial statements.

A27. The Board also added two new paragraphs to the final standard to explain the importance and associated responsibility of performing the work and adequately documenting all work that was performed. Paragraph 7 provides a list of factors the auditor should consider in determining the nature and extent of documentation. These factors should be considered by both the auditor in preparing the documentation and the reviewer in evaluating the documentation.

A28. In paragraph 9 of this standard, if, after the documentation completion date, as a result of a lack of documentation or otherwise, it appears that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must determine, and if so demonstrate, that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. In those circumstances, for example, during an inspection by the Board or during the firm's internal quality control review, the auditor is required to demonstrate with persuasive other evidence that the procedures were performed, the evidence was obtained, and appropriate conclusions were reached. In

this and similar contexts, oral explanation alone does not constitute persuasive other evidence. However, oral evidence may be used to clarify other written evidence.

A29. In addition, more reliable, objective evidence may be required depending on the nature of the test and the objective the auditor is trying to achieve. For example, if there is a high risk of a material misstatement with respect to a particular assertion, then the auditor should obtain and document sufficient procedures for the auditor to conclude on the fairness of the assertion.

Impracticality

A30. Some commenters expressed concern that the proposed standard could be construed or interpreted to require the auditor to document every conversation held with company management or among the engagement team members. Some commenters also argued that they should not be required to document every conclusion, including preliminary conclusions that were part of a thought process that may have led them to a different conclusion, on the ground that this would result in needless and costly work performed by the auditor. Commenters also expressed concern that an unqualified requirement to document procedures performed, evidence obtained, and conclusions reached without allowing the use of auditor judgment would increase the volume of documentation but not the quality. They stated that it would be unnecessary, time-consuming, and potentially counterproductive to require the auditor to make a written record of everything he or she did.

A31. The Board's standard distinguishes between (1) an audit procedure that must be documented and (2) a conversation with company management or among the members of the engagement team. Inquiries with management should be documented when an inquiry is important to a particular procedure. The inquiry could take place during planning, performance, or reporting. The auditor need not document each conversation that occurred.

A32. A final conclusion is an integral part of a working paper, unless the working paper is only for informational purposes, such as documentation of a discussion or a process. This standard does not require that the auditor document each interim conclusion reached in arriving at the risk assessments or final conclusions. Conclusions reached early on during an audit may be based on incomplete information or an incorrect understanding. Nevertheless, auditors should document a final conclusion for every audit procedure performed, if that conclusion is not readily apparent based on documented results of the procedures.

A33. The Board also believes the reference to *specialists* is an important element of paragraph 6. Specialists play a vital role in audit engagements. For example,

appraisers, actuaries, and environmental consultants provide valuable data concerning asset values, calculation assumptions, and loss reserves. When using the work of a specialist, the auditor must ensure that the specialist's work, as it relates to the audit objectives, also is adequately documented. For example, if the auditor relies on the work of an appraiser in obtaining the fair value of commercial property available for sale, then the auditor must ensure the appraisal report is adequately documented. Moreover, the term *specialist* in this standard is intended to include any specialist the auditor relies on in conducting the work, including those employed or retained by the auditor or by the company.

Audit Adjustments

A34. Several commenters recommended that the definition of *audit adjustments* in this proposed standard should be consistent with the definition contained in AU sec. 380, *Communication with Audit Committees*.

A35. Although the Board recognizes potential benefits of having a uniform definition of the term *audit adjustments*, the Board does not believe that the definition in AU sec. 380 is appropriate for this documentation standard because that definition was intended for communication with audit committees. The Board believes that the definition should be broader so that the engagement partner, engagement quality reviewer, and others can be aware of all proposed corrections of misstatements, whether or not recorded by the entity, of which the auditor is aware, that were or should have been proposed based on the audit evidence.

A36. Adjustments that should have been proposed based on known audit evidence are material misstatements that the auditor identified but did not propose to management. Examples include situations in which (1) the auditor identifies a material error but does not propose an adjustment and (2) the auditor proposes an adjustment in the working papers, but fails to note the adjustment in the summary or schedule of proposed adjustments.

Information That Is Inconsistent with or Contradicts the Auditor's Final Conclusions

A37. Paragraph .25 of AU sec. 326, *Evidential Matter*, states: "In developing his or her opinion, the auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements." Thus, during the conduct of an audit, the auditor should consider all relevant evidential matter even though it might contradict or be inconsistent with other conclusions. Audit documentation must contain information or data relating to significant findings or issues that are inconsistent with the auditor's final conclusions on the relevant matter.

A38. Also, information that initially appears to be inconsistent or contradictory, but is found to be incorrect or based on incomplete information, need not be included in the final audit documentation, provided that the apparent inconsistencies or contradictions were satisfactorily resolved by obtaining complete and correct information. In addition, with respect to differences in professional judgment, auditors need not include in audit documentation preliminary views based on incomplete information or data.

Retention of Audit Documentation

A39. The proposed standard would have required an auditor to retain audit documentation for seven years after completion of the engagement, which is the minimum period permitted under Section 103(a)(2)(A)(i) of the Act. In addition, the proposed standard would have added a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after the auditor's report is released. Such reasonable period of time should not exceed 45 days.

A40. In general, those commenting on this documentation retention requirement did not have concerns with the time period of 45 days to assemble the working papers. However, some commenters suggested the Board tie this 45-day requirement to the filing date of the company's financial statements with the SEC. One commenter recommended that the standard refer to the same trigger date for initiating both the time period during which the auditor should complete work paper assembly and the beginning of the seven-year retention period.

A41. For consistency and practical implications, the Board agreed that the standard should have the same date for the auditor to start assembling the audit documentation and initiating the seven-year retention period. The Board decided that the seven-year retention period begins on the *report release date*, which is defined as the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. In addition, auditors will have 45 days to assemble the complete and final set of audit documentation, beginning on the report release date. The Board believes that using the report release date is preferable to using the filing date of the company's financial statements, since the auditor has ultimate control over granting permission to use his or her report. If an auditor's report is not issued, then the audit documentation is to be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the seven-year period begins when the work on the engagement ceased.

Section 802 of Sarbanes-Oxley and the SEC's Implementing Rule

A42. Many commenters had concerns about the similarity in language between the proposed standard and the SEC final rule (issued in January 2003) on record retention, *Retention of Records Relevant to Audits and Reviews*.^{4/} Some commenters recommended that the PCAOB undertake a project to identify and resolve all differences between the proposed standard and the SEC's final rule. These commenters also suggested that the Board include similar language from the SEC final rule, Rule 2-06 of Regulation S-X, which limits the requirement to retain some items.

Differences between Section 802 and This Standard

A43. The objective of the Board's standard is different from the objective of the SEC's rule on record retention. The objective of the Board's standard is to require auditors to *create* certain documentation to enhance the quality of audit documentation, thereby improving the quality of audits and other related engagements. The records retention section of this standard, mandated by Section 103 of the Act, requires registered public accounting firms to "prepare and maintain for a period of not less than 7 years, *audit work papers, and other information related to any audit report*, in sufficient detail to support the conclusions reached in such report." (emphasis added)

A44. In contrast, the focus of the SEC rule is to require auditors to *retain* documents that the auditor does create, in order that those documents will be available in the event of a regulatory investigation or other proceeding. As stated in the release accompanying the SEC's final rule (SEC Release No. 33-8180):

Section 802 of the Sarbanes-Oxley Act is intended to address the destruction or fabrication of evidence and the preservation of "financial and audit records." We are directed under that section to promulgate rules related to the retention of records relevant to the audits and reviews of financial statements that companies file with the Commission.

A45. The SEC release further states, "New rule 2-06 ... addresses the retention of documents relevant to enforcement of the securities laws, Commission rules, and criminal laws."

A46. Despite their different objectives, the proposed standard and SEC Rule 2-06 use similar language in describing documentation generated during an audit or review. Paragraph 4 of the proposed standard stated that, "Audit documentation ordinarily consists of *memoranda, correspondence, schedules, and other documents created or obtained in connection with* the engagement and may be in the form of paper, electronic

^{4/} SEC Regulation S-X, 17 C.F.R. § 210.2-06 (SEC Release No. 33-8180, January 2003). (The final rule was effective in March 2003.)

files, or other media." Paragraph (a) of SEC Rule 2-06 describes "records relevant to the audit or review" that must be retained as, (1) "workpapers and other documents that form the basis of the audit or review and (2) *memoranda, correspondence, communications, other documents*, and records (including electronic records), which: [a]re *created, sent or received in connection with* the audit or review and [c]ontain conclusions, opinions, analyses, or financial data related to the audit or review. ..." (numbering and emphasis added).

A47. The SEC makes a distinction between the objectives of categories (1) and (2). Category (1) includes audit documentation. Documentation to be retained according to the Board's standard clearly falls within category (1). Items in category (2) include "desk files" which are more than "what traditionally has been thought of as auditor's 'workpapers'." The SEC's rule requiring auditors to retain items in category (2) have the principal purpose of facilitating enforcement of securities laws, SEC rules, and criminal laws. This is not an objective of the Board's standard. According to SEC Rule 2-06, items in category (2) are limited to those which: (a) are created, sent or received in connection with the audit or review, and (b) contain conclusions, opinions, analyses, or financial data related to the audit or review. The limitations, (a) and (b), do not apply to category (1).

A48. Paragraph 4 of the final standard deletes the reference in the proposed standard to "other documents created or obtained in connection with the engagement." The Board decided to keep "correspondence" in the standard because correspondence can be valid audit evidence. Paragraph 20 of the standard reminds the auditor that he or she may be required to maintain documentation in addition to that required by this standard.

Significant Matters and Significant Findings or Issues

A49. Some commenters asked how the term *significant matters*, in Rule 2-06, relates to the term *significant findings or issues* in the Board's standard. The SEC's release accompanying its final Rule 2-06 states that "... *significant matters* is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer. ..." This is very similar to the term *significant findings or issues* contained in paragraph 12 of the Board's standard which requires auditors to document *significant findings or issues*, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. Examples of significant findings or issues are provided in the standard.

A50. Based on the explanation in the SEC's final rule and accompanying release, the Board believes that *significant matters* are included in the meaning of *significant findings or issues* in the Board's standard. The Board is of the view that *significant*

findings or issues is more comprehensive and provides more clarity than *significant matters* and, therefore, has not changed the wording in the final standard.

Changes to Audit Documentation

A51. The proposed standard would have required that any changes to the working papers after completion of the engagement be documented without deleting or discarding the original documents. Such documentation must indicate the date the information was added, by whom it was added, and the reason for adding it.

A52. One commenter recommended that the Board provide examples of auditing procedures that should be performed before the report release date and procedures that may be performed after the report release date. Some commenters also requested clarification about the treatment of changes to documentation that occurred after the completion of the engagement but before the report release date. Many commenters recommended that the Board more specifically describe post-issuance procedures. The Board generally agreed with these comments.

A53. The final standard includes two important dates for the preparation of audit documentation: (1) the report release date and (2) the documentation completion date.

- Prior to the report release date, the auditor must have completed all necessary auditing procedures, including clearing review notes and providing support for all final conclusions. In addition, the auditor must have obtained sufficient evidence to support the representations in the auditor's reports before the report release date.
- After the report release date and prior to the documentation completion date, the auditor has 45 calendar days in which to assemble the documentation.

A54. During the audit, audit documentation may be superseded for various reasons. Often, during the review process, reviewers annotate the documentation with clarifications, questions, and edits. The completion process often involves revising the documentation electronically and generating a new copy. The SEC's final rule on record retention, *Retention of Records Relevant to Audits and Reviews*,^{5/} explains that the SEC rule does not require that the following documents generally need to be retained: superseded drafts of memoranda, financial statements or regulatory filings; notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking; previous copies of workpapers that have been

^{5/} See footnote 4.

corrected for typographical errors or errors due to training of new employees; and duplicates of documents. This standard also does not require auditors to retain such documents as a general matter.

A55. Any documents, however, that reflect information that is either inconsistent with or contradictory to the conclusions contained in the final working papers may not be discarded. Any documents added must indicate the date they were added, the name of the person who prepared them, and the reason for adding them.

A56. If the auditor obtains and documents evidence after the report release date, the auditor should refer to the interim auditing standards, AU sec. 390, *Consideration of Omitted Procedures After the Report Date* and AU sec. 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*. Auditors should not discard any previously existing documentation in connection with obtaining and documenting evidence after the report release date.

A57. The auditor may perform certain procedures subsequent to the report release date. For example, pursuant to AU sec. 711, *Filings Under Federal Securities Statutes*, auditors are required to perform certain procedures up to the effective date of a registration statement. The auditor should identify and document any additions to audit documentation as a result of these procedures. No audit documentation should be discarded after the documentation completion date, even if it is superseded in connection with any procedures performed, including those performed pursuant to AU sec. 711.

A58. Additions to the working papers may take the form of memoranda that explain the work performed, evidence obtained, and conclusions reached. Documentation added to the working papers must indicate the date the information was added, the name of the person adding it, and the reason for adding it. All previous working papers must remain intact and not be discarded.

A59. Documentation added to the working papers well after completion of the audit or other engagement is likely to be of a lesser quality than that produced contemporaneously when the procedures were performed. It is very difficult to reconstruct activities months, and perhaps years, after the work was actually performed. The turnover of both firm and company staff can cause difficulty in reconstructing conversations, meetings, data, or other evidence. Also, with the passage of time memories fade. Oral explanation can help confirm that procedures were performed during an audit, but oral explanation alone does not constitute persuasive other evidence. The primary source of evidence should be documented at the time the procedures are performed, and oral explanation should not be the primary source of evidence. Furthermore, any oral explanation should not contradict the documented

evidence, and appropriate consideration should be given to the credibility of the individual providing the oral explanation.

Multi-Location Audits and Using the Work of Other Auditors

A60. The proposed standard would have required the principal auditor to maintain specific audit documentation when he or she decided not to make reference to the work of another auditor.

A61. The Board also proposed an amendment to AU sec. 543 concurrently with the proposed audit documentation standard. The proposed amendment would have required the principal auditor to review the documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed.

A62. Commenters expressed concerns that these proposals could present conflicts with certain non-U.S. laws. Those commenters also expressed concern about the costs associated with the requirement for the other auditor to ship their audit documentation to the principal auditor. In addition, the commenters also objected to the requirement that principal auditors review the work of other auditors as if they were the principal auditor's staff.

Audit Documentation Must be Accessible to the Office Issuing the Auditor's Report

A63. After considering these comments, the Board decided that it could achieve one of the objectives of the proposed standard (that is, to require that the issuing office have access to those working papers on which it placed reliance) without requiring that the working papers be shipped to the issuing office. Further, given the potential difficulties of shipping audit documentation from various non-U.S. locations, the Board decided to modify the proposed standard to require that audit documentation either be retained by or be accessible to the issuing office.

A64. In addition, instead of requiring that all of the working papers be shipped to the issuing office, the Board decided to require that the issuing office obtain, review, and retain certain summary documentation. Thus, the public accounting firm issuing an audit report on consolidated financial statements of a multinational company may not release that report without the documentation described in paragraph 19 of the standard.

A65. The auditor must obtain and review and retain, prior to the report release date, documentation described in paragraph 19 of the standard, in connection with work performed by other offices of the public accounting firm or other auditors, including

affiliated or non-affiliated firms, that participated in the audit. For example, an auditor that uses the work of another of its offices or other affiliated or non-affiliated public accounting firms to audit a subsidiary that is material to a company's consolidated financial statements must obtain the documentation described in paragraph 19 of the standard, prior to the report release date. On the other hand, an auditor that uses the work of another of its offices or other affiliated or non-affiliated firms, to perform selected procedures, such as observing the physical inventories of a company, may not be required to obtain the documentation specified in paragraph 19 of the standard. However, this does not reduce the need for the auditor to obtain equivalent documentation prepared by the other auditor when those instances described in paragraph 19 of the standard are applicable.

Amendment to AU Sec. 543, Part of Audit Performed by Other Independent Auditors

A66. Some commenters also objected to the proposed requirement in the amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, that the principal auditor review another auditor's audit documentation. They objected because they were of the opinion such a review would impose an unnecessary cost and burden given that the other auditor will have already reviewed the documentation in accordance with the standards established by the principal auditor. The commenters also indicated that any review by the principal auditor would add excessive time to the SEC reporting process, causing even more difficulties as the SEC Form 10-K reporting deadlines have become shorter recently and will continue to shorten next year.

A67. The Board accepted the recommendation to modify the proposed amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*. Thus, in the final amendment, the Board imposes the same unconditional responsibility on the principal auditor to obtain certain audit documentation from the other auditor prior to the report release date. The final amendment also provides that the principal auditor should consider performing one or more of the following procedures:

- Visit the other auditors and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditors. In some cases, it may be appropriate to issue instructions to the other auditors as to the scope of the audit work.
- Review additional audit documentation of the other auditors relating to significant findings or issues in the engagement completion document.

Effective Date

A68. The Board proposed that the standard and related amendment would be effective for engagements completed on or after June 15, 2004. Many commenters were concerned that the effective date was too early. They pointed out that some audits, already begun as of the proposed effective date, would be affected and that it could be difficult to retroactively apply the standard. Some commenters also recommended delaying the effective date to give auditors adequate time to develop and implement processes and provide training with respect to several aspects of the standard.

A69. After considering the comments, the Board has delayed the effective date. However, the Board also believes that a delay beyond 2004 is not in the public interest.

A70. The Board concluded that the implementation date of this standard should coincide with that of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, because of the documentation issues prevalent in PCAOB Auditing Standard No. 2. Therefore, the Board has decided that the standard will be effective for audits of financial statements with respect to fiscal years ending on or after [the later of November 15, 2004, or 30 days after the date of approval of this standard by the SEC]. The effective date for reviews of interim financial information and other engagements, conducted pursuant to the standards of the PCAOB, would occur beginning with the first quarter ending after the first financial statement audit covered by this standard.

Reference to Audit Documentation As the Property of the Auditor

A71. Several commenters noted that SAS No. 96, *Audit Documentation*, the interim auditing standard on audit documentation, referred to audit documentation as the property of the auditor. This was not included in the proposed standard because the Board did not believe ascribing property rights would have furthered this standard's purpose to enhance the quality of audit documentation.

Confidential Client Information

A72. SAS No. 96, *Audit Documentation*, also stated that, "the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information," and referenced Rule 301, *Confidential Client Information*, of the AICPA's Code of Professional Conduct. Again, the Board's proposed standard on audit documentation did not include this provision. In adopting certain interim standards and rules as of April 16, 2003, the Board did not adopt Rule 301 of the AICPA's Code of Professional Conduct. In this standard on audit documentation, the Board seeks neither

to establish confidentiality standards nor to modify or detract from any existing applicable confidentiality requirements.

ADDENDUM

This addendum is not a part of PCAOB Auditing Standard No. 3.

Additional Documentation Requirements of SEC Rule 2-06

B1. Auditors should be aware of the additional record retention requirements in SEC Rule 2-06 of Regulation S-X ("Rule 2-06"). The Board is providing additional information below to remind auditors of the SEC requirements. This addendum is not an interpretation of Rule 2-06. Instead, this addendum provides excerpts from the SEC release accompanying the final rule which provides the SEC's interpretation of the rule's requirements, particularly paragraphs (a) and (c) of Rule 2-06.

B2. Paragraph (a) of Rule 2-06 requires that:

... the accountant shall retain ... memoranda, correspondence, communications, other documents, and records (including electronic records) which:

(1) Are created, sent or received in connection with the audit or review, and

(2) Contain conclusions, opinions, analyses, or financial data related to the audit or review.

B3. Paragraph (c) of Rule 2-06 states:

Memoranda, correspondence, communications, other documents, and records (including electronic records) described in paragraph (a) of this section shall be retained whether they support the auditor's final conclusions regarding the audit or review, or contain information or data relating to a significant matter, that is inconsistent with the auditor's final conclusions regarding that matter or the audit or review. Significance of a matter shall be determined based on an objective analysis of the facts and circumstances. Such documents and records include, but are not limited to, those documenting a consultation on or resolution of differences in professional judgment.

Other Statements by the SEC

B4. In the excerpt below, from the SEC's release accompanying its final Rule 2-06, the SEC discusses documents that generally are not required to be retained under Rule 2-06.

In the Proposing Release, we stated that non-substantive materials that are not part of the workpapers, such as administrative records, and other documents that do not contain relevant financial data or the auditor's conclusions, opinions or analyses would not meet the second of the criteria in rule 2-06(a) and would not have to be retained. Commentators questioned whether the following documents would be considered substantive and have to be retained:

- Superseded drafts of memoranda, financial statements or regulatory filings,
- Notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking,
- Previous copies of workpapers that have been corrected for typographical errors or errors due to training of new employees,
- Duplicates of documents, or
- Voice-mail messages.

These records generally would not fall within the scope of new rule 2-06 provided they do not contain information or data, relating to a significant matter that is inconsistent with the auditor's final conclusions, opinions or analyses on that matter or the audit or review. For example, rule 2-06 would require the retention of an item in this list if that item documented a consultation or resolution of differences of professional judgment.

B5. The excerpt below, from the SEC's release accompanying its final Rule 2-06, provides further explanation about documents to be retained under Rule 2-06:

In consideration of the comments received, we have revised paragraph (c) of the rule. We have removed the phrase "cast doubt" to reduce the possibility that the rule mistakenly would be interpreted to reach

typographical errors, trivial or "fleeting" matters, or errors due to "on-the-job" training. We continue to believe, however, that records that either support or contain significant information that is inconsistent with the auditor's final conclusions would be relevant to an investigation of possible violations of the securities laws, Commission rules, or criminal laws and should be retained. Paragraph (c), therefore, now provides that the materials described in paragraph (a) shall be retained whether they support the auditor's final conclusions or contain information or data, relating to a significant matter that is inconsistent with the final conclusions of the auditor on that matter or on the audit or review. Paragraph (c) also states that the documents and records to be retained include, but are not limited to, those documenting consultations on or resolutions of differences in professional judgment.

The reference in paragraph (c) to "significant" matters is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer or registered investment company. Rule 2-06(c) requires that the documentation of such matters, once prepared, must be retained even if it does not "support" the auditor's final conclusions, because it may be relevant to an investigation. Similarly, the retention of records regarding a consultation about, and resolution of, differences in professional judgment would be relevant to such an investigation and must be retained. We intend for Rule 2-06 to be incremental to, and not to supersede or otherwise affect, any other legal or procedural requirement related to the retention of records or potential evidence in a legal, administrative, disciplinary, or regulatory proceeding.

Finally, we recognize that audits and reviews of financial statements are interactive processes and views within an accounting firm on accounting, auditing or disclosure issues may evolve as new information or data comes to light during the audit or review. We do not view "differences in professional judgment" within subparagraph (c) to include such changes in preliminary views when those preliminary views are based on what is recognized to be incomplete information or data.

Amendment to Interim Auditing Standards

AU sec. 543.12 is amended as follows:

When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in AU sec. 543.10, the principal auditor must obtain, and review and retain, the following information from the other auditor:

- a. An engagement completion document consistent with paragraphs 12 and 13 of PCAOB Auditing Standard No. 3

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

- b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures.
- c. Sufficient information relating to significant findings or issues that are inconsistent with or contradict the auditor's final conclusions, as described in paragraph 8 of PCAOB Auditing Standard No. 3.
- d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.
- e. Sufficient information to enable the office issuing the auditor's report to agree or reconcile the financial statement amounts audited by the other firm to the information underlying the consolidated financial statements.
- f. A schedule of audit adjustments, including a description of the nature and cause of each misstatement.
- g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.
- h. Letters of representations from management.
- i. All matters to be communicated to the audit committee.

The principal auditor must obtain, and review and retain, such documents prior to the report release date.^{1/} In addition, the principal auditor should consider performing one or more of the following procedures:

- Visit the other auditor and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditor. In some cases, it may be appropriate to issue instructions to the other auditor as to the scope of the audit work.
- Review additional audit documentation of the other auditor relating to significant findings or issues in the engagement completion document.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

(a) Purpose

Section 103(a)(1) of the Act authorizes the PCAOB to establish, by rule, auditing standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by the Act. PCAOB Rule

^{1/} As it relates to the direction in paragraph .19 of AU sec. 324, for the auditor to "give consideration to the guidance in section 543.12," the auditor need not, in this circumstance, obtain the previously enumerated documents.

3100, "Compliance with Auditing and Related Professional Practice Standards," requires auditors to comply with all applicable auditing and related professional practice standards established by the PCAOB. The Board has adopted as interim standards, on an initial, transitional basis, the generally accepted auditing standards described in the American Institute of Certified Public Accountants' ("AICPA") Auditing Standards Board's Statement on Auditing Standards No. 95, *Generally Accepted Auditing Standards*, as in existence on April 16, 2003 (the "interim standards").

Section 103(a)(2)(A)(i) of the Act expressly directs the Board to establish auditing standards that require registered public accounting firms to prepare, and maintain for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. These proposed rules are the standards referred to in Section 103(a)(2)(A)(i) of the Act.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rule will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Pursuant to the Act and PCAOB Rule 3100, auditing and related professional practice standards established by the PCAOB must be complied with by all registered public accounting firms.

C. Board's Statement on Comments on the Proposed Rule Received from Members, Participants or Others

The Board released the proposed rule for public comment in PCAOB Release No. 2003-023 (November 21, 2003). A copy of PCAOB Release No. 2003-023 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's web site at www.pcaobus.org. The Board received 38 written comments. The Board has clarified and modified certain aspects of the proposed rules in response to comments it received, as discussed below:

Several commenters suggested that audit documentation should include audit programs. Audit programs were specifically mentioned in SAS No. 96 as a form of audit documentation. The Board accepted this recommendation, and paragraph 4 in the final standard includes audit programs as an example of documentation. Audit programs may provide evidence of audit planning as well as limited evidence of the execution of audit procedures, but the Board believes that signed-off audit programs should generally not be used as the sole documentation that a procedure was performed, evidence was obtained, or a conclusion was reached. An audit program aids in the conduct and supervision of an engagement, but completed and initialed audit program steps should be supported with proper documentation in the working papers.

Some commenters suggested that the final standard more specifically describe the qualifications of an experienced auditor. These commenters took the position that only an engagement partner with significant years of experience would have the experience necessary to be able to understand all the work that was performed and the conclusions that were reached. One commenter

suggested that an auditor who is reviewing audit documentation should have experience and knowledge consistent with the experience and knowledge that the auditor performing the audit would be required to possess, including knowledge of the current accounting, auditing, and financial reporting issues of the company's industry. Another said that the characteristics defining an experienced auditor should be consistent with those expected of the auditor with final responsibility for the engagement.

After considering these comments, the Board has provided additional specificity about the meaning of the term, *experienced auditor*. The standard now describes an experienced auditor as one who has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

Some commenters also suggested that the standard, as proposed, did not allow for the use of professional judgment. These commenters pointed to the omission of a statement about professional judgment found in paragraph 4.23 of GAGAS that states, "The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment." A nearly identical statement was found in the interim auditing standard, SAS No. 96, *Audit Documentation*.

Auditors exercise professional judgment in nearly every aspect of planning, performing, and reporting on an audit. Auditors also exercise professional judgment in the documentation of an audit and other engagements. An objective of this standard is to ensure that auditors give proper consideration to the need to document procedures performed, evidence obtained, and

conclusions reached in light of time and cost considerations in completing an engagement.

Nothing in the standard precludes auditors from exercising their professional judgment. Moreover, because professional judgment might relate to any aspect of an audit, the Board does not believe that an explicit reference to professional judgment is necessary every time the use of professional judgment may be appropriate.

A guiding principle of the proposed standard was that auditors must document procedures performed, evidence obtained, and conclusions reached. This principle is not new and was found in the interim standard, SAS No. 96, *Audit Documentation*, which this standard supersedes. Audit documentation also should demonstrate compliance with the standards of the PCAOB and include justification for any departures.

The proposed standard would have adapted a provision in the California Business and Professions Code which provides that if documentation does not exist, then there is a rebuttable presumption that the work had not been done.

The objections to this proposal fell into two general categories: the effect of the rebuttable presumption on legal proceedings and the perceived impracticality of documenting every conversation or conclusion that affected the engagement. Discussion of these issues follows.

Commenters expressed concern about the effects of the proposed language on regulatory or legal proceedings outside the context of the PCAOB's oversight. They argued that the rebuttable presumption might be understood to

establish evidentiary rules for use in judicial and administrative proceedings in other jurisdictions.

Some commenters also had concerns that oral explanation alone would not constitute persuasive other evidence that work was done, absent any documentation. Those commenters argued that not allowing oral explanations when there was no documentation would essentially make the presumption "irrebuttable." Moreover, those commenters argued that it was inappropriate for a professional standard to predetermine for a court the relative value of evidence.

The Board believes that complete audit documentation is necessary for a quality audit or other engagement. The Board intends the standard to require auditors to document procedures performed, evidence obtained, and conclusions reached to improve the quality of audits. The Board also intends that a deficiency in documentation is a departure from the Board's standards. Thus, although the Board removed the phrase *rebuttable presumption*, the Board continues to stress, in paragraph 9 of the standard, that the auditor must have persuasive other evidence that the procedures were performed, evidence was obtained, and appropriate conclusions were reached with respect to relevant financial statement assertions.

The term *should* (presumptively mandatory responsibility) was changed to *must* (unconditional responsibility) in paragraph 6 to establish a higher threshold for the auditor. Auditors have an unconditional requirement to document their work. Failure to discharge an unconditional responsibility is a violation of the standard and Rule 3100, which requires all registered public accounting firms to

adhere to the Board's auditing and related professional practice standards in connection with an audit or review of an issuer's financial statements.

The Board also added two new paragraphs to the final standard to explain the importance and associated responsibility of performing the work and adequately documenting all work that was performed. Paragraph 7 provides a list of factors the auditor should consider in determining the nature and extent of documentation. These factors should be considered by both the auditor in preparing the documentation and the reviewer in evaluating the documentation.

Some commenters expressed concern that the proposed standard could be construed or interpreted to require the auditor to document every conversation held with company management or among the engagement team members. Some commenters also argued that they should not be required to document every conclusion, including preliminary conclusions that were part of a thought process that may have led them to a different conclusion, on the ground that this would result in needless and costly work performed by the auditor. Commenters also expressed concern that an unqualified requirement to document procedures performed, evidence obtained, and conclusions reached without allowing the use of auditor judgment would increase the volume of documentation but not the quality. They stated that it would be unnecessary, time-consuming, and potentially counterproductive to require the auditor to make a written record of everything he or she did.

The Board's standard distinguishes between (1) an audit procedure that must be documented and (2) a conversation with company management or

among the members of the engagement team. Inquiries with management should be documented when an inquiry is important to a particular procedure. The inquiry could take place during planning, performance, or reporting. The auditor need not document each conversation that occurred.

A final conclusion is an integral part of a working paper, unless the working paper is only for informational purposes, such as documentation of a discussion or a process. This standard does not require that the auditor document each interim conclusion reached in arriving at the risk assessments or final conclusions. Conclusions reached early on during an audit may be based on incomplete information or an incorrect understanding. Nevertheless, auditors should document a final conclusion for every audit procedure performed, if that conclusion is not readily apparent based on documented results of the procedures.

The Board also believes the reference to *specialists* is an important element of paragraph 6. Specialists play a vital role in audit engagements. For example, appraisers, actuaries, and environmental consultants provide valuable data concerning asset values, calculation assumptions, and loss reserves. When using the work of a specialist, the auditor must ensure that the specialist's work, as it relates to the audit objectives, also is adequately documented. For example, if the auditor relies on the work of an appraiser in obtaining the fair value of commercial property available for sale, then the auditor must ensure the appraisal report is adequately documented. Moreover, the term *specialist* in this

standard is intended to include any specialist the auditor relies on in conducting the work, including those employed or retained by the auditor or by the company.

Several commenters recommended that the definition of *audit adjustments* in this proposed standard should be consistent with the definition contained in AU sec. 380, *Communication with Audit Committees*.

Although the Board recognizes potential benefits of having a uniform definition of the term *audit adjustments*, the Board does not believe that the definition in AU sec. 380 is appropriate for this documentation standard because that definition was intended for communication with audit committees. The Board believes that the definition should be broader so that the engagement partner, engagement quality reviewer, and others can be aware of all proposed corrections of misstatements, whether or not recorded by the entity, of which the auditor is aware, that were or should have been proposed based on the audit evidence.

The proposed standard would have required an auditor to retain audit documentation for seven years after completion of the engagement, which is the minimum period permitted under Section 103(a)(2)(A)(i) of the Act. In addition, the proposed standard would have added a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after the auditor's report is released. Such reasonable period of time should not exceed 45 days.

In general, those commenting on this documentation retention requirement did not have concerns with the time period of 45 days to assemble

the working papers. However, some commenters suggested the Board tie this 45-day requirement to the filing date of the company's financial statements with the SEC. One commenter recommended that the standard refer to the same trigger date for initiating both the time period during which the auditor should complete work paper assembly and the beginning of the seven-year retention period.

For consistency and practical implications, the Board agreed that the standard should have the same date for the auditor to start assembling the audit documentation and initiating the seven-year retention period. The Board decided that the seven-year retention period begins on the *report release date*, which is defined as the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. In addition, auditors will have 45 days to assemble the complete and final set of audit documentation, beginning on the report release date. The Board believes that using the report release date is preferable to using the filing date of the company's financial statements, since the auditor has ultimate control over granting permission to use his or her report. If an auditor's report is not issued, then the audit documentation is to be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the seven-year period begins when the work on the engagement ceased.

Many commenters had concerns about the similarity in language between the proposed standard and the SEC final rule (issued in January 2003) on record

retention, *Retention of Records Relevant to Audits and Reviews*.^{2/} Some commenters recommended that the PCAOB undertake a project to identify and resolve all differences between the proposed standard and the SEC's final rule. These commenters also suggested that the Board include similar language from the SEC final rule, Rule 2-06 of Regulation S-X, which limits the requirement to retain some items.

The objective of the Board's standard is different from the objective of the SEC's rule on record retention. The objective of the Board's standard is to require auditors to *create* certain documentation to enhance the quality of audit documentation, thereby improving the quality of audits and other related engagements. The records retention section of this standard, mandated by Section 103 of the Act, requires registered public accounting firms to "prepare and maintain for a period of not less than 7 years, *audit work papers, and other information related to any audit report*, in sufficient detail to support the conclusions reached in such report." (emphasis added)

In contrast, the focus of the SEC rule is to require auditors to *retain* documents that the auditor does create, in order that those documents will be available in the event of a regulatory investigation or other proceeding.

Despite their different objectives, the proposed standard and SEC Rule 2-06 use similar language in describing documentation generated during an audit or review. Paragraph 4 of the proposed standard stated that, "Audit documentation ordinarily consists of *memoranda, correspondence*, schedules,

^{2/} SEC Regulation S-X, 17 C.F.R. § 210.2-06 (SEC Release No. 33-8180, January 2003). (The final rule was effective in March 2003.)

and *other documents created or obtained in connection with* the engagement and may be in the form of paper, electronic files, or other media." Paragraph (a) of SEC Rule 2-06 describes "records relevant to the audit or review" that must be retained as, (1) "workpapers and other documents that form the basis of the audit or review and (2) *memoranda, correspondence, communications, other documents, and records (including electronic records), which: [a]re created, sent or received in connection with* the audit or review and [c]ontain conclusions, opinions, analyses, or financial data related to the audit or review. ..." (numbering and emphasis added).

The SEC makes a distinction between the objectives of categories (1) and (2). Category (1) includes audit documentation. Documentation to be retained according to the Board's standard clearly falls within category (1). Items in category (2) include "desk files" which are more than "what traditionally has been thought of as auditor's 'workpapers'." The SEC's rule requiring auditors to retain items in category (2) have the principal purpose of facilitating enforcement of securities laws, SEC rules, and criminal laws. This is not an objective of the Board's standard. According to SEC Rule 2-06, items in category (2) are limited to those which: (a) are created, sent or received in connection with the audit or review, and (b) contain conclusions, opinions, analyses, or financial data related to the audit or review. The limitations, (a) and (b), do not apply to category (1).

Paragraph 4 of the final standard deletes the reference in the proposed standard to "other documents created or obtained in connection with the engagement." The Board decided to keep "correspondence" in the standard

because correspondence can be valid audit evidence. Paragraph 20 of the standard reminds the auditor that he or she may be required to maintain documentation in addition to that required by this standard.

Some commenters asked how the term *significant matters*, in Rule 2-06, relates to the term *significant findings or issues* in the Board's standard. The SEC's release accompanying its final Rule 2-06 states that "... *significant matters* is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer. ..." This is very similar to the term *significant findings or issues* contained in paragraph 12 of the Board's standard which requires auditors to document *significant findings or issues*, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. Examples of significant findings or issues are provided in the standard.

Based on the explanation in the SEC's final rule and accompanying release, the Board believes that *significant matters* are included in the meaning of *significant findings or issues* in the Board's standard. The Board is of the view that *significant findings or issues* is more comprehensive and provides more clarity than *significant matters* and, therefore, has not changed the wording in the final standard.

The proposed standard would have required that any changes to the working papers after completion of the engagement be documented without deleting or discarding the original documents. Such documentation must indicate

the date the information was added, by whom it was added, and the reason for adding it.

One commenter recommended that the Board provide examples of auditing procedures that should be performed before the report release date and procedures that may be performed after the report release date. Some commenters also requested clarification about the treatment of changes to documentation that occurred after the completion of the engagement but before the report release date. Many commenters recommended that the Board more specifically describe post-issuance procedures. The Board generally agreed with these comments.

The final standard includes two important dates for the preparation of audit documentation: (1) the report release date and (2) the documentation completion date.

- Prior to the report release date, the auditor must have completed all necessary auditing procedures, including clearing review notes and providing support for all final conclusions. In addition, the auditor must have obtained sufficient evidence to support the representations in the auditor's reports before the report release date.
- After the report release date and prior to the documentation completion date, the auditor has 45 calendar days in which to assemble the documentation.

During the audit, audit documentation may be superseded for various reasons. Often, during the review process, reviewers annotate the documentation with clarifications, questions, and edits. The completion process often involves revising the documentation electronically and generating a new copy. The SEC's final rule on record retention explains that the SEC rule does not require that the following documents generally need to be retained: superseded drafts of memoranda, financial statements or regulatory filings; notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking; previous copies of workpapers that have been corrected for typographical errors or errors due to training of new employees; and duplicates of documents. This standard also does not require auditors to retain such documents as a general matter.

Any documents, however, that reflect information that is either inconsistent with or contradictory to the conclusions contained in the final working papers may not be discarded. Any documents added must indicate the date they were added, the name of the person who prepared them, and the reason for adding them.

If the auditor obtains and documents evidence after the report release date, the auditor should refer to the interim auditing standards, AU sec. 390, *Consideration of Omitted Procedures After the Report Date* and AU sec. 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*. Auditors should not discard any previously existing documentation in connection with obtaining and documenting evidence after the report release date.

The auditor may perform certain procedures subsequent to the report release date. For example, pursuant to AU sec. 711, *Filings Under Federal Securities Statutes*, auditors are required to perform certain procedures up to the effective date of a registration statement. The auditor should identify and document any additions to audit documentation as a result of these procedures. No audit documentation should be discarded after the documentation completion date, even if it is superseded in connection with any procedures performed, including those performed pursuant to AU sec. 711.

Additions to the working papers may take the form of memoranda that explain the work performed, evidence obtained, and conclusions reached. Documentation added to the working papers must indicate the date the information was added, the name of the person adding it, and the reason for adding it. All previous working papers must remain intact and not be discarded.

Documentation added to the working papers well after completion of the audit or other engagement is likely to be of a lesser quality than that produced contemporaneously when the procedures were performed. It is very difficult to reconstruct activities months, and perhaps years, after the work was actually performed. The turnover of both firm and company staff can cause difficulty in reconstructing conversations, meetings, data, or other evidence. Also, with the passage of time memories fade. Oral explanation can help confirm that procedures were performed during an audit, but oral explanation alone does not constitute persuasive other evidence. The primary source of evidence should be documented at the time the procedures are performed, and oral explanation

should not be the primary source of evidence. Furthermore, any oral explanation should not contradict the documented evidence, and appropriate consideration should be given to the credibility of the individual providing the oral explanation.

The proposed standard would have required the principal auditor to maintain specific audit documentation when he or she decided not to make reference to the work of another auditor.

The Board also proposed an amendment to AU sec. 543 concurrently with the proposed audit documentation standard. The proposed amendment would have required the principal auditor to review the documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed.

Commenters expressed concerns that these proposals could present conflicts with certain non-U.S. laws. Those commenters also expressed concern about the costs associated with the requirement for the other auditor to ship their audit documentation to the principal auditor. In addition, the commenters also objected to the requirement that principal auditors review the work of other auditors as if they were the principal auditor's staff.

After considering these comments, the Board decided that it could achieve one of the objectives of the proposed standard (that is, to require that the issuing office have access to those working papers on which it placed reliance) without requiring that the working papers be shipped to the issuing office. Further, given the potential difficulties of shipping audit documentation from various non-U.S.

locations, the Board decided to modify the proposed standard to require that audit documentation either be retained by or be accessible to the issuing office.

In addition, instead of requiring that all of the working papers be shipped to the issuing office, the Board decided to require that the issuing office obtain, review, and retain certain summary documentation. Thus, the public accounting firm issuing an audit report on consolidated financial statements of a multinational company may not release that report without the documentation described in paragraph 19 of the standard.

Some commenters also objected to the proposed requirement in the amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, that the principal auditor review another auditor's audit documentation. They objected because they were of the opinion such a review would impose an unnecessary cost and burden given that the other auditor will have already reviewed the documentation in accordance with the standards established by the principal auditor. The commenters also indicated that any review by the principal auditor would add excessive time to the SEC reporting process, causing even more difficulties as the SEC Form 10-K reporting deadlines have become shorter recently and will continue to shorten next year.

The Board accepted the recommendation to modify the proposed amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*. Thus, in the final amendment, the Board imposes the same unconditional responsibility on the principal auditor to obtain certain audit documentation from the other auditor prior to the report release date. The final

amendment also provides that the principal auditor should consider performing one or more of the following procedures:

- Visit the other auditors and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditors. In some cases, it may be appropriate to issue instructions to the other auditors as to the scope of the audit work.
- Review additional audit documentation of the other auditors relating to significant findings or issues in the engagement completion document.

The Board proposed that the standard and related amendment would be effective for engagements completed on or after June 15, 2004. Many commenters were concerned that the effective date was too early. They pointed out that some audits, already begun as of the proposed effective date, would be affected and that it could be difficult to retroactively apply the standard. Some commenters also recommended delaying the effective date to give auditors adequate time to develop and implement processes and provide training with respect to several aspects of the standard.

After considering the comments, the Board has delayed the effective date. However, the Board also believes that a delay beyond 2004 is not in the public interest. The Board concluded that the implementation date of this standard should coincide with that of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of*

Financial Statements, because of the documentation issues prevalent in PCAOB Auditing Standard No. 2. Therefore, the Board has decided that the standard will be effective for audits of financial statements with respect to fiscal years ending on or after [the later of November 15, 2004, or 30 days after the date of approval of this standard by the SEC]. The effective date for reviews of interim financial information and other engagements, conducted pursuant to the standards of the PCAOB, would occur beginning with the first quarter ending after the first financial statement audit covered by this standard.

Several commenters noted that SAS No. 96, *Audit Documentation*, the interim auditing standard on audit documentation, referred to audit documentation as the property of the auditor. This was not included in the proposed standard because the Board did not believe ascribing property rights would have furthered this standard's purpose to enhance the quality of audit documentation.

SAS No. 96, *Audit Documentation*, also stated that, "the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information," and referenced Rule 301, *Confidential Client Information*, of the AICPA's Code of Professional Conduct. Again, the Board's proposed standard on audit documentation did not include this provision. In adopting certain interim standards and rules as of April 16, 2003, the Board did not adopt Rule 301 of the AICPA's Code of Professional Conduct. In this standard on audit documentation, the Board seeks neither to establish confidentiality standards nor to modify or detract from any existing applicable confidentiality requirements.

III. Date of Effectiveness of the Proposed Rule and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents the Commission will:

(a) by order approve such proposed rule; or

(b) institute proceedings to determine whether the proposed rule should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule is consistent with the requirements of Title I of the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All

submissions should refer to File No. PCAOB-2004-05 and should be submitted within [] days.

By the Commission.

Secretary



1666 K Street, N.W.
Washington, DC 20006
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PROPOSED AUDITING STANDARD ON AUDIT)	PCAOB Release No. 2003-023
DOCUMENTATION AND PROPOSED)	November 21, 2003
AMENDMENT TO INTERIM AUDITING)	
STANDARDS)	PCAOB Rulemaking
)	Docket Matter No. 012
)	
)	
)	

Summary: The Public Company Accounting Oversight Board (the "Board" or "PCAOB") has proposed an Auditing Standard, *Audit Documentation*, and an amendment to the interim auditing standards.

Public Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 012 in the subject or reference line and should be received by the Board no later than 5:00 p.m. EST on January 20, 2004.

Board Contacts: Thomas Ray, Deputy Chief Auditor (202/207-9112; rayt@pcaobus.org), Greg Scates, Associate Chief Auditor (202/207-9114; scatesg@pcaobus.org).

The Board has proposed, and is seeking comment on, an auditing standard, *Audit Documentation*, and an amendment to the Board's interim auditing standard, "Part of Audit Performed by Other Independent Auditors,"^{1/} Section 103(a)(2)(A)(i) of the

^{1/} Codification of Statements on Auditing Standards, AU § 543 (AICPA 2003).



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Sarbanes-Oxley Act of 2002 (the "Act") expressly directs the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. Audit documentation is one of only a few topics that the Act expressly requires the Board to address in its standards. Accordingly, the Board has made audit documentation a priority.

The Board's standard on audit documentation will be one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest. The integrity of the audit depends in large part on the existence of a complete and understandable record of the work that the auditor performed, of the conclusions that the auditor reached, and of the evidence that supports those conclusions. Meaningful review by a second partner, or by the Board in the context of its inspections, would be difficult or impossible without adequate documentation. Clear and comprehensive audit documentation is essential in order to enhance the quality of the audit and for the Board to fulfill its mandate to inspect registered public accounting firms "to assess the degree of compliance" of those firms with applicable standards and laws.

Appendices 1 and 2 to this release contain, respectively, the text of the proposed auditing standard, *Audit Documentation*, and the proposed amendment to AU Section 543. Section A of this release provides an overview of the proposed new standard and the proposed amendment. Section B of this release discusses the proposed implementation date and Section C requests comments and describes how they may be submitted to the Board.

A. Audit Documentation

Auditors support the conclusions in their reports with a work product commonly referred to as work papers or audit documentation. Audit documentation is the principal record of the basis for the conclusions in the auditor's report. Audit documentation also facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Examples of audit documentation include memoranda, correspondence, and schedules. Audit documentation may be in the form of paper, electronic files, or other media.



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Section 103 of the Act specifically directs the Board to "include[,] in the auditing standards that it adopts, requirements that each registered public accounting firm shall . . . prepare, and maintain . . . , audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached" in an audit report of a public company.^{2/} In response to this mandate, the Board commenced a standards-development project on audit documentation by convening a public roundtable discussion on September 29, 2003 to discuss issues and hear views on audit documentation. Before that roundtable discussion, the Board prepared and released a briefing paper on audit documentation, which posed several questions to identify the objectives – and the appropriate scope and form – of audit documentation.^{3/} In addition, the Board asked participants to address specific issues in practice relating to, among other things, changes in audit documentation after an audit report has been released, essential elements and the appropriate amount of detail of audit documentation, the effect on audit documentation of a principal auditor's decision to use the work of other auditors, and retention of audit documentation.

The comments the Board received at this roundtable discussion played a significant role in its development of its proposed standard on audit documentation and proposed amendment to its interim auditing standard. Based on these comments, and in order to implement Section 103(a)(2)(A)(i) of the Act, the Board has proposed certain changes to the existing requirements, principally described in the American Institute of Certified Public Accountant's Statement on Auditing Standards ("SAS") No. 96. The more significant differences between existing requirements and these proposals on audit documentation are as follows –

Reviewability Standard. This proposed standard would adopt the substance of the General Accounting Offices' ("GAO") documentation standard for government and other audits conducted according to *generally accepted government auditing standards* ("GAGAS"), which requires that "audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain

^{2/} See Sarbanes-Oxley Act, Section 103(a)(2)(A).

^{3/} See Briefing Paper for the Roundtable on Audit Documentation, dated September 10, 2003. The transcript of the September 29 roundtable discussion, and copies of the briefing paper, are available on the Board's Web site.



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from the audit documentation the evidence that supports the auditors' significant judgments and conclusions." Field Work Standards for Financial Audits, Government Auditing Standards § 4.22 (U.S. Government Accounting Office, 2003 rev.). This has been an important requirement in the field of government auditing because government audits have long been reviewed by GAO auditors who, although experienced in auditing, do not participate in the actual audits. Public company audits will now, under the Act, be subject to review by PCAOB inspectors, and therefore a documentation standard that would enable such an inspector to understand the work that was performed in the audit seems appropriate.

Specifically, the Board's proposed standard would require that audit documentation contain sufficient information to enable an *experienced auditor, having no previous connection with the engagement*, to understand the work that was performed, who performed it, when it was completed, and the conclusions reached. This experienced auditor also must be able to determine who reviewed the work and the date of such review.

Rebuttable Presumption. In order to improve the completeness and reliability of written documentation, the proposed standard would adopt the substance of the state of California's statute on audit documentation, which creates a rebuttable presumption that the failure to document work performed indicates that the work was not performed. See California Business and Professions Code § 5097(c) (Deering 2003). Under the proposal, the failure to document in the work papers that an audit procedure was performed, that evidence was obtained, or that a conclusion was reached would create a presumption that such procedure was not performed, that the evidence was not obtained, or that the conclusion was not supported. The proposed presumption could be rebutted by persuasive evidence that the procedures were applied, the evidence was obtained, or sufficient support was provided for the conclusions reached. The Board contemplates that oral explanation alone would not constitute persuasive other evidence and invites comment on the addition of such a requirement to the proposed standard.

Retention of Audit Documentation. The proposed standard would require that an auditor retain audit documentation for seven years after completion of the engagement, which is the minimum period permitted under Section 103(a) of the Act. In addition, the proposed standard would add a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after



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the auditor's report is released. Such reasonable period of time ordinarily should not exceed 45 days. During the roundtable discussion on September 29, 2003, there was a general agreement that the auditor should be allowed a reasonable period of time to assemble the working papers after the release of the auditor's report.

Subsequent Changes to Audit Documentation. The proposed standard would also require that any changes to the working papers after completion of the engagement be documented without deleting or discarding the original documents. Such documentation must indicate the date the information was added, by whom it was added, and the reason for adding it.

Multi-location Audits. The proposed standard would require that sufficient audit documentation, including documentation of work performed by others, be retained by the office issuing the auditor's report. With respect to the audit documentation related to the work performed by others, the auditor issuing the report ordinarily should retain the original audit documentation or copies of such documentation. The auditor issuing the report may, however, prepare and retain audit documentation of the work performed by others as a part of the review of such work, as long as this documentation complies with the requirements of this proposed standard. This provision of the proposed standard is based on the comments of several participants at the September 29, 2003 roundtable discussion, who raised the issue that working papers from the audits of foreign affiliates should be available and accessible at the accounting firm's office issuing the audit report. This requirement would improve audit quality by enhancing the probability that *all* audit documentation will be prepared consistently with the same standards of audit quality.

Using the Work of Other Auditors. When reporting on a company's consolidated financial statements, an auditor may use the work of other auditors who have audited one or more affiliates or divisions of the company. When more than one auditor is involved in an audit engagement, one of the firms typically serves as the principal auditor. If a firm decides to serve as the principal auditor, then the firm must decide whether to make reference in the auditor's report to the audit performed by the other auditor. If the principal auditor decides to assume responsibility for the work of other auditors, then the principal auditor will not make reference to the work of other auditors in his or her audit report. However, if the principal auditor decides not to assume that responsibility, then the principal auditor should clearly indicate the division



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of responsibility between the principal auditor and other auditors in expressing an opinion on the consolidated financial statements.

In connection with the proposed requirement for the issuing office to retain all audit documentation, the proposed amendment to the interim auditing standard, AU Section 543, would help to ensure that proper audit documentation is prepared and retained when a principal auditor *decides not to make reference* to the work of other auditors and the principal auditor performs an adequate review of the audit documentation prepared by the other auditor.

B. Implementation Date of the Proposed Standard and Related Amendment

The Board is proposing June 15, 2004 as the implementation date for its standard, *Audit Documentation*, and related amendment to AU Section 543. Although, early implementation of the standard and related amendment would be permitted, the standard and amendment would be mandatory for engagements completed on or after June 15, 2004. The Board is also requesting comment on this proposed implementation date.

C. Opportunity for Public Comment

The Board will seek comment on the proposed standard and amendment for a 60-day period. Interested persons are encouraged to submit their views to the Board. Written comments should be sent to Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 012 in the subject or reference line and should be received by the Board no later than 5:00 p.m. EST on January 20, 2004.

The Board will carefully consider all comments received. Following the close of the comment period, the Board will determine whether to adopt a final standard and amendment, with or without amendments. Any final standard and amendment adopted will be submitted to the Securities and Exchange Commission for approval. Pursuant to Section 107 of the Act, proposed rules of the Board do not take effect unless approved by the Commission. Standards are deemed to be rules under the Act.



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On the 21st day of November, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Acting Secretary

November 21, 2003

APPENDICES –

1. *Proposed Auditing Standard – Audit Documentation*
2. *Proposed Amendment to Interim Auditing Standards – Part of Audit Performed by Other Independent Auditors*



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APPENDIX 1 – PROPOSED AUDITING STANDARD – AUDIT DOCUMENTATION

AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

Proposed Auditing Standard—

AUDIT DOCUMENTATION





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STATEMENT OF AUTHORITY

The Public Company Accounting Oversight Board (the "Board") is a private-sector, non-profit corporation created by the Sarbanes-Oxley Act of 2002 (the "Act") to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

The Board has adopted Rule 3100 to require all registered public accounting firms to adhere to the Board's auditing and related professional practice standards (including interim professional standards) in the audits of public companies. Any registered public accounting firm that fails to adhere to the Board's standards is subject to disciplinary proceedings in accordance with Section 105 of the Act and the Board's rules.

Reference in the Board's standards to "the auditor" means a registered public accounting firm or an associated person of such a firm as defined in the Act and the Board's rules, unless specifically stated otherwise.

Reference in the Board's standards to the AICPA Professional Standards refers to those professional standards as they existed on April 16, 2003, the date the Board adopted them as interim standards.

The Board has proposed Rule 3101 regarding the use of certain terms in the Board's standards.^{2/} The Board's standards use the words "must," "shall," and "is required" to indicate unconditional obligations. The auditor must accomplish obligations of this type in all cases in which the circumstances exist to which the obligation applies. The auditor's performance of these obligations is necessary to the accomplishment of the audit. The standards use the word "should" to indicate obligations that are presumptively mandatory. The auditor must comply with the requirements of this nature specified in the Board's standards unless the auditor can demonstrate, by verifiable objective and documented evidence, that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard and serve adequately to protect the interests of investors and further the preparation of informative, fair, and independent audit reports. The Board uses the words "may," "might," "could," or other terms and phrases to describe actions and procedures that auditors have a professional obligation to consider. Matters described in this fashion

^{2/} See PCAOB Release No. 2003-018, *Proposed Rule Regarding Certain Terms Used in Auditing and Related Professional Practice Standards*.



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require the auditor's attention and understanding. How and whether the auditor implements these matters in an audit will depend on the exercise of professional judgment in the circumstances. Additionally, appendices to the Board's standards are an integral part of the standard and carry the same authoritative weight as the body of the standard.

This Statement of Authority is an integral part of the Board's auditing and related professional practice standards.



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Auditing and Related Professional Practice Standards

Proposed Auditing Standard

Audit Documentation

[supersedes AU sec. 339]

Introduction

1. This standard establishes general requirements for documentation the auditor should prepare and retain in connection with any engagement conducted in accordance with auditing and related professional practice standards. This standard does not supplant specific documentation requirements of other auditing and related professional practice standards.

Objectives of Audit Documentation

2. *Audit documentation* is the principal record of the basis for the auditor's conclusions and provides the principal support for the representations in the auditor's report. Audit documentation also facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Audit documentation includes records on the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

3. Audit documentation is reviewed by members of the engagement team performing the work and by others. For example:

- a. Auditors who are new to an engagement review the prior year's documentation to understand the work performed as an aid in planning and performing the current engagement.
- b. Supervisory personnel review documentation prepared by assistants on the engagement.



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- c. Engagement partners and engagement quality control reviewers review documentation to understand how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions.
- d. A successor auditor reviews a predecessor auditor's audit documentation.
- e. Internal and external inspection teams review documentation to assess audit quality and compliance with auditing and related professional practice standards; applicable laws, rules, and regulations; and the firm's own quality control policies.
- f. Others, including advisors engaged by the audit committee or representatives of a party to an acquisition might review audit documentation.

Content of Audit Documentation

- 4. The auditor must prepare audit documentation in connection with each engagement conducted in accordance with auditing and related professional practice standards. Audit documentation ordinarily consists of memoranda, correspondence, schedules, and other documents created or obtained in connection with the engagement and may be in the form of paper, electronic files, or other media.
- 5. Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:
 - a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
 - b. To determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.
- 6. Auditors, including any specialists, should document the procedures performed, evidence obtained, and conclusions reached. Failure to do so creates a presumption



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that the procedures were not applied, the evidence was not obtained, and the conclusions reached were not suitably supported. This presumption is rebuttable by persuasive other evidence that the procedures were applied and the evidence was obtained to provide sufficient support for the conclusions reached.

7. Because audit documentation provides the principal support for the representations in the auditor's report, it should:

- a. Demonstrate how the audit complied with auditing and related professional practice standards;
- b. Support the basis for the auditor's conclusions concerning every material financial statement assertion; and
- c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.

8. Certain matters, such as auditor independence and staff training and proficiency, may be documented in a central repository for the firm or the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should contain a reference to the central repository. Documentation of matters unique to a particular engagement should be included in the audit documentation of the pertinent engagement.

9. The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. *Significant findings or issues* include, but are not limited to, the following:

- a. Significant matters involving the selection, application, and consistency of accounting principles, including related disclosures. Such significant matters include accounting for complex or unusual transactions, accounting estimates, and uncertainties as well as related management assumptions.
- b. Results of auditing procedures that indicate a need for significant modification of planned auditing procedures or the existence of material



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misstatements or omissions in the financial statements or the existence of significant deficiencies in internal control over financial reporting.

- c. Audit adjustments and the ultimate resolution of these items. For purposes of this standard, an *audit adjustment* is a proposed correction of a misstatement of the financial statements that could, in the auditor's judgment, either individually or in the aggregate, have a material effect^{1/} on the company's financial reporting process. Audit adjustments include corrections of misstatements, of which the auditor is aware, that were or should have been proposed based on the known audit evidence.
- d. Disagreements among members of the engagement team or with others consulted on the engagement about conclusions reached on significant accounting or auditing matters.
- e. Significant findings or issues identified during the review of quarterly financial information.
- f. Circumstances that cause significant difficulty in applying auditing procedures.
- g. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.
- h. Any other matters that could result in modification of the auditor's report.

10. The auditor must identify all significant findings or issues in an engagement completion memorandum. This memorandum should be as specific as necessary in the circumstances for a reviewer to gain a thorough understanding of the significant findings or issues. This memorandum should include cross-references, as appropriate, to other supporting audit documentation.

11. Documentation of auditing procedures that involve the inspection of documents or confirmation, such as tests of details and tests of operating effectiveness of controls,

^{1/} Materiality includes both quantitative and qualitative considerations as discussed in SEC Staff Accounting Bulletin No. 99.



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should include identification of the items tested.² Documentation of auditing procedures that involve the inspection of significant contracts or agreements should include abstracts or copies of the documents.

12. In addition to the documentation necessary to support the auditor's final conclusions, information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions must also be included in the audit documentation. The relevant records to be retained include, but are not limited to, procedures performed in response to the information, and records documenting consultations on, or resolutions of, differences in professional judgment among members of the audit team or between the audit team and others consulted.

Retention of and Subsequent Changes to Audit Documentation

13. Audit documentation must be retained for seven years from the date of completion of the engagement, as indicated by the date of the auditor's report,³ unless a longer period of time is required by law.

^{2/} The identification of the items tested may be satisfied by indicating the source from which the items were selected and the specific selection criteria, for example:

- If an audit sample is selected from a population of documents, the documentation should include identifying characteristics (for example, the specific check numbers of the items included in the sample).
- If all items over a specific dollar amount are selected from a population of documents, the documentation need describe only the scope and the identification of the population (for example, all checks over \$10,000 from the October disbursements journal).
- If a systematic sample is selected from a population of documents, the documentation need only provide an identification of the source of the documents and an indication of the starting point and the sampling interval (for example, a systematic sample of sales invoices was selected from the sales journal for the period from October 1 to December 31, starting with invoice number 452 and selecting every 40th invoice).

^{3/} If a report is not issued in connection with an engagement, then the date of completion of the engagement would be the date that fieldwork was substantially completed.



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14. Prior to granting permission to use the auditor's report in connection with the issuance of the company's financial statements, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation must be assembled for retention within a reasonable period of time following the first time the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. Such reasonable period of time ordinarily should not be more than 45 days.

15. Circumstances may require subsequent additions to the audit documentation. If evidence is obtained after completion of the engagement, or if work performed before engagement completion is documented after completion, the documentation added must indicate the date the information was added, by whom it was added, and the reason for adding it. Audit documentation must not be deleted or discarded; however, information may be added, including an explanation of its relevance, as long as the information identifies the date the information was added; by whom it was added; and the reason for adding it. The auditor should also identify and document changes to audit documentation as a result of post-issuance procedures. Documentation should include the nature of the change, the date of such change, by whom the change was made, and the reason for the change.

16. Audit documentation sufficient to meet the requirements of paragraphs 4-12 (including documentation of work performed by others, such as affiliated firms) must be retained by the office issuing the auditor's report. With respect to the audit documentation related to the work performed by others, the auditor issuing the report ordinarily should retain the original audit documentation or copies of such documentation. Alternatively, if the auditor considers it necessary in the circumstances, the auditor issuing the report should prepare and retain audit documentation of the work performed by others as a part of the review required by paragraph 12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, as long as the audit documentation complies with paragraphs 4-12 of this standard.



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17. The auditor also may be required to maintain documentation in addition to that required by this standard.^{4/}

Implementation Date

18. This standard will apply to engagements completed on or after June 15, 2004.

^{4/} For example, the SEC requires auditors to retain memoranda, correspondence, communications (for example, electronic mail), other documents, and records (in the form of paper, electronic, or other media) that are created, sent, or received in connection with an engagement conducted in accordance with auditing and related professional practice standards and that contain conclusions, opinions, analyses, or data related to the engagement. (Retention of Audit and Review Records, 17 CFR § 210.2-06, effective for audits or reviews completed on or after October 31, 2003.)



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**APPENDIX 2 – PROPOSED AMENDMENT TO INTERIM AUDITING STANDARDS – PART OF AUDIT
PERFORMED BY OTHER INDEPENDENT AUDITORS**

AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

Proposed Amendment to Interim Auditing Standards—

***PART OF AUDIT PERFORMED BY OTHER INDEPENDENT
AUDITORS***





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Part of Audit Performed by Other Independent Auditors – An Amendment to Interim Standards

In reporting on a company's consolidated financial statements, an auditor may use the work of other auditors who have audited one or more affiliates or divisions of the company. When more than one auditor is involved in an audit engagement, one of the firms typically serves as the principal auditor. In considering whether a firm may serve as the principal auditor, the firm considers, among other things, the materiality of the portion of the financial statements the firm audited in relation to the consolidated group as well as the materiality of the other components audited by other firms.

If the firm decides to serve as the principal auditor, then the firm must decide whether to make reference in the auditor's report to the audit performed by the other auditor. If the principal auditor decides to assume responsibility for the work of other auditors, then the principal auditor will not make reference to the work of other auditors in his or her audit report. However, if the principal auditor decides not to assume that responsibility, then the principal auditor should indicate clearly the division of responsibility between the principal auditor and other auditors in expressing an opinion on the consolidated financial statements. Existing guidance when using the work of other auditors is contained in AU sec. 543, *Part of Audit Performed by Other Independent Auditors*. However, this existing standard does not establish any specific documentation requirements.

This proposed amendment (below) is considered necessary to ensure that proper audit documentation is prepared and retained when a principal auditor *decides not to make reference* to the work of other auditors. This proposed amendment is not the result of a comprehensive review of existing standards, which will take place at a future date.

This proposal would amend AU sec. 543.12 as follows:

When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in AU sec. 543.10, the principal auditor should review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed. Sufficient audit documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor to meet all the requirements of PCAOB Auditing and Related Professional Practice Standards No. X, as if the



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principal auditor had performed the work himself or herself. In addition to reviewing the audit documentation of the other auditor, the principal auditor should consider whether it is necessary to visit the other auditor and discuss the audit procedures followed and the results thereof and whether it is necessary to instruct the other auditor as to the scope of work to be performed.



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Exhibit 2(a)(B)

Tab Number	Comment Source
1	The Accounting and Auditing Procedures Committee of the Pennsylvania Institute of Certified Public Accountants, January 19, 2004
2	American Accounting Association, Auditing Section, Auditing Standards Committee, January 7, 2004
3	American Institute of Certified Public Accountants, Authors: S. Scott Voynich, CPA, Chairman of the Board, and Barry C. Melancon, CPA, President and CEO, January 20, 2004
4	The Association of Chartered Certified Accountants, Author: David YorkHead of Auditing Practice, January 19, 2004
5	BDO Seidman, LLP, January 20, 2004
6	Bruce H. Nearon, Steven Teppler, and Charles R. Merrill, January 20, 2004
7	California Board of Accountancy, Author: Ian B. Thomas, President, March 10, 2004
8	Charles R. Drott, December 23, 2004
9	Committee on Law and Accounting and the Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association, Authors: Thomas L. Riesenberg, Chair, Committee on Law and Accounting; and Dixie L. Johnson, Chair, Committee on Federal Regulation of Securities, January 30, 2004
10	Commonwealth of Virginia, Auditor of Public Accounts, Author: Walter J. Kucharski, January 15, 2004
11	Compagnie Nationale des Commissaires aux Comptes, Author: Michel Tudel, President, January 20, 2004
12	Crowe Chizek and Company LLC, January 20, 2004
13	Deloitte & Touche LLP, January 20, 2004
14	Donald H. Chapin, CPA, December 12, 2003
15	Ernst & Young LLP, January 20, 2004
16	Fédération des Experts Comptables Européens – European Federation of Accountants, Author: David Devlin, President, January 13, 2004
17	Fitch, Inc., Author: Joseph St. Denis, Senior Director – Credit Policy, January 21, 2004
18	Illinois CPA Society, Audit and Assurance Services Committee,

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	Authors: William P. Graf, Chair, Audit & Assurance Services Committee, and Simon Petravick, Chair, Comment Letter Subcommittee, January 20, 2004
19	Institut der Wirtschaftsprüfer, Authors: Wolfgang Schaum, Executive Director, and Wolfgang P. Böhm, Special Advisor to the Executive Board, January 20, 2004
20	Institute of Chartered Accountants in England & Wales, Author: Robert Hodgkinson, Director, Technical, January 20, 2004
21	International Federation of Accountants' International Auditing and Assurance Standards Board, Author: James M. Sylph, Technical Director, January 19, 2004
22	KPMG LLP, January 20, 2004
23	Linklaters, January 20, 2004
24	L. Michael Howard, December 1, 2003
25	McGladrey & Pullen, LLP, January 20, 2004
26	National Association of State Boards of Accountancy, Authors: David A. Vaudt, CPA, Chair; and David A. Costello, CPA, President and CEO, January 8, 2004
27	National State Auditors Association, Author: William G. Holland, President, January 20, 2004
28	New York State Society of Certified Public Accountants, Author: Jeffrey R. Hoops, President, January 20, 2004
29	Piercy Bowler Taylor & Kern, Authors: L. Ralph Piercy, President and Managing Shareholder; and Howard B. Lvey, Senior Principal and Director, Technical Services, January 12, 2004
30	PricewaterhouseCoopers LLP, January 20, 2004
31	RSM International, Author: William D. Travis Chairman, Transnational Assurance Services Executive Committee, January 20, 2004
32	Sonnellitter Professional Services, LLC, Author: Robert J. Sonnellitter, Jr., CPA, Principal, January 8, 2004
33	State of Tennessee, Comptroller of the Treasury, Department of Audit, Division of State Audit; Author: Arthur A. Hayes, Director, January 5, 2004
34	Swiss Institute of Certified Accountants and Tax Consultants, Authors: Hans Wey, Member of the Executive Committee, and Walter Hess, General Secretary, January 20, 2004
35	Texas Society of Certified Public Accountants, Author: C. Jeff Gregg,



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	CPA, Chair, Professional Standards Committee, January 20, 2004
36	United States General Accounting Office, Author: David M. Walker, Comptroller General of the United States, January 12, 2004
37	VisageSolutions LLC, Author: Glen W. Conway, January 20, 2004

January 13, 2004

Office of the Secretary, PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No 012

The Accounting and Auditing Procedures Committee of the Pennsylvania Institute of Certified Public Accountants has prepared the following comments with regard to the proposed PCAOB Rulemaking Docket Matter No. 012..

Comment 1:

The PCAOB (the Board) has adopted the Standards on Auditing (AU) that have been issued by the American Institute of Certified Public Accountants Auditing Standards Board (ASB). The PCAOB is suggesting in its release that their Proposed Auditing Standard *Audit Documentation* will supercede AU sec. 339. However, unless the ASB adopts the PCAOB standard to be effective for audits of non-registered companies there will be two conflicting auditing standards using the same authoritative reference. We suggest that the PCAOB, in fulfilling its requirement to establish auditing standards for audits of public companies, establish a separate and unique referencing system for its standards.

Comment 2:

The Interim Auditing Standards as adopted by the Board on April 16, 2003 included Statement on Auditing Standard (SAS) Number 96, *Audit Documentation* (AU 339). This standard is effective for audits of years beginning after May 15, 2002. Therefore, SAS 96 is just being implemented on audit engagements of companies with calendar year ends.

In Rulemaking Docket Number 012, the PCAOB proposed additional audit documentation standards. SAS 96 and the proposed standard are similar in most aspects. We suggest that the PCAOB remove the proposed additional audit documentation standards from Rulemaking Docket Number 012 and work with the ASB to amend SAS 96 to include the pertinent changes the PCAOB is seeking.

Specifically, we believe those changes to be as follows:

1. The additional requirement that the date the work was performed and reviewed should be in the audit documentation. (paragraph 4(b)).
2. Auditor independence, staff training and proficiency support, if held in a central repository in the firm, should be so indicated in the audit documentation(paragraph 8).
3. Specific language requiring audit adjustments and the ultimate resolution of those items should be included in the standards. (paragraph 9(c)).
4. Specific language identifying significant findings and issues in an engagement completion memorandum. (paragraph 10).
5. Documentation of information that contradicts the auditors' final conclusion(paragraph 12).
6. Assembly of the final set of audit documentation (paragraph 14).
7. The documentation required if additional evidence is obtained or added to the audit documentation subsequent to the completion of the engagement. (paragraph 15).

Comment 3:

The Board has proposed the requirement that audit documentation be retained for seven years from the date of completion of the engagement unless a longer period of time is required by law. The inclusion of a specific period of time in the Standard makes it difficult to quickly make changes if the underlying law (such as Section 103(a) of the Act) were to change. We propose that paragraph 13 read "audit documentation must be retained for a period of time required under applicable laws and regulations."

Comment 4:

The Board proposed that the office of the issuing auditing firm retain the audit documentation (or copies) of work performed by others. Currently, audit firms use a variety of audit documentation techniques: manual workpapers, "over-the-counter" software systems, proprietary software systems, and a mix of the three. A current standard to enable these various systems to communicate with each other has not been established. We would suggest that this section of the proposal (paragraph 16) be eliminated and replaced by additional documentation of the inquiries made between the principal and "other" auditor, documentation of the proficiency of the other auditor (such as copies of peer review reports, resumes of key team members, etc.) and if necessary documentation of an inspection of the audit documentation that supports key financial statement areas or assertions.

Comment 5:

The Board proposed in paragraph 15 that any deletions from audit documentation be prohibited after the completion of the engagement. In paragraph 13 completion of the engagement has been defined as the date of the auditors' report. Often there are

additional procedures and wrap-up work that are completed between the actual date of the auditors' report and the issuance of the report on the financial statements. We suggest that the measurement period for determining whether audit documentation can be deleted or discarded, and whether supplemental explanations need to accompany additional information (paragraph 15) be determined based on issuance date and not audit report date. This should be clarified in paragraph 15.

American Accounting Association ♦ Auditing Section
Auditing Standards Committee

January 6, 2004

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

RE: Invitation to Comment on PCAOB Rulemaking Docket Matter No. 012

Dear PCAOB:

The Auditing Standards Committee (ASC) of the Auditing Section of the American Accounting Association welcomes the opportunity to comment on *Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards*. We offer the comments below primarily to enhance the clarity of the proposed standard and to address a few more substantive questions. We support the major provisions put forth in the proposed standard.

1. Paragraph 2 – Line 6 provides a list of what audit documentation includes. Should that list also indicate that audit documentation includes records on who performed and reviewed the work and when the performance and review occurred? This point is made more explicit in paragraph 5b, and thus should probably be highlighted in the overview paragraph (i.e., paragraph 2).
2. Paragraph 2 – The last sentence allows audit documentation to be referred to as “work papers or working papers.” Given the movement to electronic formats of audit documentation, we recommend that the standard only utilize the term “audit documentation” to illustrate to professionals that the nature of documenting audits has evolved beyond more traditional forms. Paragraph 4 makes this point, but we recommend more emphasis throughout the document (also see comment #4 below).
3. Paragraph 3a – Although we concur that auditors who are new to an engagement might want to review the prior year’s documentation, we encourage the Board to consider adding language to the standard that encourages auditors new to an engagement to first consider the audit objectives of the current year before using the prior year’s documentation to “aid in planning and performing the current engagement.” We believe that it is important to consider the current audit objectives and business environment before relying on last year’s documentation.

4. Paragraph 5 – The proposed standard notes that audit documentation may be in the form of paper or electronic files. The proposed standard goes on to say (paragraphs 5a and 5b) that the documentation has to be understandable by an experienced auditor having no previous connection with the engagement. We foresee a potential operational difficulty that is not addressed in the standard. Many firms now have firm-specific electronic audit software, with embedded links, electronic signatures, and electronic notations indicating reviewers, review levels, dates of review, etc. We question whether Board staff would be able to do the things in paragraphs 5a and 5b without the assistance of firm personnel guiding them through the software. As a result, we believe that the standard ought to address in what form electronic documentation must ultimately be provided to the Board for review. The standard as currently written only addresses how the firms will store the information internally (i.e., they can store it however they want to), not how they will have to provide the information to a regulatory body or some other audit firm or other interested party.
5. Paragraphs 5 and 11 – The proposed standard suggests that a reviewability standard be achieved (see paragraph 5 indicating that experienced outsiders should be able to review the auditor’s work). We question whether it would be more appropriate to achieve a reperformance standard (i.e., an experienced outsider could theoretically reperform the auditor’s work). Paragraph 11 seems to suggest that reperformance is the desired standard. However, a reperformance standard might suggest the need for additional documentation (e.g., client inquiry procedures should indicate the client personnel involved in the inquiry and the date of such inquiry, observation procedures might include the specifics on who / what was observed and when the observation took place, etc.). We encourage further consideration of reviewability versus reperformance as the appropriate standard. Also, with respect to reviewability in paragraph 5a, in addition to the information specified, the Board might consider whether the documentation should also indicate the objective of the work that was performed.
6. Paragraph 6 – We concur with the Board’s notion of rebuttable presumption and with the contemplation that oral explanation alone would not constitute persuasive other evidence. We believe that some guidance as to what “persuasive other evidence” might include would be helpful in this section. In addition, we recommend that the Board consider more explanation linking the presumption of nonperformance and the ability to rebut with persuasive other evidence. We are concerned that auditors could interpret this paragraph to mean that audit documentation can be willfully omitted from an engagement as long as the auditors retain the necessary evidence to use as rebuttal evidence *if necessary*. We believe that the Board’s intention is that withholding information from audit documentation is a serious problem.
7. Paragraph 9 – In documenting significant findings and issues, should the work papers also detail the client personnel with whom these matters were discussed (e.g., specific management, audit committee members, etc.)?

8. Paragraph 9b – Should material weaknesses in internal control over financial reporting be explicitly indicated as well (“significant deficiencies and material weaknesses”)?
9. Paragraph 9c – The paragraph starts with the words, “Audit adjustments and the ultimate resolution of these items.” It then goes on to say that an audit adjustment includes “a proposed correction”, implying that auditors need to document proposed adjustments, as well as recorded adjustments. We believe that the standard should be very explicit, noting that auditors are required to document both booked and waived adjustments. To be more explicit, the first sentence could be restated as follows, “Proposed audit adjustments: Documentation required concerning the resolution of these items, including a discussion of the reasons for booked versus waived adjustments.” Also, we wondered about the purpose of defining “audit adjustments” to include those “that should have been proposed based on the known audit evidence.” If an auditor is deficient by not proposing an adjustment that should have been proposed, does this section serve to open the auditor up to an audit documentation violation in addition to the underlying audit quality problem?
10. Paragraph 10 – We believe that the engagement completion memorandum will serve as an effective technique for helping decision-makers consider how other people will evaluate their decisions. Should this memorandum also specifically indicate the resolution of all significant findings and issues? This would seem to be suggested in paragraph 9, but it might be helpful to be explicit in paragraph 10.
11. Paragraph 12 – We appreciate the apparent goal of paragraph 12, which would require the auditor to document information that is “inconsistent with or contradicts the auditor’s final conclusions.” However, we wonder about the practicality of this requirement given the reality of auditor litigation. Specifically, would audit firms view this requirement as handing the plaintiffs’ bar ammunition for their lawsuits, such that the documentation is very sketchy and not informative? In addition, we wonder how an audit firm would handle documentation of information that (a) contradicts the auditor’s conclusion, but (b) was refuted or was of very low quality. In cases of refuted or low quality information, would the auditor be required to document such evidence? Overall, we are concerned about how paragraph 12 will be implemented in practice.
12. Paragraph 14 – The proposed standard would require that the auditor have completed the audit before granting permission to use the auditor’s report. We wonder whether the Board has considered an auditor workload or documentation “hurdle” at the time the auditor approves the client’s release of earnings to the media (which typically occurs long before the financial statements and 10-K are released). Earnings releases provide significant information to investors, and we believe that there may be merit to considering a formal requirement that the auditor have completed and documented the portions of the audit that could

reasonably affect the figures in the client's earnings release before the auditor "signs off" on the release.

13. Paragraph 15 – In addition to the information requirements identified by the Board, we believe that the audit documentation should also indicate any implications on significant audit conclusions of any changes made to the audit documentation.
14. Other Comment - Should there be explicit discussion about what to document when relying on work performed by internal auditors? Or should there just be a reference to SAS No. 65?

We hope that our suggestions are helpful and will assist in finalizing the auditing standard. Please feel free to contact our committee Chair for elaboration on or clarification of any comment.

Respectfully Submitted,

Auditing Standards Committee
Auditing Section, American Accounting Association

Committee Members:

Dana R. Hermanson, Kennesaw State University (Chair)
770.423.6077, Dana_Hermanson@coles2.kennesaw.edu
Audrey Gramling, Georgia State University (Vice Chair)
Brian Ballou, University of Illinois (Past Chair)
Karla Johnstone, University of Wisconsin-Madison
Roger Martin, University of Virginia
Stephen Asare, University of Florida
Stuart Turley, University of Manchester



January 20, 2004
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 012, *Proposed Auditing Standard On Audit Documentation And Proposed Amendment To Interim Auditing Standards*

Dear Mr. Secretary:

The American Institute of Certified Public Accountants ("AICPA") respectfully submits the following written comments on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") proposed auditing standard on documentation entitled *Audit Documentation* (the proposed standard). Our comments reflect our views as they pertain to audits of issuers subject to the Act and do not necessarily reflect our viewpoint for audits of nonissuers. The AICPA is the largest professional association of Certified Public Accountants in the United States, with more than 330,000 members in public practice, business, industry, government, and education.

Executive Summary

The AICPA recognizes the effort put forth by the PCAOB to implement the provisions of the Act and enhance professional standards. The PCAOB's efforts are an important element in restoring public confidence in audited financial statements of public companies. The establishment and maintenance of high quality auditing and other professional standards is critical to that goal. The AICPA is committed to working cooperatively with the PCAOB in the continuous improvement of auditing standards.

We believe that incorporating our recommendations into the final standard will improve implementation of the requirements of the Act both by auditors and issuers. Our more significant concerns with the proposed standard are the following:

Auditor Judgment

The PCAOB's release states that the proposed standard would adopt the essence of U.S. Government Accounting Office's (GAO) documentation standard for government and other audits conducted according to generally accepted government auditing standards. However, the GAO documentation standard acknowledges the role of professional judgment regarding the

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quantity, type, and content of audit documentation—the PCAOB’s proposed standard does not.

While eliminating the auditor’s ability to exercise professional judgment regarding documentation matters will indeed facilitate enforcement actions, we question whether, and if so how, such elimination will improve audit effectiveness on *all* audits. Our detailed comment on this issue appears in the attachment to this letter (see comment on paragraph 1).

Experienced Auditor

The proposed standard requires auditors to prepare documentation that will enable an “experienced auditor” to understand the work and conclusions reached in an audit engagement. An engagement partner’s years of on-the-job experience and training are among the competencies that give him or her the ability to exercise the critical judgments and to reach the conclusions that are required in an audit engagement, especially in complex or very large engagements. Any other auditor who doesn’t possess a level of experience and knowledge of the client’s industry and business that is equivalent to that of the engagement partner lacks the capacity to evaluate the judgments and conclusions reached by the engagement partner and should not be considered an experienced auditor. Our detailed comment on this issue appears in the attachment to this letter (see comment on paragraph 5).

Implementation Date

The standard applies to all engagements completed on or after June 15, 2004. Many of the engagements that auditors will complete on or shortly after June 15 may already be underway. That means that auditors on those engagements should be documenting their work in accordance with a standard that is in its exposure phase and has not yet been approved by the PCAOB or the SEC. We question whether this is consistent with the PCAOB’s standards-setting process. Our detailed comment relating to this issue appears in the attachment to this letter (see comment on paragraph 18).

Details of our recommendations relating to the above as well as other recommendations are attached to this letter.

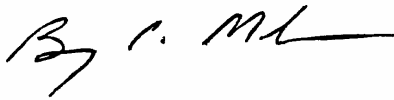
We appreciate the opportunity to comment on the proposed statement, and would be pleased to meet with Board members and staff to discuss our comments.

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Sincerely,

A handwritten signature in black ink, appearing to read "S. Scott Voynich". The signature is written in a cursive style with a prominent initial "S".

S. Scott Voynich, CPA
Chairman of the Board

A handwritten signature in black ink, appearing to read "Barry C. Melancon". The signature is written in a cursive style with a prominent initial "B".

Barry C. Melancon, CPA
President and CEO

ATTACHMENT

Specific Comments

PCAOB Proposed Auditing Standard, *Audit Documentation*

Paragraph 1

According to the PCAOB's release, the proposed standard adopts the substance of the documentation standard in the United States General Accounting Office's *Government Auditing Standards* (also known as the Yellow Book). That standard acknowledges the role of auditor judgment in the determination of the quantity, type, and content of audit documentation. Specifically, paragraph 4.23 of the Yellow Book states that "The form and content of audit documentation should be designed to meet the circumstances of the particular audit....The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment."

In view of the fact that the PCAOB derived the substance of the proposed standard from the GAO's documentation standard, we found it surprising then that the PCAOB proposed standard does not acknowledge the role of the auditor's professional judgment in the determination of the quantity, type, and content of audit documentation. The application of professional judgment is necessary in identifying the procedures, evidence, and conclusions that are relevant to the audit and therefore should be documented. It is impractical or impossible to document every aspect of a complex audit engagement.

Accordingly, we recommend adding language to the proposed auditing standard similar to the cited language from the Yellow Book. Also, to aid auditors in making the necessary judgments regarding documentation, the final standard should include language similar to the language in paragraph 7 of the interim standard on audit documentation that states:

In determining the nature and extent of the documentation for a particular audit area or auditing procedure, the auditor should consider the following factors:

- Risk of material misstatement associated with the assertion, or account or class of transactions
- Extent of judgment involved in performing the work and evaluating the results
- Nature of the auditing procedure
- Significance of the evidence obtained to the assertion being tested
- Nature and extent of exceptions identified
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed

This guidance would supplement the guidance in paragraph 5 of the proposed standard.

Paragraph 2

This paragraph states that audit documentation “provides the basis for the review of the quality of the work by providing the *reviewer* [emphasis added] with written documentation of the evidence supporting the auditor’s significant conclusions.”

We recommend specifically identifying the reviewer as any one of the individuals identified in paragraph 3a-c of the proposed standard. (See also our comment on paragraph 3.)

Paragraph 3

Item *f* of paragraph 3 implies without any basis that the auditor has an obligation to provide to other unspecified individuals information that is useful to their purpose or grant access to all audit documentation. It further improperly suggests that these unspecified third parties are entitled to review all audit documentation. Auditors do not consider the needs, and it is impractical and likely impossible to do so, of these unspecified third parties when preparing documentation during the audit because their needs are unknown at the time the documentation is prepared. Additionally, audit documentation contains a significant amount of confidential client information and information on audit processes proprietary to the accounting firm. Auditors are often required by state law or regulation, and professional Codes of Conduct to maintain the confidentiality of that information and for that reason need to limit the access of others who are not subject to the same standard of confidentiality as the auditor.

We therefore recommend deleting item *f* of paragraph 3.

Paragraph 4

This paragraph contains examples of audit documentation. With one notable exception, the list of items is similar to the one in the interim auditing standard on documentation. The notable exception is *audit programs*. Audit programs generally provide the principal record of the audit procedures the auditor plans to perform, and the auditor initials and dates them to indicate who performed the work. Therefore, the audit program meets the objectives of audit documentation described in paragraph 2 of the PCAOB’s proposed documentation standard.

We recommend adding audit programs to the examples of audit documentation in paragraph 4. If the PCAOB’s position is that audit programs are not audit documentation, or should not be used for certain purposes, it should specifically state so in the final standard.

Paragraph 5 This paragraph requires documentation to contain sufficient information to enable an “experienced auditor, having no previous connection with the engagement: to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached....”

Audit engagement partners are often individuals with significant years of experience in the client's industry and often have a substantial amount of accumulated knowledge of the client's operations or those of a comparable entity, as well as of the business and financial statement risks affecting the client or similar entities in the client's industry. This experience enables engagement partners to make the necessary judgments and decisions in an audit. An individual whose audit experience isn't at least equivalent to the experience level required of a partner or concurring reviewer (e.g., industry, client operations), lacks the capacity to evaluate that partner's judgments and conclusions.

We recommend specifically indicating that the "experienced auditor" contemplated by the standard is an individual whose competencies would have otherwise enabled him or her to serve as engagement or concurring partner on the engagement.

Paragraph 6

Specialists: It is unclear whether the "specialists" referred to in this paragraph are audit firm employees with special skills, outside specialists hired by the auditor for certain aspects of the audit, or both. Outside specialists may not be CPAs and therefore may be unfamiliar with, and not required to abide by, the documentation standards governing financial statement audits, including those of the PCAOB. Also, the auditor may be unable to obtain the outside specialist's documentation.

Because the proposed standard's jurisdiction is over auditors/audit firms registered with the PCAOB and outside specialists are not required to register with the PCAOB, we recommend deleting from paragraph 6 the phrase "including any specialists". If the PCAOB wishes to require specific documentation relating to the work of a specialist who is not an employee of the firm, it should consider adding detailed documentation requirements to SAS No. 73, Using the Work of Specialists.

Rebuttable presumption: The proposed standard states that the presumption that if audit work was not documented it was not performed is rebuttable by *persuasive other evidence* that the procedures were applied and the evidence was obtained.

We recommend clarifying or providing examples in the final standard of what the PCAOB considers persuasive other evidence. This is especially important in view of the statement in the PCAOB's release that "...oral explanation alone would not constitute persuasive other evidence..."

Paragraph 9

The definition of *audit adjustment* in the proposed standard is inconsistent with the definition of audit adjustment that is currently elsewhere in the PCAOB's interim auditing standards (see paragraph 9 of SAS No. 61, *Communication With*

Audit Committees. Additionally, the definition in the proposed standard is expressed in terms of a financial statement misstatement's effect on the company's "financial reporting process." This reference to financial reporting process seems more appropriate in the context of item *b* of paragraph 9.

We recommend deleting everything but the first sentence in item c of paragraph 9. If the PCAOB retains all of the guidance in this item, we suggest that it clarify what it means by "material effect on the company's financial reporting process [emphasis added]" since this item seems to already be addressed in item b of paragraph 9.

Recommended addition to the guidance in paragraph 13

As indicated in our comment on paragraph 3, auditors are bound by state law and regulation, and professional Codes of Conduct that require them to maintain confidentiality of client information. Audit documentation contains a significant amount of confidential client information. In addition, most states recognize the auditor's right of ownership of the documentation and this also helps to maintain confidentiality. Individuals outside of the audit firm are not bound by the same confidentiality provisions as auditors.

We recommend specifically stating in the final standard that audit documentation is the property of the auditor in order to enable the auditor to fulfill his or her professional responsibilities regarding confidentiality of client information and to ensure the proper continuous custody of the documentation. Additionally, we suggest language similar to the language in paragraphs 11 and 12 of the interim audit documentation standard to specifically recognize the auditor's confidentiality obligation. Those paragraphs state as follows:

11. The auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information...Because audit documentation often contains confidential client information, the auditor should adopt reasonable procedures to maintain the confidentiality of that information.
12. The auditor also should adopt reasonable procedures to prevent unauthorized access to the audit documentation.

Paragraph 14

The 45 day deadline for assembling audit documentation is burdensome, especially for certain types of engagements and at certain times of the year (e.g., "busy season"), especially in light of the current implementation date for the Section 404 requirements and the requirement to include sufficient documentation of the work performed by other auditors, which may include foreign affiliates.

We recommend extending this period initially to at least 60 days until procedures and best practices can be put in place to facilitate the 45 day deadline.

Paragraph 17

As written, the paragraph could be interpreted to classify as *audit documentation* documents and information that are not considered audit documentation by the Securities and Exchange Commission (SEC) requirement cited in footnote 4 to paragraph 17.

We recommend changing the example cited in footnote 4 or more specifically limiting the example to the records in the SEC requirement that constitute audit documentation for purposes of the proposed standard.

Paragraph 18

If the proposed effective date is implemented as proposed, the requirements of the proposed standard would be considered to be in effect since the beginning of the exposure period although it has not yet been approved as a final standard by the PCAOB or the SEC. That is because the audits to which the standard applies are currently underway. We believe it impractical to retroactively apply a standard such as this one on documentation, as it may not be possible to retroactively obtain certain temporal information or documents or create a transcript of past discussions, conversations or meetings. We believe this aspect of the proposal is inappropriate and question whether it is consistent with the PCAOB's standards-setting process.

We recommend changing the effective date of the final standard to allow the audit firms adequate time to develop procedures and staff training to effect an orderly implementation of the standard. The new standards should be effective for periods beginning no sooner than 60 days after the publication of the final standard.

Minor Editorial Observations

Paragraph 7a: Should "audit" be "auditor"? And if so, how does the auditor demonstrate "how" he or she complied with all auditing and related professional practice standards?

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The ACCA logo consists of the letters 'ACCA' in a stylized, outlined font, set against a black square background.

one hundred

20 January 2004

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

Dear Sirs

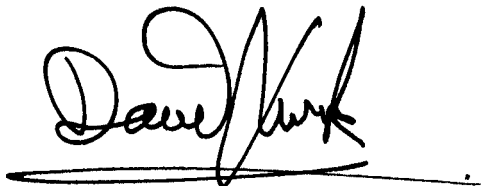
**PCAOB Rulemaking Docket Matter No. 012
Proposed Auditing Standard – Audit Documentation**

ACCA is the largest and fastest-growing international accountancy body. Over 300,000 students and members in 160 countries are served by more than 70 staffed offices and other centres.

ACCA's mission is to work in the public interest to provide quality professional opportunities to people of ability and application, to promote the highest ethical and governance standards and to be a leader in the development of the accountancy profession.

ACCA is an active member of the European Federation of Accountants and we fully endorse the comments made to you in that body's letter.

Yours faithfully

A handwritten signature in black ink, appearing to read 'David York', with a horizontal line underneath.

David York
Head of Auditing Practice

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January 20, 2004

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

Re: PCAOB Rulemaking Docket Matter No. 012 - Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards

Dear Mr. Secretary:

BDO Seidman, LLP respectfully submits the following comments on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") proposed auditing standard ("the proposed standard") on audit documentation and proposed amendment to AU section 543, *Part of an Audit Performed by Other Independent Auditors*. BDO Seidman, LLP is pleased to have participated in the 2003 PCAOB roundtable discussion on Audit Documentation. Additionally, we currently serve on an AICPA Task Force that is reconsidering documentation issues, and the Firm previously participated in the development and ASB approval process leading to the issuance of SAS 96, *Audit Documentation*.

We recognize the importance of continuing to refine and improve standards that will restore confidence in our financial reporting environment and are eager to participate further in the initiatives of the PCAOB and other regulatory bodies to advance the quality of our professional standards. We appreciate the dedicated effort necessary to develop quality standards.

We also recognize the importance to the audit process of clear and adequate documentation. Not only will such documentation provide a roadmap for engagement team members and reviewers of workpapers, but it will also provide a foundation upon which auditors can perform higher quality audits.

While we support the Board's objective of solidifying the audit documentation process, there are certain aspects of the proposed standard that cause us concern. Our comments are categorized between those of significant concern and those requiring clarification.



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ISSUES OF SIGNIFICANT CONCERN

Implementation Date

The proposed standard would be effective for audits completed on or after June 15, 2004. In our view, this is not a reasonable implementation timeframe for the reasons noted below:

Retroactivity

Based on the proposed timetable for the issuance of this standard, it is likely that a final standard cannot be approved by the SEC before March or April. Thus, issuers with a June year-end may be in or close to the final quarter of their fiscal year before the final requirements are known. Audits of these issuers may already be in progress, with certain phases of preliminary work completed. The proposed implementation date would retroactively apply the standard to work already performed that may or may not have been documented under the criteria of the proposed standard. We believe this would be unprecedented and inappropriate. To the extent that there might be circumstances where it would be necessary to reconsider prior documentation in light of this proposed standard or as a result of clarifications of certain provisions in this proposal, it may not be practical or even possible to recreate documentation of prior work (for example, due to issuer system limitations). In addition, members of the audit team who performed work during the early stages of the audit may no longer be with the firm.

Compression of Additional Work

The changes in audit documentation requirements and workpaper assembly procedures would occur contemporaneously with the following issues, audit procedures, and new audit requirements. It would unnecessarily distract auditors and, therefore, could be counterproductive to the effective implementation of this important standard:

- High quality audits require careful planning. Communication and training needs to precede implementation of a standard that introduces new performance requirements. The complexity of some large multi-national engagements may make the implementation of this requirement unachievable for current engagements in the proposed timeframe. Moreover, the additional work in developing processes and procedures, and training of staff to understand the proposed new file accumulation requirements for many fiscal year issuers, will take place in the same time frame as this year's auditing "busy-season," when the focus instead should be on finalizing the audits of calendar-year issuers. Traditionally, this has been a period of very significant audit effort. That is particularly the case this year, as companies and auditors are in the process of meeting accelerated filing deadlines and new SEC independence and other requirements. We believe it would be counterproductive, and not in the public interest, to distract auditors from these efforts by requiring them to undergo documentation training during that period.



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- Significant additional procedures already are required for the first time on 2003 audits to address fraud risks in response to SAS 99, and the additional quarterly inquiries, procedures, and responsibilities (including fourth quarter procedures and assessments) were required for the first time this year by SAS 100.
- As currently proposed, accelerated filers with a June 2004 year-end will also be reporting for the first time on the effectiveness of their internal controls. We believe that Section 404 audits will lead to a substantial increase in the volume of documentation and will raise significant technical implementation issues, as such audits have not previously been performed. This has been confirmed by the work of the PCAOB and AICPA implementation Task Forces on which BDO Seidman participates. Given the complexity of the subject matter and, in our view, the lack of timely specific performance and documentation requirements in the internal controls proposal (see BDO Seidman's November 22, 2003 response to the PCAOB's ED, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*), there will need to be a significant focus in the last quarter of the fiscal year on the newly issued technical requirements of the final internal control audit requirements.

- *Remote Locations*

The proposed standard requires that workpapers from remote locations, including foreign jurisdictions, be assembled in the office issuing the auditor's report. Logistically, we believe that for some audits this will be difficult to achieve due to legal impediments in certain other countries (see comments below regarding workpapers prepared by foreign auditors). We hope that, over time, any legal impediments will be removed; but firms do not have any control over the laws that established these impediments.

Furthermore, we understand that an important motivation for the imposition of this requirement is to facilitate the inspection and enforcement process, which will likely only apply to a small subset of public company audits. However, the costs of compliance, which we believe will be very substantial in some circumstances, will apply to all issuers. In our view, this requirement does not in itself improve the quality of the audit.

- *45-Day Rule*

The proposed standard requires the review and inclusion in the completed audit file of all workpapers, including those prepared by other firms and by those operating in other auditing jurisdictions. It is stated that a complete audit file would ordinarily be finalized within 45 days from the auditor's approval to release the report. This provision requires, at the least, a significant new administrative process to assemble these audit files in the reporting location, and will require firms to develop processes and guidance on how this can be most efficiently and effectively accomplished. If the Board adopts this provision to require all workpapers to be in one location, we



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suggest that it consider initially implementing this rule with a requirement to finalize the audit file within, say, 60 days. The deadline could be modified in the future if supported by the implementation experience and feedback from the inspection process.

* * * *

For the reasons stated above, we strongly urge the Board to defer the effective date of the final standard to years beginning after June 15, 2004 and, in any event, no sooner than for audits beginning 60 days after the final standard is approved by the SEC and published. We do not believe that this recommended deferral will dilute the response to specific corporate and professional issues that led to the Sarbanes-Oxley Act of 2002. We concur with the Board's view that in many areas the proposed standard does not go beyond the recently effective SAS 96 on audit documentation. We also believe that SAS 96 was a substantial advancement in standards that addressed the bulk of the documentation issues that had been identified prior to its release, and those issues noted in the Report of the Panel on Audit Effectiveness. Thus, we strongly urge the Board to consider our suggested deferral dates in this context.

Work Performed by Others

A significant new requirement of the proposed standard is that documentation of the work performed by others be retained by the office issuing the auditor's report. We are aware that there are legal impediments (e.g., the United Kingdom's Data Protection Act) in many foreign countries that will need to be addressed before this requirement can be fully achieved. We do not believe the proposed timeframe for implementation will be sufficient to resolve existing and possible new objections to this requirement on the part of governments and professional associations in other jurisdictions.

We believe that further discussion and better understanding on the part of all parties will enable the PCAOB to accomplish its objectives of quality and consistency in documentation, but that pressing this issue within the proposed timeframe will be counterproductive to the Board's goals and the firms' ability to meet the requirements of the standard. In this regard, we reference the Audit Documentation Comment Letter submitted to the PCAOB by the law firm of Linklaters, London.

Accordingly, we recommend that the Board defer the effective date of the requirement to obtain workpapers of foreign auditors where there are legal impediments, until such impediment issues are satisfactorily resolved by all parties.



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Subsequent Changes to Audit Documentation

Paragraph 15 of the proposed standard states that, if evidence is obtained after completion of the engagement, or if work performed before engagement completion is documented after completion, the documentation added must indicate the date the information was added, by whom it was added, and the reason for adding it. We believe that the use of the date of “completion of the engagement” for this purpose (the date of the completion of fieldwork) is inappropriate. We believe that if the Board mandates that file deletions may not be made after a specific date, the date that should be used is the date on which a complete and final set of audit documentation is assembled.

It is customary for many audit administrative and file clean-up procedures to be performed subsequent to the completion of fieldwork. To mandate that no deletions from the file occur during this period and that each addition to the file be accompanied by an explanation of its reason for being added will increase the cost and time necessary to perform this task without an increase in audit quality. Documents retained unnecessarily will need to be clearly and extensively annotated as to why they are superseded or irrelevant; otherwise, the retention of irrelevant or superseded documents may create a confusing record of the audit procedures performed and conclusions reached. Furthermore, the imposition of the “completion of the audit” date as a deadline for discarding irrelevant or superseded documents may have the unintended effect of encouraging the premature or erroneous discarding of documents.

Oral Explanations

Paragraph 2 states that “Audit documentation is the *principal* record of the basis for the auditor’s conclusions and provides the *principal* support for the representations in the auditor’s report” [emphasis added]. While this statement seems to recognize that undocumented (i.e., oral) evidence could provide some degree of support for the auditor’s work, paragraph 6 states that lack of documentation creates a rebuttable presumption that the procedures were not applied, the evidence was not obtained, and the conclusions were not suitably supported. In our view, some weight should be given in the standard to oral explanations since it is not realistic to assume that an auditor can document the entirety of his or her thought process. To document every communication and thought during the audit could result in volumes of documentation (much of which would be inconsequential) and would not give practical recognition to the constant stream of oral interaction between the auditors and the issuer.

One cannot anticipate all engagement issues and problems that may only become evident after the completion of the audit. These situations could require further explanation or amplification of the work performed. We acknowledge the process the Board has outlined to permit the amplification of documentation in a completed audit file. However, in some cases, it will not be possible to anticipate the nature of the inquiries made and it may not be possible to modify the file due to legal constraints. Our view is that oral explanations will often be needed to provide necessary *supplemental* information to the existing documentation, but we support the view that oral explanations



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are not an appropriate substitute for appropriate written documentation of the *principal* procedures performed and the conclusions reached.

ISSUES REQUIRING CLARIFICATION

Auditor Judgment

Both SAS 96 (paragraph 1) and the GAO “yellow book” standard make it clear that auditor judgment is important in determining the extent and form of audit documentation. However, the proposed standard appears to have omitted this concept. We believe it is unreasonable and perhaps impossible to document every aspect and nuance relating to an audit, and that judgment is clearly required in determining the quantity and form of audit documentation. For example, the proposed standard (footnote 2) provides examples of three methods for documenting the testing of items. Judgment is required in selecting an efficient and effective method to document the testing. We believe the final standard should expressly state that the use of judgment is implicit in the documentation process.

Omission of Documentation Guidance in the Proposed Standard

SAS 96 (paragraph 7) provides 6 examples of matters for the auditor to consider when determining the nature and extent of audit documentation. We believe this is helpful guidance and should be included in the Board’s final standard.

Experienced Auditor

The proposed standard states that “audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement...” to understand what work was performed and who performed it (paragraph 5). SAS 96 identifies the documentation focus to be “members of the engagement team with supervision and review responsibilities...” (paragraph 6). We understand the proposed language parallels language previously used in the context of audits performed under GAO auditing requirements. In the context of an auditor experienced in governmental auditing reviewing a governmental engagement, this was not troublesome. However, broadening this to the general public company audit environment without clarification causes us some concern. In this context we believe the term “experienced auditor” should be defined to include characteristics such as (1) a partner-level or concurring reviewer level of audit experience and (2) familiarity with the issuer’s industry.

Audit Programs

A comparison of SAS 96 (paragraph 5) to the proposed standard (paragraph 4) reveals that the proposed standard omits *audit programs* from a list of examples of documentation. In our view, audit programs are important evidence of the performance of effective planning, and serve as a cornerstone in directing the detailed audit



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procedures. They are also the traditional place to document who performed the audit work and when the work was performed. We recommend that audit programs be included as examples of documentation in the final standard.

Specialists

We suggest that the final standard clarify whether the reference to “specialists” in paragraph 6 of the proposed standard is meant to include those specialists hired by management, but whose work then will be used by the auditor. When the specialist is hired by the auditor (e.g., to advise the auditor) or the specialist is a member of the engagement team, we understand the application of this proposed requirement. However, in the case where the issuer hires a third party specialist (e.g., to perform valuation work), the auditor would not be a party to that contractual relationship. In that regard, there are issues such as the ownership and availability of the third party specialist’s workpapers that will need to be resolved.

Work Performed by Others

Paragraph 16 states “[A]lternatively... the auditor issuing the report should prepare and retain audit documentation of the work performed by others as part of the review required by paragraph 12 of AU Section 543, as long as this documentation complies with paragraph 4-12 of this standard.” It is unclear how this requirement differs substantially from that in the previous sentence of the proposed standard, which indicates the auditor should ordinarily retain the original audit documentation or copies of such documentation. If this alternative is intended to be a means of overcoming the impediments to the production of the actual workpapers, it is doubtful whether this is a viable solution. Furthermore, the detailed documentation required to implement this seems to be highly impractical to create.

Documentation of Significant Findings

We agree with the implication of paragraph 10 that the contents of the engagement completion memorandum should be flexible, but suggest that the provision be clarified to indicate that it is acceptable for the significant findings to be cross-referenced from a topical listing in the engagement completion memorandum to the specific supporting memoranda and other audit documentation.

Since the Board has mandated the preparation of this document and that it contain “all significant findings or issues,” we ask the Board to explicitly recognize that in some situations, facts and circumstances subsequent to the engagement can alter perceptions of what should have been considered significant. We suggest the Board clarify that the “all” in the required memorandum reflects the judgment of the engagement team at the time the memorandum was prepared based on then-existing facts and circumstances.



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Confidentiality obligation

Paragraphs 11 and 12 of SAS 96, *Audit Documentation*, specifically recognize the auditor's confidentiality obligation regarding audit documentation:

11. The auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information. Because audit documentation often contains confidential client information, the auditor should adopt reasonable procedures to maintain the confidentiality of that information.

12. The auditor also should adopt reasonable procedures to prevent unauthorized access to the audit documentation.

The proposed standard does not include this concept. We are unsure if such language will be restored in some other section of the PCAOB Auditing Standards literature, but are unaware of any reason to delete this concept from public company standards. We recommend the Board restore this concept in its final documentation standard or appropriately modify other standards to achieve this objective.

* * * * *

We appreciate your consideration of our comments and suggestions, and would be pleased to communicate or meet with the PCAOB and its staff to clarify any of our comments.

Please direct comments to Wayne Kolins, National Director of Assurance, at 212-885-8595 Wkolins@bdo.com or Lynford Graham, National Director of Audit Policy, at 212-885-8551 Lgraham@bdo.com.

Sincerely,

BDO Seidman, LLP

BDO Seidman, LLP

January 16, 2004

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803.

Also submitted via e-mail to comments@pcaobus.org

Re: Public Company Accounting and Oversight Board (PCAOB)
Proposed Auditing Standard On Audit Documentation And Proposed Amendment To
Interim Auditing Standards.
PCAOB Release No. 2003-023
November 21, 2003
PCAOB Rulemaking
Docket Matter No. 012

Dear Sirs:

Thank you for the opportunity to comment on the PCAOB's Proposed Auditing Standard referred to above. We have read the PCAOB's Briefing Paper on the Proposed Auditing Standard, the PCAOB's Audit Documentation Roundtable (September 29, 2003), and the proposed standard. We applaud the PCAOB's efforts to fulfill their mission in implementing the Sarbanes-Oxley Act of 2002, and believe the proposed standard will improve the practice of auditing and the quality of audits. In my opinion, the standard is an improvement over SAS 96, the current professional standard governing audit documentation, because it is more clearly written and states in no uncertain terms the auditor's obligation for documentation of the work performed.

We agree with the PCAOB's adopting the substance of the Government Accounting Office's (GAO) documentation standard for government and other audits conducted according to generally accepted auditing standards (GAGAS), which state that "audit documentation should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain, from the audit documentation, the evidence that supports the auditor's significant judgments and conclusions." as well as the California statute on audit documentation, which creates a rebuttable presumption that the failure to document work performed indicates that the work was not performed.

In regard to the rebuttable presumption, some of the panelists in the September 29, 2003 roundtable were of the opinion that verbal explanation should be allowed if audit documentation failed to provide evidence that the work was performed or support the conclusions reached. We strongly disagreed with these panelists because allowing verbal explanation to support the conclusion will open the door for abuse if the auditors are allowed to not document their work but verbally claim after the fact that they did do the work.

My area of expertise is internal control, information technology (IT), and information security (InfoSec), and the remainder of my comments will address the relevant portions of the proposed standard affected by IT and InfoSec. In particular, We will address issues regarding:

- Maintaining audit documentation;
- Who prepared, reviewed, or changed audit documentation;
- The date audit documentation was prepared, reviewed, or changed;
- Retaining audit documentation;
- Subsequent changes to audit documentation.

The basic assumption of my comments is that today's audit documentation is almost entirely digital rather than hardcopy paper, and audit documentation in pen (or pencil) and paper is prepared by a very small minority of auditors of small issuers. Audit documentation is currently created and maintained digitally with audit documentation software, desktop software, and other computer applications. The movement from hardcopy paper to digital is nearly universal in almost all companies and audit firms. When reviewers or regulators review hardcopy audit binders they are only looking at "views" of digital data¹, which may have been fraudulently created especially for them with the intent to deceive. The transition from pen, ink, and paper to digital has turned important elements of the audit documentation paradigm on its head, such as the integrity of such documentation, the ability to determine who created it, and the ability to determine when it was created. It is important that the PCAOB and the auditing standards recognize this profound shift. The balance of my comments will first discuss some background information and then address specific issues in the proposed standard related to digital audit documentation and the need for information security controls over it.

BACKGROUND

Today, ninety-three percent of all business records are estimated to be in digital forms² and "almost all 'source data' now generated by enterprises is electronic or digital in nature and not physical. A University of California study conducted in 2000 has shown that 99.993% of the 3 billion gigabytes of data generated worldwide is computer generated. It is also clear that almost all enterprise source data for operations, accounting, audit, financial reporting and other purposes are digital, and have no paper and ink parentage."³

Since audit documentation is composed of business records and since auditors almost universally use computers to document and store evidence of their work, it stands to reason that a similar percentage of audit documentation is digital. Maintaining records means keeping the records in existence and preserving them. Since audit documentation

¹ Paul, G, H. Kesterson II, C. Merrill, and B. Nearon. "Views of Digital Data," Treatise on Digital Evidence. American Bar Association Information Security Committee, forthcoming.

² Lange, M. 2003. "Electronic Evidence & The Sarbanes-Oxley Act of 2003." *Kroll On Track*. <http://www.krollontrack.com/LawLibrary/Articles/sarbanes.pdf>.

³ Nearon, B., J. Stanley, S. Tepler, and J. Burton. "Life After Sarbanes-Oxley: The Merger Of Security And Accountability." Working Paper. December 2003.

is most likely maintained with information technology, to maintain its existence and preserve it would require adequate information technology controls. Information technology controls in this context means information security controls. Specifically, as it applies to audit documentation, the relevant information security controls are:

- Controls to unambiguously determine *who* created, changed, or reviewed audit documentation.
- Controls to unambiguously determine *when* the audit documentation was created, changed or reviewed.
- Controls over *availability*.⁴
- Controls over *integrity* of the audit documentation and changes to it; integrity meaning the audit documentation remains intact and unchanged since the final set of audit documentation is assembled for retention. (Ordinarily, which should not be more than 45 days after the auditor grants permission to use the auditor's report,)⁵ or if changes are made there are controls over such changes.⁶)

SPECIFIC COMMENTS

Content of Audit Documentation

¶ 4 “Audit documentation ordinarily consists of memoranda, correspondence, schedules, and other documents created or obtained in connection with the engagement and may be in the form of paper, electronic files, or other media.”

The audit standards need to recognize that audit documentation is most likely in the form of electronic files, that original paper audit documentation is a rare exception, and that paper audit documentation is most likely only one of many possible “views” of the original underlying digital audit documentation. The underlying digital data used to assemble the “views” of audit documentation is an ordered assembly of 0s and 1s and is unobservable to the human eye. As stored in memory or storage the 0s and 1s of a valid audit document appear indistinguishable from a fraudulent document, a digital photo, or a digital music file. Layers of software are used to construct the “views” of the audit documentation and software in common desktop computers used by auditors may consist of millions of lines of computer code and ten of thousands of files. Without information security controls over the operating system, programs, and files that create and display “views” the integrity of audit documentation being viewed is suspect.

¶ 5. “Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

⁴ PCAOB Proposed Auditing Standard On Audit Documentation And Proposed Amendment To Interim Auditing Standards. PCAOB Release No. 2003-023. Id. ¶ 13. Audit documentation must be retained for seven years from the date of completion of the engagement, as indicated by the date of the auditor's report, unless a longer period is required by law.

⁵ Id. ¶ 14

⁶ Id. ¶ 15

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine *who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.*"

My comments for ¶ 5 focus on determining the “~~who~~ who performed and reviewed the work, and the “~~when~~ the date the work was performed and reviewed. This is not a trivial issue when it comes to digital documents, because without appropriate information security controls over digital audit documentation the “who” and “when” are not determinable with reasonable certainty.

Determining Who Prepared and Reviewed the Audit Documentation

Prior to the migration from ink (or pencil) and paper audit documentation to digital audit documentation, the “who” was determined by the auditor and reviewer evidencing their work by initialing or signing the documents. Forgeries of another person’s initials or signature created in pen and ink are quite often obvious to untrained people and advances in forensic technology has made such forgeries easily detected by experts. Digital audit documentation is often signed-off by electronically initialing documents, and in some instances may legally bind the signer;⁷ however, without appropriate information security controls, such electronic initialing offers no certainty as to the identity of the signer. It is a trivial exercise to forge another’s electronic initials and without appropriate information security controls it is virtually impossible even for an expert to detect such a forgery. Therefore, without appropriate information security controls it is not possible to determine with reasonable certainty who prepared or reviewed digital audit documentation.

The forgery of an auditor’s or reviewer’s initials without detection is a very real possibility given the ease of doing this. Audit firms involved in accounting malpractice lawsuits, failed audits, litigation, and government enforcement actions have a powerful incentive to commit such forgeries and, as stated above, without appropriate information security controls such forgeries are not easily detected.

Therefore, we recommend that the auditing standard include a requirement that sign-off by auditors or reviewers of digital audit documentation be executed using Public Key Infrastructure (PKI) and digital signatures or equivalent technology.⁸ Presently, PKI is a mature proven technology that can be cost effective when implemented for large groups of users. The “Big 4” accounting firms could certainly afford such a technology when spread across their large employee base. For smaller firms, professional accounting associations or even the PCAOB could offer their members digital signatures at a nominal charge. The use of PKI and digital signatures or equivalent technology would limit forgery of auditor and reviewer sign-off and allow users of digital audit

⁷ See, *Electronic Signatures In Global And National Commerce*” 15 U.S.C. Sec 7000

⁸ A useful reference work dealing comprehensively with PKI and PKI legal applications is ABA Information Security Committee, *Digital Signature Guidelines* (2001), <available at <http://abanet.org/scitech/ec/isc/>>. For a recent report dealing with PKI use in the U.S. Federal Government, see GAO, *Information Security – Status of Public Key Infrastructure Activities at Major Federal Departments and Agencies* <available at <http://www.gao.gov/new.items/d04157.pdf>>

documentation to determine with reasonable certainty the identities of the preparer and reviewer.

Determining When the Audit Documentation Was Prepared and Reviewed

When audit documentation was prepared in pen and paper, the auditor manually and contemporaneously inscribed the date the work was done or reviewed. If this were done after-the-fact within a reasonable amount of time, a fraudulent date would be almost impossible to detect even with advanced forensic techniques. It would take special forensic investigative techniques to detect such a fraud.

Today, the auditor or reviewer often dates digital audit documentation by manually entering a date on a digital audit document, or the entry of the date may be automatically made by audit documentation software using the computer system's time clock. Like the discussion of the "who", audit firms involved in accounting malpractice, litigation or government enforcement action have a powerful incentive to make it appear that work that was not done during the audit was actually done during the audit. It is a trivial exercise to manually backdate a digital document or reset the system time clock and it requires no special skills. This is not just a hypothetical, theoretical, or remote risk, considering that there have been several accounting frauds perpetrated in this manner. For example, see the SEC cases of Sensormatic,⁹ Mortell,¹⁰ and Newman¹¹ where management reset the system time clock to move income from a subsequent period to the audit period. Without controls over the system time clock in a like manner an audit firm that did not perform or review audit work prior to the release of the audit report could create audit documentation after-the-fact and backdate it. Without information security controls over the system time clock on computers used to prepare digital audit

⁹ "In the Matter of Thomas H. Pike, Securities Exchange Act of 1934," Release No. 39793. (Mar. 25, 1998) ("At the end of each quarter, Sensormatic turned back the computer clock that dated and recorded shipments. Based on these computer-generated documents reflecting shipments, Sensormatic then prematurely recognized revenue on shipments made past the end of the quarter.") David Priebe. "Corporate Governance Reform and Electronic Documents." Forthcoming in *The American Bar Association Information Security Committee's Treatise on Digital Evidence*.

¹⁰ *Securities & Exch. Comm'n v. Mortell*, No. 1:02 CV 01090 (RW) ¶ 32 (D.D.C. 2002). (<http://www.sec.gov/litigation/complaints/compl17542.htm>). ("Under [a defendant's] supervision, PCN's shipping department reset the computer clock that dated certain shipping records and generated shipping documents bearing false shipping dates. The documents indicated that certain products were shipped by year-end 1996, when they were actually shipped during the first few days of 1997.") David Priebe. Forthcoming in *The American Bar Association Information Security Committee's Treatise on Digital Evidence*.

¹¹ *Securities & Exch. Comm'n v. Newman*, No. SA CV-00-948-GLT (Eex) C.D. Cal. Nov. 5, 2001. (<http://www.sec.gov/litigation/litreleases/lr17250.htm>). (Summary judgment granted against officer in case alleging that officer ordered "resetting the date on Sirena's computer clock to March 30 or March 31. Manipulation of the computer clock allowed April shipments to be recorded as March revenue because the computer clock controlled the date that was printed on the company's invoices. The computer system also automatically recorded revenue earned as of the date of the invoice. In this way, [the defendants] held the March 1999 quarter open until April 12, 1999.") David Priebe. Cited in "Corporate Governance Reform and Electronic Documents." Forthcoming in *The American Bar Association Information Security Committee's Treatise on Digital Evidence*.xx

documentation, back-dating of audit documentation would be trivial to accomplish even by novices and difficult to detect by experts.

Therefore, We recommend that the auditing standards include a requirement that there be information security controls over the system's time generating device (the system time clock) on computers that are used to generate audit documentation so that the date the audit documentation was prepared or reviewed could be determined with reasonable certainty.

Determining the Content Integrity of the Audit Documentation from Time of Creation through Review

Information is an enterprise's most valuable asset, and this asset is now electronically generated as source data. Without some time reference and content anchor, however, digital records, as well as paper records originating therefrom, have little or no real substantive value if the binary data (organized sets of zeroes and ones) cannot be authenticated for the content it purports to provide auditors. During the life-cycle of data content, therefore, we propose that an identity independent trusted timestamping process be required to authenticate electronic content relevant to this proposed standard.

All financial and other business transactions, communications, and business records are ultimately time based and time dependent. Time plays a critical part in the everyday processes and operations of the business world, and accordingly in the generation, management and retention of documents used in connection with the audit process.

In the old days, physical records were recorded, and some time references (i.e., a raised impression and/or ink stamp, or other mark) would be affixed to a paper and ink physical record. If the record or the timestamp were tampered with, or forged after the fact, a wide array of forensic tools could be used to ascertain the genuineness of either the record or the notation of the time it was created.

Paper based forensics, which once provided sufficient means for determining the provenance of paper and ink source documents, is now woefully inadequate to the task of authentication.

There exists, therefore, a significant new issue and vulnerability arising from the aforementioned migration of source data to digital or electronic format. The issue is one of content authentication, i.e., relating to a strong binding of the "when" and the "what." The vulnerability is the system clock of the covered entity, and its susceptibility to tampering by insiders. Content integrity authentication processes can operate irrespective of and must operate independent of any identity based authentication schema.

An unscrupulous insider can modify, substitute or destroy existing data and by resetting the system clock to an earlier time, can cover their tracks, completely and without any way to "audit" back to ascertain what is real, and what is not.

Accordingly, it is clear that with the onset of electronic data as source records for business and government enterprise, there has arisen a vulnerability unique to electronic data that has not yet been addressed, and that is the issue of time-based data manipulation. Witness the unfolding Parmalat scandal, in which the CEO, the CFO, with the alleged complicity of auditors, used time-based digital data manipulation to create a forged document purporting to substantiate the existence of more than 4 billion dollars in a Bank of America account. In late 2003 a former audit partner from Ernst & Young was charged by the SEC with criminally destroying and altering audit workpapers related to a federal examination of NextCard, a former online credit card company that is being liquidated in a 400 million dollar bankruptcy. The charge stated that the auditors accessed workpapers contained in an archive and revised them. The revised versions were saved, and original workpapers were deleted. To ensure that the computer did not record the revisions as "after the fact" the team reset the internal clock on their computer to make an earlier date appear. Similar tactics were used by the auditors and attorneys involved in the Enron scandal.

The problem with such time-based digital data manipulation is that it is most often employed by "trusted insiders" such as CEO's CFO's and auditors, and not discovered until the cow has long since left the barn. For instance, if a trusted time-stamping schema had been required for use by auditors for Parmalat, the source of the forged document would have immediately exposed the fraud. Routine scans of time-stamped digitized information used in the audit process would uncover, on an immediate basis, and data tampering by insiders.

Cases of such insider initiated time-based data manipulation are increasingly being uncovered in the US due to greater scrutiny on corporate governance and it is our opinion that the spirit and intent of Sarbanes-Oxley, as well as the rules promulgated thereunder, should encompass the adoption of processes for "new age" technologies that protect against "old-time" fraud. Act and the realization that electronic data that are comprised of zeroes and ones, and are not physical in nature are really very easily manipulated. No auditor, CEO, or technology expert can read binary data and interpret them as a spreadsheet, an email or database table element.

System clocks are essentially untrusted time sources, and what are generally considered "time-stamps" are human-manipulatable data strings. If the organization that creates or manages the audit data can also alter the system clock, the data is untrustworthy. Where insider control over network time exists, the capability for digital data fraud exists. In the United States, other data-protection oriented laws (Gramm-Leach-Bliley and HIPAA) both require that data integrity be maintained on a continuing basis and be protected from internal as well as external attack.

This weakness in the data generating process may result in a material misrepresentation sufficient to call into question the certification of authenticity, and place both the certifier as well as the auditor in peril. Further, this vulnerability could affect the admissibility and weight of the data as digital evidence.

The solution to this relatively new, largely undetectable, but growing problem is independent trusted time-stamping technologies. Indeed, the issue has been well recognized in the United States by the American National Standards Institute (ANSI) that formulates security standards for the financial services industry and is working on the new American National Standard X9.95 Trusted Time Stamps.

Trusted time-stamping removes the risk of undetectable data tampering, manipulation, alteration or deletion by “trusted” insiders, and so removes twin vulnerabilities; insider exploitation of the lack of sufficient controls and legal challenges to data authenticity. It also provides an enterprise with the benefit of transparency and immediate fraud detection in the data and data audit trails that it does generate.

The risk inherent in not adopting a digital data trusted timestamping requirement is not that fraud will escape undetected. Detected it will be, but only after the fact, i.e., after the money has disappeared, and in all likelihood after any possibility of recapture, reversal, or meaningful restitution to investors. The costs of implementation of this technology are far outweighed by the forward-looking protection afforded investors in public companies. The investing public simply should not be exposed to another round Parmalat, Enron, Rite-Aid, Sirena, NextCard frauds resulting from time-based data manipulation, and we believe that the intent and spirit of both Sarbanes-Oxley as well as the rules promulgated by this Board mandate the prevention of such occurrences in the future.

We therefore recommend that the auditing standards be drafted to include a requirement that digital information that may be used in connection with the audit process be time-stamped using a trusted-timestamp schema.

Retention of Audit Documentation

¶ 13. “Audit documentation must be retained for seven years from the date of completion of the engagement, as indicated by the date of the auditor’s report,¹² unless a longer period of time is required by law.”

Audit documentation that was created in pen and ink on paper was relatively easy to retain. It was bound, identified on the covers, indexed, boxed, and stored in secure file rooms or by record storage providers. In such form, audit documentation was easily located, retrieved, and available for reading by those that needed it. An individual physical work paper could be easily destroyed, but it would take great effort or a catastrophic event, such as a fire, natural disaster, or act of terrorism to destroy a whole set of work papers.

Retention of digital audit documentation is almost completely different than retention of hardcopy documents. First, the storage media itself, whether it is magnetic tape, compact disc, or hard-drive, is subject to minor physical damage and deterioration that could

¹² PCOAB Footnote 3. If a report is not issued in connection with an engagement, then the date of completion of the engagement would be the date that fieldwork was substantially completed.

render the media completely unreadable. Second, digital documents are often stored in specific technology formats that only work with specific software, specific versions of software, and specific hardware. Computer software and hardware is subject to Moore's Law, a generally accepted theory, which posits that computer processing power doubles every two years. Moore's law has held for the last fifty years and is expected to hold for the foreseeable future. The effect of Moore's law is that software and hardware are often obsolete within two years of purchase. Given the retention requirement of the proposed standard, it is likely that much of the digital audit documentation created today will be unreadable by software and hardware in use seven years hence, or even less.

Therefore, with respect to the easily damaged nature of the media used to store digital records, we recommend that the auditing standards require that audit firms to maintain at least two copies of digital audit documentation. With respect to the obsolescence of computer technology, we also recommend that when audit firms upgrade their software and hardware used to prepare audit documentation they be required to maintain compatible software and hardware capable of reading the original digital audit documentation for the required retention period.

Integrity of the Audit Documentation (Changes to Audit Documentation)

¶ 14 “A complete and final set of audit documentation must be assembled for retention within a reasonable period of time following the first time the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements.”

¶ 15 “Audit documentation must not be deleted or discarded; however, information may be added, including an explanation of its relevance, as long as the information identifies the date the information was added; by whom it was added; and the reason for adding it.”

When audit documentation was in pen, ink (or pencil) and paper form, it would be difficult to insert whole workpapers within a set of workpapers after-the-fact due to the indexing system. Such insertions would be obvious unless great care was taken. Likewise deletions would also be obvious leaving gaps in the indexing system and hanging work paper references that led nowhere.

With digital audit documentation, the insertion, deletion, or change of workpapers after-the-fact is a trivial exercise with slight chance of detection without appropriate information security controls. Changing a digital audit document or deleting it entirely is as easy as point and click. Software such as Evidence Eliminator¹³ makes the job even easier and more effective. As indicated previously, audit firms subject to litigation or government enforcement action have a powerful incentive to commit such fraud. The fact that it is easy and there is little chance of getting caught makes the fraud more likely.

Therefore, with respect to the integrity of the audit documentation to reasonably ensure that changes made after 45 days are detected, we recommend that the auditing standards

¹³ Evidence eliminator is a software product to assist a PC user in wiping files from their computer and purports to defeat forensic software. See <http://www.evidence-eliminator.com/>

require that digital audit documentation be sealed with a combination of PKI and digital signature technology and secure computer time stamping technology. Such technologies would make it difficult to alter audit documentation after-the-fact without detection and provide reasonable assurance that the audit documentation has been unchanged from the date it was finalized and digitally sealed.

The above comments are ours personally and have not been approved by our Firms, nor should they be attributed to it. We would be glad to further discuss the proposed auditing standard and answer questions regarding my comments and may be reached at 973-871-4035.

Respectively submitted,

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March 3, 2004

Dr. Douglas R. Carmichael
Chief Auditor and Director of Professional Standards
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 012

Dear Dr. Carmichael:

Although we recognize that the comment period on this matter has closed, the California Board of Accountancy (CBA) has recently learned that the Public Company Accounting Oversight Board (PCAOB) has received comments on its Proposed Auditing Standard on Audit Documentation suggesting that the rebuttable presumption standard is workable only if it applies exclusively to PCAOB proceedings. As you know, the CBA is fully supportive of the current proposal, including its provision for the rebuttable presumption. The CBA is greatly concerned regarding this suggested amendment to the PCAOB proposed standard and its impact on the rebuttable presumption standard in California.

California's rebuttable presumption requirement (California Business and Professions Code Section 5097(c)) is not limited to proceedings before the CBA. Instead, all California audits currently must conform to California's audit documentation standards including the rebuttable presumption. If the PCAOB adopts an audit documentation standard which limits the rebuttable presumption provision to PCAOB proceedings solely, the CBA is concerned that some might assert or contend that in California a lower documentation standard would apply to audits of public companies than to audits of non-public companies. This could make it more difficult for the CBA to prove an audit failure in a disciplinary matter involving an audit of a public company.

The rebuttable presumption is an important standard because it is an additional critical incentive for licensees to properly document their work. This standard greatly enhances the ability of regulatory entities to protect the public. Under this standard, if work is not properly documented, then the burden of proving that the required work was performed properly falls on the licensee because the licensee has control over the audit documentation.

Because of the unique position of the California Board of Accountancy in the above noted matter, we urge you to give consideration to this Board's concerns and not make substantive changes related to the rebuttable presumption in the PCAOB's proposed audit documentation standard. Should you have questions or need additional information, please contact Carol Sigmann, Executive Officer, at (916) 263-3980.

Sincerely,

Ian B. Thomas
President

c: Members, California Board of Accountancy

CHARLES R. DROTT

CERTIFIED PUBLIC ACCOUNTANT • CERTIFIED FRAUD EXAMINER

December 23, 2003

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

Re: PCAOB Rulemaking Docket Matter No. 012

I am pleased to have this opportunity to comment on the PCAOB's Proposed Auditing Standard, "Audit Documentation," and Proposed Amendment to Interim Auditing Standards, "Part of Audit Performed By Other Independent Auditors." Comprehensible and thorough audit documentation is essential in order to achieve audit integrity and quality. It provides greater discipline to the audit process which, in turn, should result in enhanced investor protection.

This proposed standard is a significant improvement over the existing standard on audit documentation because it incorporates many new provisions which are necessary to (1) enhance the quality of audits; (2) enable the PCAOB to fulfill its oversight and inspection mandates; and (3) improve investor protection by reducing the incidence of audit failures. I, therefore, enthusiastically endorse this greatly improved audit documentation standard and recommend its early adoption by the PCAOB. I also wish to highly commend the authors of the proposed standard for their significant efforts in producing such greatly improved guidance to the nation's auditors.

The remainder of this letter constitutes my specific comments and suggestions relative to certain provisions of the proposed standard, and I respectfully request that the PCAOB consider them in finalizing the standard. The paragraph numbers reflected herein refer to specific paragraphs in the text of the proposed standard.

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OBJECTIVES OF AUDIT DOCUMENTATION

Paragraph 3

Paragraph 3.c. of the proposed standard states that: "Engagement partners and engagement quality control reviewers review documentation to understand how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions." I recommend that an additional reason be given for such reviews which states that reviewers review documentation to ensure that an appropriate opinion is issued relative to the audit engagement based on the evidence obtained. Such a comment should be added because it describes the primary objective of any review by an engagement partner or engagement quality control reviewer.

CONTENT OF AUDIT DOCUMENTATION

Paragraph 5

Paragraph 5 of the proposed standard states the following:

Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent and results of the procedures performed, evidence obtained, and conclusions reached, and
- b. To determine who performed the work and the date such work was completed, as well as the person who reviewed the work and the date of such review.

I support the above described language for inclusion in this proposed standard, which is similar to the G.A.O.'s standard on audit documentation, because it clearly represents a significant improvement over the current existing standard. However, I

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recommend other additional items for inclusion in this paragraph. First, the term "experienced auditor" needs to be defined, or at least explained, because, without such definition or explanation, it is vague and open to widely varying interpretation. Such definition or explanation should, at a minimum, refer to an appropriate level of experience relative to the risks and complexities of the engagement and the industry in which the client company operates.

I further suggest that paragraph 5.a. be expanded to include "an understanding of the logic and reasoning supporting important audit judgments." If such logic and reasoning are not appropriately documented, there is no effective manner for an "experienced auditor" or reviewer to evaluate the soundness of significant audit judgments made and their compliance with professional standards. In essence, without such documentation, overall audit quality is difficult to evaluate, which has been a significant continuing problem for firms and peer reviewers as well as regulators and others who review audit documentation.

Paragraph 5.b. states that audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement to determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review. I fully support this requirement, which is very similar to a provision of a newly enacted California regulation. It is critical for firms and outside reviewers to know the identities of the professionals responsible for the work and the timing thereof in order to evaluate the exercise of due professional care in the engagement and compliance with other professional practice standards (independence, training, adequate professional skepticism, etc.).

The new California regulation referred to above, however, also includes certain other provisions that this proposed standard does not currently incorporate. Such California regulation requires that audit documentation also include both the audit report (opinion) date and the date such audit report was issued because such vital information is often not included in audit documentation. Further, there is another California requirement that audit documentation include an index or guide which identifies the components of the audit documentation. I respectfully request, therefore, that the PCAOB give

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consideration to including these additional requirements in its final standard in order to further enhance the usefulness of audit documentation to the PCAOB's inspection staff and others who review audit documentation.

Paragraph 6

Paragraph 6 of the proposed standard incorporates the rebuttable presumption provision which I wholeheartedly endorse. Such provision, which has been enacted into law in California, states that failure by an auditor to document audit procedures performed, evidence obtained, and conclusions reached will create a presumption that the procedures were not applied, the evidence was not obtained, and the conclusions reached were not suitably supported. Such presumption, however, can be rebutted by persuasive other evidence that the procedures were applied and the evidence was obtained to provide sufficient support for the conclusions reached.

The California Board of Accountancy ("California Board") has continually encountered instances in enforcement proceedings where auditors claimed that audit work was performed but not documented. This has made the California Board's investigations and related enforcement proceedings very difficult because the burden of proof at the time rested with such Board. In order to better protect consumers and investors by enhancing the ability of its enforcement staff to engage in meaningful investigations of alleged audit failures, the California Board and lawmakers adopted a rebuttable presumption provision which shifted the burden of proof to the auditor that performed the audit. The California Board and lawmakers determined that it was not only logical but also more fair to consumers and investors for the burden of proof to be shifted from the California Board to the auditor that performed the work because the auditor is the most knowledgeable about the actual work that was performed.

I noted that the PCAOB's November 12, 2003 Briefing Paper contained an important statement that is not included in paragraph 6 of the proposed standard. Such statement is as follows:

Oral explanation alone does not constitute persuasive other evidence (to rebut the presumption that the

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audit procedures were not performed, the evidence was not obtained, and the conclusions reached were not suitably supported).

In response to the PCAOB's invitation to comment on the addition of such a requirement to the proposed standard, I strongly believe that while auditors should be allowed to offer oral explanations regarding the performance of audit procedures and evidence obtained, such oral explanations alone should not constitute persuasive other evidence. Accordingly, I urge the PCAOB to incorporate into its final standard the critical statement described above that was included in its Briefing Paper in order to discourage auditors from claiming that audit work was performed but not documented. By taking this position, the PCAOB will greatly enhance investor protection.

Paragraph 9

Paragraph 9 of the proposed standard describes several examples of "significant findings or issues" that must be reflected in audit documentation. As one such example, paragraph 9.d. refers to disagreements among members of the engagement team or with others consulted on the engagement about conclusions reached in significant accounting or auditing matters. I suggest that this example be expanded to also include disagreements with client management or other representatives of the client regarding significant accounting or auditing matters. Further, I would also include another example, as follows: "Evidence of and conclusions regarding fraudulent financial reporting or misappropriation of assets." This is a particularly important example to include in the standard because of the significant number of incidences of fraudulent financial reporting involving public companies in recent years.

Although paragraph 9 gives several good examples, as referred to above, there is no clear definition or explanation of "significant findings or issues." I suggest that the proposed standard include a definition or an explanation as well as examples of "significant findings and issues" in order to provide as much guidance as possible to auditors, and, thus, minimize confusion in the application of the standard.

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Paragraph 10

Paragraph 10 of the proposed standard requires that the auditor identify all significant findings or issues in an engagement completion memorandum and that such memorandum be as specific as necessary in the circumstances and include cross-references to other supporting audit documentation. As the use of an engagement completion memorandum currently varies in practice, I fully support the provision to require its use in all audits of public companies. Such a memorandum that reflects all significant findings or issues is a valuable and efficient tool to assist the audit engagement partner and others that review audit documentation in identifying and evaluating important matters in an audit engagement. Its value is especially evident in large engagements involving audit work performed and documentation generated in multiple locations.

I further recommend that paragraph 10 be expanded to require that the engagement completion memorandum include a discussion of any audit evidence that does not support or that contradicts the auditor's final conclusions (see paragraph 12 of the proposed standard) or where there has been a difference of opinion among the audit staff or between client management and the auditors regarding any significant auditing or accounting issue. Further, I also recommend the inclusion in paragraph 10 of a provision that requires the audit engagement partner to state his or her conclusions regarding the appropriateness of the audit opinion issued and whether the audit work has complied with all relevant auditing and other professional practice standards.

RETENTION OF AND SUBSEQUENT CHANGES TO AUDIT DOCUMENTATION

Paragraph 13

Paragraph 13 of the proposed standard requires that audit documentation be retained for seven years from the date of completion of the engagement, as indicated by the date of the auditor's report, unless a longer period of time is required by law. I recommend that an additional provision be included in the proposed standard which provides that all audit documentation required to be maintained shall be maintained in

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accessible form. Further, the proposed standard should also include a statement that if audit documentation is required to be kept for longer than seven years because of a pending PCAOB or other regulatory investigation or disciplinary action, audit documentation shall not be destroyed until the audit firm or auditor has been notified in writing by the PCAOB or other regulatory agency of the closure of the investigation or disciplinary proceeding.

I also strongly recommend that a further provision be added to paragraph 13 which requires audit firms to maintain and document compliance with a written audit documentation retention and destruction policy. Such policy should provide for the preservation of audit documentation for the full seven year period or longer period of time required by law, as described above. The policy and documentation of compliance therewith must be made available to the PCAOB or other regulatory agencies upon request. The policy should include procedures for maintaining audit documentation, approving changes to audit documentation, approving the destruction of audit documentation, and authorized custody of audit documentation.

Paragraphs 14 and 15

Paragraph 14 of the proposed standard requires that the auditor complete all necessary auditing procedures and obtain sufficient evidence to support the representations in the auditor's report prior to granting permission to use the auditor's report in connection with the issuance of the client's financial statements. Such proposed standard further states that a complete and final set of audit documentation must be assembled for retention within a reasonable period of time following the first time the auditor grants permission to use the auditor's report in connection with the issuance of the client's financial statements, and that "such reasonable period of time ordinarily should not be more than 45 days." (Emphasis added).

While this is an excellent provision, I am concerned that use of the phrase "ordinarily should not be more than 45 days" is vague, confusing, and may open the door for circumvention of an otherwise good provision. I, therefore, strongly recommend elimination of the word "ordinarily" from the above phrase which clarifies that there is a 45 day maximum time period to

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assemble a complete and final set of audit documentation for retention.

As stated above, paragraph 14 of the proposed standard requires that the auditor complete all necessary auditing procedures and obtain sufficient evidence to support the representations in the auditor's report prior to granting permission to use the auditor's report in connection with the issuance of the client's financial statements. However, paragraph 15 then states that circumstances may require subsequent additions to the audit documentation. Moreover, paragraph 15 also refers to obtaining evidence after completion of the engagement as well as "post-issuance procedures." I am concerned that auditors may view paragraph 15 as somewhat contradictory to paragraph 14 and, as a result, there could be confusion as to what is allowed regarding work performed or evidence obtained subsequent to issuance of the audit report.

In order to provide clarity, I recommend that paragraph 15 be expanded to include an explanation and/or examples of the "circumstances" that may require subsequent additions to audit documentation and an explanation of the circumstances under which evidence may be obtained after completion of the engagement. Moreover, I further suggest that an explanation and/or examples be given in paragraph 15 of the reasons for performing and the nature of any "post-issuance procedures." I am concerned that without such explanations and/or examples, auditors may erroneously conclude that there may be circumstances where they can actually perform audit procedures and obtain evidence subsequent to the issuance of an audit report which would violate the requirements of paragraph 14, as discussed above.

In order to avoid such a problem, the California Board of Accountancy adopted regulations which stated the following:

During a 60 day period after the date of issuance of the audit report, documents may be added to the file for the assemblage and documentation of work previously performed. Nothing in this subsection authorizes the deferral of audit procedures required to be performed prior to the date of issuance of the [audit] report. (Emphasis added).

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Paragraph 15 also contains a requirement that any additions or changes to audit documentation subsequent to issuance of the audit report must reflect the date the information was added or changed, by whom it was added or changed, the reason for the addition or change, and, in the case of a change in documentation, the nature of the change. I very much support these new requirements and recommend a further requirement in paragraph 15 (similar to the new requirement enacted in California), as follows:

The documentation which is added or changed must contain sufficient detail to enable a reviewer with relevant knowledge and experience, having no previous connection with the audit engagement, to understand the nature, timing, reasons for, and extent of the addition or change.

Paragraph 16

Paragraph 16 of the proposed standard requires that audit documentation sufficient to meet the requirements of paragraphs 4-12 of such standard must be retained by the office issuing the auditor's report. As paragraph 16 notes, this requirement encompasses documentation of work performed by others, such as affiliated firms (including foreign affiliates) of the auditor issuing the audit report. I fully support and have advocated this new requirement because of significant problems encountered in the past in not being able to obtain audit documentation from foreign affiliates of audit firms whose work was being investigated because of foreign legal jurisdictional issues and lack of cooperation from foreign affiliates.

It is critically important that the PCAOB and other regulatory agencies have access to all audit documentation for an audit engagement, including documentation from foreign affiliate firms, for inspection at the office that issued the audit report. It is only logical and reasonable to have all the audit documentation at the office that issued the audit report, especially since the engagement partner at such office has the ultimate responsibility to review the documentation and sign such audit report. The only possible hardship on the audit firm would be transportation and/or copying costs which pale compared

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to the inability of the PCAOB and other regulatory agencies to inspect audit documentation of foreign affiliates. Further, in instances where the audit work performed by foreign affiliates constitute significant support for the audit report, the problem is exacerbated.

I, therefore, applaud the PCAOB for including this important provision in its proposed standard in order to assure that all audit documentation is available for inspection by the PCAOB and other regulatory agencies. In my opinion, if this new language does not remain intact in the proposed standard because of opposition to its inclusion, it will open the door for further abuse by audit firms that either do not want to go to the trouble of making such documentation available to all authorized agencies, or that have performed substandard audit work at foreign locations and wish to conceal the evidence of such work from the PCAOB and other regulatory agencies.

Thank you for this opportunity to express my views and offer recommendations relative to the excellent proposed standard on audit documentation. Should you have any questions or need additional information, please do not hesitate to contact me.

Yours very truly,

Charles R. Drott

**AMERICAN BAR ASSOCIATION
Section of Business Law
750 North Lake Shore Drive
Chicago, IL 60611**

January 30, 2004

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

Re: PCAOB Rulemaking Release No. 2003-023, Docket No. 012

Dear Board Members:

On behalf of the Committee on Law and Accounting and the Committee on Federal Regulation of Securities Section of Business Law of the American Bar Association (jointly, the "Committees"), we are pleased to have the opportunity to comment on the Public Company Accounting Oversight Board's (the "PCAOB") proposed auditing standard relating to the retention of audit documentation (the "Proposed Standards").

The comments expressed in the letter represent the views of the Committees only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, they do not represent the official position of the ABA Section of Business Law, nor do they necessarily reflect the views of all members of the Committees.

As a general comment, the Committees fully understand and appreciate that the PCAOB was created to enhance the quality of public company audit practice and that a requirement to maintain a complete record of all audit procedures will not only tend to assure that complete and thorough audits are performed, but also will facilitate the PCAOB's inspections of firm practices. Nevertheless, we are concerned that the Proposed Standards would impose substantial additional burdens on registered firms and their public company clients that may not be cost-beneficial. Indeed, we see no evidence that the PCAOB has even considered these additional cost burdens. Nor does the Release explain the rationale or basis for its proposals.

The PCAOB is not a government agency, and accordingly it is not required to follow the Administrative Procedure Act. Nonetheless, we believe the Board will enhance both the acceptance of its rules and the standard-setting process as a whole if it fully explains the purposes behind rule proposals and considers the cost-implications.

Accordingly, we encourage the PCAOB to review the Proposed Standards from this perspective and to discuss its findings in its adopting release. As more fully discussed below, we

also believe that the requirement to store work papers from foreign components of an audit may be in conflict with the laws of certain foreign countries.

What Is Audit Documentation?

The Proposed Standard seems to significantly expand what has traditionally been deemed to be included within the term “audit work papers.” That definition is stated in Paragraph 2 of the Proposed Standard (namely; “records on the planning and performance of the work, the procedures performed, evidence obtained and conclusions reached. . .”).¹ Under the Proposed Standard, however, an auditor is also required to include documentation of compliance with independence, training and proficiency standards (Paragraph 8), as well as a “completion memorandum” addressing the issues specified in Paragraph 9 of the Proposed Standard. Moreover, under the Proposed Standard audit work papers must also “demonstrate how the audit complied with the principal auditing and related professional practice standards” (Paragraph 7). While we appreciate the Board’s desire to have audit work papers become a self-contained record of all aspects of an audit so as to facilitate the Board’s inspection function, these additional requirements are going to greatly increase the record-keeping burdens of public company auditors and the cost of providing audit services to their public company clients. We wonder whether all of these additional requirements are both necessary and cost-beneficial.

In the same regard, we note that Paragraph 4 of the Proposed Standard lists numerous categories of documents deemed to constitute “audit documentation” if they were “created or obtained in connection with the engagement” This would seemingly include miscellaneous communications such as requests to the client for supporting documents, superseded drafts of financial statements and work papers and a host of other documents that would add little to an understanding of the auditor’s opinion or audit processes. Therefore, we believe that it would clearly be helpful for the Proposed Standard to provide further guidance as to what is and is not required to be included in the audit documentation. For example, must an auditor document his or her efforts to ascertain whether the client has paid its annual assessment to the PCAOB? This problem is somewhat exacerbated by the requirement that the audit firm document its “significant findings or issues” terms which the Proposed Standard defines in an open-ended manner.

We further note that Paragraph 12 requires the inclusion of findings and documents that are inconsistent with the auditor’s final conclusions as well as the procedures applied with respect to such matters. Similarly, Paragraph 9(d) requires the documentation of disagreements among members of the engagement team.² These particular requirements contain no materiality screen; nor do they seemingly contemplate that the audit partner may have simply not found the

¹ Because the auditor’s opinion on the client’s internal controls is deemed to be an integral part of the audit, the audit documentation rules presumably encompass the audit firm’s work papers relating to this aspect of its engagement. This should be clarified in the final rule.

² If the PCAOB elects to include this requirement, it should provide further guidance as to when a difference of views among members of an audit team constitutes a “disagreement.”

audit evidence to be credible or the arguments of dissenting members of the audit team to be persuasive. While we appreciate that an auditor must go through the thought process by which such audit evidence is rejected, we are not aware that such instances have proven sufficiently problematic to warrant a further documentation requirement in view of the new burdens already being imposed upon public company auditors and their clients who ultimately must absorb the costs of these additional efforts. We, therefore, suggest that these requirements be deferred until the cost burden of the Proposed Standard can be better assessed.

Undocumented Procedures

Paragraph 6 of the Proposed Standard provides that a failure to document the procedures performed, evidence obtained and conclusions reached creates a rebuttable presumption that the procedures were not applied, the evidence was not obtained and *the conclusions reached were not suitably supported*. As you are undoubtedly aware, every set of financial statements contains literally hundreds, if not thousands, of assertions regarding the existence, value and ownership of client assets, not to mention the reasonableness of hundreds of accounting estimates. Accordingly, this presumption will require audit firms to formally record literally scores of tests and comparisons that they make during the course of their audit, greatly retarding the audit process. Thus, while this well-intended change is quite logical, it nevertheless will compel a much higher degree of documentation that will only further add to the cost of audit services. This added burden could be significant, especially for small public companies.

It is also unclear from the Proposed Standard what evidence is necessary to rebut the presumption. The Proposed Standard only refers to “persuasive other evidence.” This is a highly subjective standard that could easily be misinterpreted. Under current practice an auditor has been permitted to prove that he or she performed an audit procedure through his or her own testimony, if that testimony were deemed credible. If the PCAOB intends to depart from this practice, it is important that the Proposed Standard be explicit. Moreover, is the Board purporting to establish a standard that only pertains its own disciplinary procedures or one to be applied in civil litigation as well? It would appear that, since it is an auditing standard, the standard would be applicable in civil litigation, and we are concerned about the impact it might have in lawsuits against accounting firms. We encourage the PCAOB to address these issues when it reconsiders the Proposed Standard.

Amendments To Work Papers

Paragraphs 14 and 15 of the Proposed Standard address the issue of changes to work papers and pose a minor contradiction. Whereas Paragraph 14 seems to contemplate that an audit firm has up to 45 days following the completion of an audit to finalize its audit work papers, Paragraph 15 seems to require that superseded versions of audit work papers not be discarded following the completion of the engagement even if superseded within the 45-day period. We suggest that the prohibition regarding discarding work papers commence at the conclusion of the 45-day period.

We also note that Paragraph 15 requires that *all* additions to the work papers made after the completion of the engagement be currently dated. Thus, if the engagement partner spots a deficiency in the work papers when making his or her final review and decides to issue the audit

report based upon a representation from a staff accountant that an undocumented audit procedure was actually performed, the work paper subsequently created to evidence that procedure would have to be dated as of the date of the creation of the work paper and not as of the date the audit procedure was performed, and this would be true even if the work paper were created during the 45-day period following the completion of the engagement. Even though this rule might cast some suspicion upon the firm's performance of the audit procedure, it will create an incentive to document work as it is performed, which we believe is appropriate.

Retention of Work Papers

Perhaps the most troubling aspect of the Proposed Standard is the requirement that all work papers associated with the engagement be maintained "at the office issuing the auditor's report." Although we recognize that this requirement would assure that the engagement partner would have all relevant data before him or her when signing off on the report and would facilitate a review of the engagement by the PCAOB inspection team, we are informed that this requirement could pose problems with respect to audits of certain multi-national corporations with material operations in those countries in which there are privacy laws prohibiting the transfer of client records. It is also our understanding that in order to avoid these restrictions the audit firm would have to obtain the client's consent prior to acceptance of the engagement to permit the transfer of the audit work papers; and in some countries (such as France) these restrictions may not even be subject to waiver. We, therefore, encourage the PCAOB to carefully consider the discussion of this subject being submitted by the large international accounting firms, and provide guidance in its release promulgating its final rule.

Reading Paragraph 16 literally, the audit work papers (going back seven years) would have to be maintained "in the office" issuing the audit report. We assume that this does not preclude the storage of certain of these files in off-site storage warehouses. If not, this could pose a substantial storage burden on firms that still maintain a significant portion of their work papers in hard copy format.

Successor Auditor Reviews

Paragraph 4 (b) of the Proposed Standard makes reference to "successor auditor reviews" of audit work papers, but omits the purpose of such reviews. While this standard may not be the appropriate place in which to address the issue of such reviews, we believe that there is a void in the audit literature regarding the purpose of such reviews and the extent to which a successor auditor is permitted to rely upon the work performed by the predecessor auditor, especially with reference to the opening balance sheet.

Ownership of Audit Work Papers

Audit work papers, under the Statements on Auditing Standards promulgated by the Auditing Standards Board, are considered the property of the auditor and not the client. This is an important concept and we believe that it should also be embodied in the rules of the PCAOB.

Concluding Remarks

We appreciate the opportunity to comment on the PCAOB's Proposed Standard. If you have any questions regarding the substance of our comments, those questions should be addressed to the undersigned.

COMMITTEE ON LAW & ACCOUNTING

/s/ Thomas L. Riesenber

By _____
Thomas L. Riesenber, Chair

COMMITTEE ON FEDERAL REGULATION
OF SECURITIES

/s/ Dixie L. Johnson

By _____
Dixie L. Johnson, Chair

Drafting Committee:

Dan L. Goldwasser, Chair
Peter A. Basilevsky
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David B. Hardison
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COMMONWEALTH of VIRGINIA

Auditor of Public Accounts

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January 15, 2004

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

Subject: PCAOB Rulemaking Docket Matter No. 012

Dear Sirs:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board (PCAOB) Proposed Auditing Standard *Audit Documentation and Proposed Amendment to Interim Auditing Standards*.

We have provided a response to two issues included in the exposure draft, which we would like to encourage the Board to consider when finalizing the standard.

Paragraph 6:

In general, we agree with Paragraph 6 of the proposed standard that states that documentation should include procedures performed, evidence obtained and conclusions reached. However, we have a concern with the presumption that conclusions that are not adequately documented are not suitably supported. We believe there is a difference between not having done the testwork and not having adequately documented the conclusion. For example, a situation could arise where audit procedures were applied, evidence obtained and no exceptions were noted but the auditor did not document a conclusion. We do not believe it should be assumed that the lack of documentation of a conclusion means that there is inadequate support for the auditor's report.

Paragraph 18:

We believe that the implementation date should be changed from "*completed on or after*" to "*beginning on or after*". An audit that was planned to have ended prior to the proposed June 15, 2004 implementation date but unforeseeably ending after June 15, 2004 would potentially not be in compliance with the standard. The date itself could be made sooner so that the standard could take effect sooner if that is the desire of the Board.

Office of the Secretary
Public Company Accounting Oversight Board
January 15, 2004
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We appreciate the efforts of the Board and the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact me or Martha Mavredes at (804) 225-3350.

Sincerely,

A handwritten signature in black ink, appearing to read "Walter J. Kucharski". The signature is written in a cursive style with a prominent initial "W".

Walter J. Kucharski
Auditor of Public Accounts

WJK:aom



Office of the Secretary
Public Accounting Oversight Board
1666 K Street, N.W.
Washington D.C. 20006-2803
United States of America

January 20th, 2004

Subject : Rulemaking Docket Matter n°012 - Proposed auditing standard on audit documentation and proposed amendment to interim standards

Dear Mr Secretary,

The CNCC (“Compagnie Nationale des Commissaires aux Comptes”, the French Body of statutory auditors) is very pleased to have the opportunity to provide its comments on the release n°2003-23 of the Public Company Accounting Oversight Board (the “PCAOB” hereafter) relating to the proposed auditing standard on audit documentation and proposed amendment to interim standards.

The CNCC strongly supports the goal of the PCAOB to improve the quality and transparency of financial reporting. We share the PCAOB’s viewpoint that “the integrity of the audit depends in large part on the existence of a complete and understandable record of the work that the auditor performed, of the conclusions that the auditor reached, and of the evidence that supports those conclusions”. Clear and comprehensive audit documentation is an essential element of a quality audit. Further we understand that the rule is intended to respond to Section 103 of the Sarbanes-Oxley Act of 2002 which states, inter alia, that “each registered public accounting firm shall ...prepare and maintain...audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached.”

For a variety of reasons set forth below we strongly object to the provision of the proposed standard to retain the working papers at the office issuing the auditor’s report . In addition to the legal barriers in France that would prevent French firms from complying with this provision, we disagree with the fundamental premise that “this requirement would improve audit quality by enhancing the probability that all audit documentation will be prepared with the same standards of audit quality.”

In addition, the CNCC considers that certain provisions of release 2003-23 are inconsistent with release n°2003-024 “Rules related to oversight of non-US accounting firms”. In release 2003-024 the PCAOB expressed a willingness to cooperate with local oversight bodies. The PCAOB also recognized that some provisions of its rules “raise special concerns for non-US registered firms such as unnecessarily duplicative costs and potential conflicts of law”. Release n°2003-023 does not appear to take into account these concerns.

... / ...

We provide hereafter our detailed comments on :

- the retention of working papers at the office issuing the auditor's report ;
- the use of the work of other auditors.

Our detailed comments cover both general considerations which could be common to many countries and legal impediments specific to France.

Concerning general considerations, as an alternative to centralizing work papers at the Issuing Firms, our suggestion would be to collect key documentation which :

- identifies the auditor responsible for supervising the work at each location,
- confirms that the audit procedures performed at each location were planned, performed and supervised in accordance with US GAAS,
- identifies all significant matters which should be valued by the issuing office engagement team,
- confirms that the participating firm or office is responsible for retaining audit documentation for the required period.

We believe such recommendation coupled with a regular program of quality control reviews would achieve the objective of clear and complete documentation being prepared and maintained.

Concerning legal issues, we suggest that the only satisfactory resolution of the situation is a cooperation with the "Haut Conseil du commissariat aux comptes" as recently established by the "Loi de Sécurité Financière" of August 1st 2003.

The "Haut Conseil" was established, to oversee the professional standards, practices and independence of French "commissaires aux comptes", with the assistance of the "Compagnie nationale des commissaires aux comptes". Decree n° 2003-1121, dated November 25, 2003, with respect to the organization of the "Haut Conseil", specifically provides that the "Haut Conseil" is to maintain regular relationships with its foreign homologues, both within the European Union and internationally. Although the "Haut Conseil" is just beginning its functions, the "Haut Conseil" should have the power to enter into arrangements with foreign regulators that would permit, if it so decides, the sharing of information and documents.

The "Haut Conseil" has jurisdiction for quality control over all French "commissaires aux comptes" including those responsible for the audit of French foreign registrants and French affiliates of other SEC Registrants.

Thus, many of the issues raised by releases 2003-023 and 2003-024 may be addressed in the context of discussions between the PCAOB and the "Haut Conseil". In this regard, we understand that representatives of the "Haut Conseil" expect to meet with representatives of the PCAOB in the near future in order to discuss these matters.

Yours sincerely,

Michel Tudel
President,
Compagnie Nationale des Commissaires aux Comptes

DETAILED COMMENTS

- **Retention of working papers at the office issuing the auditor's report**

Paragraph 16 of the proposed auditing standard states that “audit documentation sufficient to meet the requirements of paragraphs 4-12 [...] must be retained by the office issuing the auditor's report”.

We believe that the wording of the provision is too general and could give rise to different interpretations. In addition the proposed standard does not specify if any audit procedures are to be carried out on the documentation collected by the principal auditor. It is unrealistic to expect that members of any Issuing Firm could perform any type of meaningful review of transmitted work papers within the time frame necessary to allow for the issuance of a timely audit report.

- **This provision does not contribute to an overall improvement of audit quality :**

This provision appears to be impracticable in the business environment, which tends to be complex and international. The organization of internal control's and accounting systems to produce the financial statements may be very complicated. It does not systematically correspond to legal structures and reporting may be driven by business lines consisting of segment of activities that are carried out by different legal entities. In such situations, the transmission of the audit documentation as prescribed in paragraph 4 to 12 of the release could imply several communication of the audit documentation to several offices.

Furthermore, the transfer of audit documentation raises several issues regarding data integrity. Secured methods for shipping of paper documents, transfer of electronic files and physical control over these items at the Issuing Firm premises would need to be studied. We do not think that the volume of the documentation for a global multinational SEC registrant has been evaluated. Transmission of all audit work papers would create a logistical challenge that could serve to impede rather than facilitate the assessment of audit quality and the evaluation of audit results.

If the objective of centralization of audit documentation is to allow quality control in one location, we draw your attention to the fact that the audit working papers may include numerous elements in local language. There is also a risk that the audit documentation could be misunderstood by a reader or quality control reviewer who is not fully conversant in local laws, regulations and business environment. Work papers implicitly reflect the local auditors knowledge of the French Commercial Code as well as common business terms and practices, common contractual frameworks, local tax and regulatory rules and the local business environment. French “commissaires aux comptes” undergo years of education and training, including practical on-the-job training prior to receiving their professional licenses. This is designed to equip them to carry out an effective audit in the context of the French business environment with its attendant legal and tax structures. While work papers are designed to be complete and comprehensive, they do not and cannot contain exhaustive background information on, for example, French business law. Work papers can and should “contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was done, who performed it, when it was completed, and the conclusions reached,” however in this case the “experienced auditor would have to be an experienced French trained auditor.

The retention of working papers at the office issuing the audit report will create a significant administrative burden. This process has no evident impact on the quality of the audit. This could lead to an increase of audit fees that is not justified by audit work itself but by administrative tasks.

For the reasons above, we believe that the centralization of audit documentation is impracticable and will not facilitate the PCAOB's objective of consistent audit quality control.

- **Local legal impediments**

In the ordinary course of their professional activities, "commissaires aux comptes" ("French statutory auditors") do have some limited communications with other auditors at the behest of their clients. Thus, in the context of an audit of a consolidated group, the "commissaires aux comptes" (group auditors) may communicate with auditors of a parent or other group company to the extent necessary to permit completion of the audit. Such communications are permitted expressly as concerns other French auditors (Article L. 822-15 of the Code de Commerce) and implicitly as concerns non-French auditors. Such communications are, however, quite limited in scope, and extent to what is strictly needed for the lead auditor to understand the subsidiary's financial statements and do not include communication of audit working papers and other documents.

Other local legal prescriptions will not allow him to transfer their working papers to another auditor in the specific circumstances set out in law where a communication is permissible. These prohibitions are mainly based on the substantive content of documents or information. Additionally and as already mentioned in our letter dated 28 March 2003, "French law prohibits communications of certain information of an economic, commercial, industrial, financial or technical nature to a foreign authority without having obtained authorization from the relevant ministry. Further restrictions could apply to information in sensitive industries with national security implications". It should be also emphasized that violation of some of these provisions are punishable under criminal law.

Due to the international context, local legal impediments of the different countries where groups operate may be cumulative.

For all the reasons highlighted previously, the transmission of the audit documentation as defined in paragraph 4 to 12 of release n° 2003-23 would not be permitted under law for French "commissaires aux comptes".

• **Using the work of other auditors**

Paragraph 16 of the proposed auditing standard states that: "Alternatively, if the auditor considers is necessary in the circumstances, the auditor issuing the report should prepare and retain audit documentation of the work performed by others as part of the review by paragraph 12 of AU sec. 543[...]".

We strongly disagree with that requirement due to legal impediments as discussed above and practical issues. Moreover, this provision does not take into account the specific case of joint audit which is mandatory for all companies presenting consolidated financial statements.

- **Use of other auditors' work**

As discussed above, obtaining the original or copy of the other auditor's audit documentation - whether they belong to the same network as the principal auditor or not - could be prohibited by law. Even if there is no such restriction, it is highly unlikely that the other auditor would provide copies without obligation to do so. This obligation could be imposed by the PCAOB in its standards but only upon auditors registered with the Board. As a consequence, the principal auditor could be in the position of being required to obtain documentation that another party has no obligation or no possibility due to legal impediments to provide.

The alternative presented by the PCAOB to "prepare and retain documentation of the work by other auditors" as a part of the review by the principal auditor is equally unworkable. In fact, there are only two ways in which the principal auditor can incorporate sufficient documentation to meet the documentation standards in the Board's proposed amendment : obtain the originals or a copy of the other auditor's audit documentation or re-perform the work and assemble the audit documentation himself or herself.

Furthermore, this requirement will not be cost effective for the French issuers. The requirement to incorporate the documentation of the other auditors as if the [...] auditor had performed the work himself¹ will lead to a disproportionate increase of audit fees in comparison to the impact on audit's quality. It may lead to discriminatory consequences for the French issuers. The other issuers having a principal auditor will have a competitive advantage that is unacceptable in the context of an equal access to securities markets.

Accordingly, we recommend the PCAOB change its proposed standard and require that the principal auditor document the review of the other auditor's documentation in a memorandum. The memorandum should include the principal auditor's conclusion that the other auditor's work is sufficient for the principal auditor to rely upon the other auditor's report as a basis, in part, for the principal auditor's report, and should include a summary of the other auditor's major findings and conclusions on important auditing, accounting, and reporting issues.

- **Specific French case of mandatory joint audit**

All French SEC Registrants are subjected to joint audit by law : the requirement of joint audit for companies issuing consolidated financial statements (listed or not) is set out in article of 225-228 of the French Code of Commerce. The Law on Financial Security of 1st August 2003 has confirmed this matter as a safeguard to reinforce the audit quality and maintain the auditors' independence.

Therefore, there are some situations where the financial statements filed at the SEC are jointly signed by two "commissaires aux comptes". Both of them act as principal auditor and the responsibilities are jointly shared. Each joint auditor is jointly and severally responsible for the entire audit. Procedures for a joint audit require that the audits are jointly planned including the determination of the nature and extent of test work in all areas. All audit results are shared, files are cross-reviewed and the audit files are considered to be the property of both auditors.

In addition, audit files of the joint auditors are accessible and controlled as they are one unique file even if located in separate offices in particular within the framework of the French national quality control.

We as such consider that joint audits do not fall under the provision's release 2003-023 related to use of other auditors' work.

~

¹ Proposed amendment to AU section 543.12 page A2-3



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January 20, 2004

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

Subject: PCAOB Rulemaking Docket Matter No. 012

We are pleased to comment on the proposed auditing standard on audit documentation. Our comments are presented in the same order as the proposed auditing standard, and each comment begins with a reference to the paragraph number in the proposed standard followed by a recitation of the particular wording we comment on.

#1. "in connection with any engagement conducted in accordance with auditing.... Standards"
We suggest that in the final PCAOB standard, and in all future PCAOB standards, that the PCAOB clearly and specifically indicate that this standard applies to the audits for which the PCAOB has been given the authority by the Sarbanes-Oxley Act to regulate, and not to other audits. While this is well understood to be the case, we nevertheless believe there is likely to be use, out of context, of the wording of this PCAOB standard. We believe that someone, for their purposes, may quote the "any engagement" language in seeking to impose an obligation contained in a PCAOB standard upon an auditor in a situation where the Sarbanes-Oxley Act and the PCAOB standards do not apply. For example, this PCAOB standard does not apply to audits of governmental enterprises, to audits of non-public enterprises, or to audits conducted by non-US auditors following the rules of their respective countries and not involving entities subject to the Sarbanes-Oxley Act.

#2. "provides the basis for the review of the quality"
We believe audit documentation should not be stated as "the basis" for the review of the quality of the work by the reviewer, as that wording implies it is the sole basis for that review. However, oral discussion with other auditors on the audit team, including inquiry and observation, is also relevant in certain areas and may be useful in the review of the quality of the work performed. Existing PCAOB auditing standards acknowledge the usefulness of inquiry and observation in various auditing procedures, such as the usefulness of making inquiries of management (AU 319.58 "inquiries of appropriate management, supervisory, and staff personnel") and of observation (AU 319.58 "observation of entity activities and operations"). Oral discussions are also useful and, in the case of the brainstorming meeting to discuss fraud, required (AU 316.14 "members of the audit team should discuss the potential for

material misstatement"). There are numerous other examples. While the results of many of these oral procedures and discussions are often documented in some fashion, the oral discussion itself that occurs may be valuable information for the reviewer about the quality of the work performed and the abilities of the auditor performing it, and this cannot always be captured in written form.

#5. "the date such work was completed..... the date of such review"

We suggest that documentation of the date something was completed and of the date it was reviewed are not significant matters that need be documented for each procedure, especially for non-significant procedures. This form of documentation should be required only for significant matters or for especially time-sensitive matters, such as subsequent event procedures. It may often not particularly relevant to document when a recalculation of depreciation was completed, or when a planning analytical review was completed, or when the assessment of the adequacy of a disclosure was completed. The absence of a date of completion for matters such as these is not significant.

Further, in the process of reviewing work, a workpaper may be requested to be changed to better reflect what happened. The person preparing the workpaper thought they were done, and documented what they thought was the completion date. If they later change the workpaper, is that now the new date of completion or does the original date still apply? Further, if the work is considered completed when the workpaper was revised, the date of completion may now be a date that is after the date the work was reviewed, especially when the matter revised was not of such significance to require a re-review by the reviewer.

Something else is not clear in paragraph 5 as to what is meant by "the date such work was completed". In the case of a typical workpaper that documents performance of a test, there may be four or five procedures performed on each item in a sample of transactions, and such work may take place over a span of several days. Is the completion of each individual procedure on each individual transaction something that must be initialed and dated, as to who performed such work and when? Or is it only on the completion of a given workpaper, recognizing that much of the work shown on that workpaper was in fact completed earlier? For example, consider a workpaper with some procedures done at interim and others done at year-end: what is the proper date to use?

Further, in today's electronic age, a workpaper is not necessarily the size of a piece of paper, but may be significantly larger or smaller, depending on the design of an electronic system, and some workpapers may be assembled "as needed" by sorting and grouping information in different ways. Guidance should be flexible enough to handle the many varying ways in which information is prepared, stored, and analyzed in a set of workpapers as to when that information, or the varied ways of presenting it and looking at it, are to be considered "completed".

#8. "a reference to the central repository"

While such a reference may be useful, we suggest that this is likely quickly to become a boilerplate comment in the working papers and thus may be of limited real value. There is likely to be a sentence added to preprinted forms that states: "Documentation of auditor independence, staff training, and proficiency is maintained in central files of the firm." That's fine, but what does it add to the set of auditing workpapers? A firm's quality control documentation will normally refer to where and how such central repositories are maintained, and adding this reference to each set of working papers adds little benefit.

Further, it is not feasible to place such documentation in individual audit working papers due to its volume and possible privacy concerns. In most cases, the auditors involved on a typical audit would not be the best qualified ones to assess whether, say, a given auditor's staff training is adequate, whether each covered member in a firm has recently indicated their independence, whether suitable hiring practices are followed and so on. The auditors on an engagement would rely on the experts within a firm to ensure that independence problems have not arisen, that personnel evaluations are being performed, etc., and may lack the training or ability or knowledge to conclude on all these matters. Even if they have the training and ability, a firm's quality control process will normally have already dealt with these issues and it need not be separately concluded on each audit.

#9. "significant findings or issues include..... any other matters that could result in modification of the auditor's report"

We suggest that the definition of "significant findings or issues" be revised to focus only on matters that were believed, on the particular audit involved, to present issues that could result in modification of the auditor's report.

Also, it is possible that some matters covered in 9b, for example, might involve a reduction in the auditing procedures needed versus what was originally planned, due to internal control improvements made subsequent to planning or similar reasons. It is possible that some matters covered in 9g, for example, might be reductions in the assessed level of audit risk due to changes in business practices or controls, disposition of an area of operations, or other factors. Matters such as these would not need to be considered as significant findings.

#10 "identify all significant findings or issues in an engagement completion memorandum"

We do not think that the specific format or location of these matters should be prescribed. There are a variety of ways to present information so that it comes to the attention of reviewers, and prescribing one way limits the ability to control audit processes in other ways. For example, a firm may wish a certain matter, such as proposed audit adjustments, to be presented in one place in each of the firm's audits and to be presented using a particular software tool, which tool may not work well for documentation of other matters. In smaller audits, there is likely less need for a separate engagement completion memorandum, as the workpapers are more easily accessible and needed documentation therein is more easily found. The degree of senior audit executive involvement may also affect the need to gather information together into one spot, as the audit executive may already be so familiar or involved in the issues as to reduce the need for a separate summarization of the issues in a different place.

Further, we presume that the significant findings or issues required to be placed in this one memorandum are only those that merited actual consideration as to whether to modify the auditor's report. As an example, consider management representation letters. Lack of such a letter would cause a modification of the auditor's report, but if there are no issues involved in obtaining such a letter and one is obtained, we presume that this does not need to be documented in an engagement completion memorandum. However, the proposed standard is unclear because many matters that aren't issues "could" have resulted in a report modification if they had been an issue.

It also appears that issues documented in an engagement completion memorandum might be able to be briefly summarized with reference to other working papers, rather than having to be repeated in length in this memorandum. Clarification of this would be useful.

#14 “complete and final set of audit documentation must be assembled within.... 45 days”

This time period is too short. There are often many people working on a given audit, and these auditors may be working on a number of audits one after the other, so as to find themselves not able to return to better document something until several weeks later. It may take a period of time for a person’s work to be reviewed, for questions raised by a reviewer to be addressed by the one that performed the work (especially when they are busy on another audit and need to get physical access to the first audit’s working papers or time to make the changes), and for the revisions to be reviewed by the reviewer. Sometimes the revisions made need a further series of revisions. Often there are multiple reviewers and the process may take some time. Much of this revision includes an on-the-job training aspect, whereby newer personnel are taught improved documentation and other auditing skills via the review process. In short, during this busy time of year of January through mid-April, the significant matters are taken care of and cleared up, but additional cleanup work may possibly be involved later to further refine the working papers, so they accurately reflect everything that was done in the appropriate manner. We suggest more time be allowed, such as 120 days after release of the audit report, to wrap up all the documentation needed.

#16 “(...documentation of work performed by others, such as affiliated firms) must be retained by the office issuing

The scope of this requirement appears to be excessive, and we see no exclusion for relative insignificance. Consider first the use by the principal auditor of information about a relatively minor subsidiary. In many cases, the principal auditor obtains an audit report from another auditor for a subsidiary that is relatively minor, and the principal auditor does not make reference to the audit of the other auditor. However, the proposal states that, in this case, the principal auditor should review the audit documentation of the other auditor to the same extent as if the principal auditor had prepared it, which in effect is a double review of the other auditor’s workpapers – the other auditor will perform and review the work, while the principal auditor now appears to need to obtain and also review all the work done by the other auditor. This appears excessive and may not have been intended.

In addition to reviewing all the work of the other auditor, this proposal refers to complying with the requirements of paragraphs 4-12, so that the audit firm (and the office of that firm issuing the audit report) must apparently retain copies of all the workpapers prepared by another auditor, as part of the audit. We note this conclusion because paragraph 5 requires audit documentation sufficient to allow an experienced auditor with no previous connection to understand the nature, timing, extent, and results of the procedures performed and evidence obtained as well as who did the work, when it was completed, who reviewed it, and when the review was performed. We are not certain if there is an acceptable way to do this short of providing a complete set of the one auditor’s workpapers to the audit firm office issuing the report. We note that the alternative discussed (“Alternatively.... the auditor issuing the report should prepare and retain.... as long as the audit documentation complies with paragraphs 4-12...”) appears to require the auditor issuing the report to prepare documentation sufficient to allow an experienced auditor with no previous connection to understand the nature, timing, extent, and results of the procedures performed and evidence obtained as well as who did the work, when it was completed, who reviewed it, and when the review was performed (paragraph 5’s requirement). We believe this is an excessive amount of documentation that must be prepared and maintained.

Additionally, firms performing portions of the audits in other countries are likely to prepare their workpapers in the language used in that country, say German, or Arabic, or Chinese. Often a summary is prepared in English, but the detailed workpapers frequently remain in another language. It thus becomes very difficult to meet several of the matters discussed in paragraph 16, including the principal auditor review of documentation of the other auditor in the same way as if the principal auditor had prepared it, providing enough information for an experienced auditor to understand who performed the work, etc.

Further, the proposal should clarify whether one firm that has several of its domestic offices participate in an audit needs to assemble copies of workpapers from all of its domestic offices at the location of the office issuing the audit report.

#18. "engagements completed on or after June 15, 2004"

This effective date is too soon. Many of the engagements that will be completed after June 15, 2004 are now in process. For example, audit work on entities with a March 31, 2004 year-end may be completed on or after June 15, 2004, and there were likely quarterly Form 10-Q review procedures performed that pertain to that audit in July and August 2003 on the June 30, 2003 Form 10-Q. In addition, quarterly review procedures (which are included in the areas covered in the matters to be documented, per paragraph 9e,) are likely underway today for audits of periods ending September 30, 2004 on the first quarter Form 10-Q for the period ending December 31, 2003. These audits may be completed in mid-December 31, 2004, and the effective date of this standard should thus be after that date. Assuming this standard is issued February 28, 2004, the effective date should apply for audit work performed after that date for audits ending on or after January 31, 2005, allowing time for the completion of earlier audits before this new standard applies. This will allow time for firms to implement needed procedural changes and related staff training on significant implementation issues that may arise, as well as to avoid affecting audit work already performed.

Significant implementation issues may arise in developing policies and practices for the matters that must be included in the engagement completion memorandum, the dating of when audit work was 'completed' as well as when it was reviewed, the identification of items tested, information as to issues inconsistent with final conclusions, abstracts or copies of documents, and obtaining workpapers from affiliates or others, as well as to what specialists must now document. In addition to developing suitable policies and practices, there are many people that will require training on what needs to be done. Thus, a later effective date, as discussed in the prior paragraph, should be provided.

Page 4 of Release "invites comment on the addition of such a requirement"

The Board requested comment as to whether it should add a provision that oral explanation alone would not constitute persuasive other evidence. We do not think such a provision would be appropriate.

First, if a person does something, they should be permitted by every means possible to present the truth about what was done. It may often be that oral evidence, in the absence of written evidence, may be less persuasive in the minds of some, but it is not necessarily the case and all information a person can present as to what was done should be allowed.

Second, it is not possible to do so well as to write down in a document everything that one knows, or all the information that is gathered in the course of an audit. Consider an audit that requires 2,000 hours of time, which many audits do require. Documenting everything that

happens in that volume of time is the equivalent of writing down everything one does during on each 8-hour working day over the course of a full year, which is certainly a considerable amount of information. If one cannot supplement what is written down by providing oral information at a later date to help answer questions that might arise, the volume that may need to be documented, in anticipation of future unknowable questions, quickly becomes excessive.

Third, matters that are documented may often represent the “primary” means by which someone believes something, and may omit other corroborative evidence obtained that also might be useful. An example of this might be a document in which the auditor mentions that the auditor knows who someone else is, or met with or talked with that person. Perhaps the primary key for the auditor’s knowledge of who that person is, is that the auditor heard the other person state their name, but perhaps in addition the auditor also recognizes the other person from a photograph they have seen, or from a name-badge the person is wearing, or from prior experience with the person, or from an introduction by a third party, etc. Perhaps all of these are relevant as some degree of evidence, but ordinarily someone wishing to document the fact that they know someone will use just one basis. A standard that would require written documentation and prevent an oral supplement would not allow the auditor to present these additional reasons as to why the auditor knows who someone is, even if the auditor did document the primary basis for such knowledge. If there later is suspicion that the person stating their name to the auditor might have lied about their name, it might then become relevant if the other evidence used by the auditor—recognition from a photograph, or name-badge, or prior experience, or a third party introduction, etc.—could be presented if needed. It would clearly be overkill if each and every possible and potential, and redundant, basis for a belief were to be documented in every single circumstance because the auditor was limited to support that had been written down.

Fourth, using the above example of how someone knows who another is, in many cases such a fact will be commonly assumed to be true without special efforts to document it. If an auditor makes a note that they met with Mr. X and Mrs. Y, the auditor normally will not need to document how they know that those people are who the auditor believed them to be. Yet, it might conceivably be relevant some day to know how the auditor believed those two people to be who the auditor believed them to be. In short, how far should an auditor have to go in writing things down, if the PCAOB says that something that is not written down cannot, in spite of its truth, be ever be presented in an oral fashion.

In closing, we submit these comments to the PCAOB and its staff for consideration and with the desire to clarify and improve the guidance for the use of both auditors and the PCAOB’s inspection force. If we may help with anything, please contact Jim Brown.

Very truly yours,

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January 20, 2004

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

Re: PCAOB Rulemaking Docket Matter No. 012
Proposed Auditing Standard on Audit Documentation and Proposed Amendment to
Interim Auditing Standards

Deloitte & Touche LLP is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards, PCAOB Rulemaking Docket Matter No. 012 (the "Release," the "Proposed Standard," or the "Proposed Amendment") (November 21, 2003), to implement Sections 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act"). This letter is submitted on behalf of Deloitte & Touche LLP, the non-U.S. member firms of Deloitte Touche Tohmatsu, and Deloitte Touche Tohmatsu.

We strongly support the goals of the PCAOB to develop responsible auditing standards that will improve the quality of engagements conducted in accordance with auditing and related professional practice standards and help increase investor confidence in our capital markets. We fully support appropriate audit documentation requirements that will enhance audit effectiveness, and agree with the position of the Board that the auditor should prepare and maintain audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report.¹ However, we are concerned that the rules-based approach taken in the Proposed Standard, significant ambiguities in the language used, and inconsistencies between the Proposed Standard and the "Final Rule: Retention of Records Relevant to Audits and Reviews" issued by the Securities and Exchange Commission on January 28, 2003 (the "SEC Rule"), will likely have the unintended effect of diminishing audit quality by shifting the focus of auditors from performing quality audits to concentrating on documentation matters. We also believe the documentation requirements with respect to work performed by others,

¹ PCAOB Release, page 2.

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including associated firms², contained in the Proposed Standard and the Proposed Amendment are unworkable.

While we are committed to serving the public interest and will strongly support any and all workable efforts to enhance the quality of audits, we are not supportive of the Proposed Standard or the Proposed Amendment in their present form. We believe the Proposed Standard will be subject to wide variations in interpretation and that many significant issues must be addressed to enable the Proposed Standard to be implemented consistently and in a manner that meets the objectives of the Board and the Act.

We have organized our comments into three sections. First, we set forth seven issues that we believe are the most important for the Board to address. Specifically, we ask that the Board:

- Eliminate the rebuttable presumption that would attach in the absence of certain audit documentation;
- Revise the Proposed Standard to not require the consolidation of all audit documentation in one location, especially in view of conflicts with non-U.S. laws;
- Clarify what would constitute an “experienced auditor” for purposes of the general audit documentation standard;
- Coordinate with the SEC so that the standard adopted by the Board and the SEC Rule on audit documentation are the same;
- State explicitly that the various state law provisions requiring audit documentation are preempted by the Act and the Board’s rules, to the extent that the state law provisions are different;
- Clarify its rules concerning the retention of “information relating to significant findings or issues that is inconsistent with the conclusions of the audit” to focus on documenting only material considerations and materially inconsistent information; and
- Require a different implementation date for the standard so that auditors will be able to apply the new standard beginning with audit planning, as opposed to changing standards midstream during an active engagement.

Second, we discuss overall comments that concern the totality of the Proposed Standard that we believe the Board should address. Finally, we provide additional comments concerning issues that arise in specific paragraphs of the Proposed Standard and the Proposed Amendment.

² As used herein, the term “associated firms” includes individual firms that are members of international organizations or members of international associations of firms.

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I. MOST SIGNIFICANT COMMENTS

1. Rebuttable Presumption

We strongly disagree with the inclusion in the Proposed Standard of the “rebuttable presumption.”

The Proposed Standard would establish a “rebuttable presumption” that, in the absence of specified documentation, “the procedures were not applied, evidence was not obtained, and conclusions reached were not suitably supported” during an audit.³ As described below, we believe that the proposed “rebuttable presumption”: (a) is not appropriately included in an auditing standard; (b) would not effectively enforce the Board’s audit documentation requirements and, indeed, would be detrimental to audit quality; (c) threatens the accuracy and fairness of the Board’s inspections and disciplinary processes by preventing the Board and its staff from fairly considering all of the available information; and (d) jeopardizes the ability of other judicial and disciplinary proceedings to produce accurate and fair judgments. Accordingly, we strongly believe that the “rebuttable presumption” should not be retained in the Board’s final standard.

a. The “Rebuttable Presumption” Does Not Belong In An Auditing Standard

For the reasons set forth below, we believe that the Board should not adopt a “rebuttable presumption” in any form. But in any event, the “rebuttable presumption” is not properly part of the Board’s auditing standards. The “rebuttable presumption” proposal does not pertain either to the procedures by which audits are conducted or to the retention of audit documentation. Instead, the presumption proposal seeks to establish evidentiary rules for use in later adjudicatory proceedings. Therefore, the presumption has no place in the Board’s “auditing standards” and should be removed from the Proposed Standard.

At most, the Board could argue it has authority to establish a “rebuttable presumption” for its own disciplinary proceedings.⁴ If the Board were to determine that some form of a

³ Release at A1-4-5. According to the Release, the “rebuttable presumption” is based on Section 5097(c) of the California Business and Professions Code. The California statute became effective on January 1, 2003, and California courts have not yet interpreted the statute.

⁴ Although the Release is not clear that the proposed presumption would be restricted to the Board’s own disciplinary proceedings, that is the only result consistent with the limits on the Board’s authority, and any “rebuttable presumption” must be clarified to make that limitation clear. In contrast, establishing evidentiary standards for judicial and administrative proceedings in other jurisdictions is far outside the Act’s mandate for the Board’s authority. Although we recognize that the Board may have authority to preempt differing state *auditing* standards, that preemption carries out the Board’s authority to

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“rebuttable presumption” is appropriate for its own proceedings, the Board should undertake to implement the presumption through a separate rulemaking proceeding. The Board has proposed other rules that will establish the rules for the conduct of various Board disciplinary proceedings, and this type of evidentiary rule should be included, if anywhere, only with those other procedural rules.

This point is of considerable significance; it is not simply a technical concern. By proposing the “rebuttable presumption” as part of an auditing standard, the Board appears to be suggesting that a violation of its rules, predicated solely on the application of the presumption, is a violation of auditing standards. Such a result would be unfair and unjust in a Board proceeding, and may well have litigation consequences far beyond Board proceedings, as the private plaintiffs’ bar may seek to establish a violation of the securities laws or other legal liability based on a failure to satisfy a Board auditing standard.

b. The “Rebuttable Presumption” Would Not Effectively Enforce The Board’s Audit Documentation Requirement And Would Be Detrimental To Audit Quality

As a practical matter, the presumption would not be effective to enforce the Board’s audit documentation standards. Auditors will have all the incentive necessary to document issues that they believe to be relevant at the time of the audit by their need to comply with the Board’s enhanced documentation requirements and the direct consequences of failing to do so. Because the presumption would be imposed in proceedings only after the fact -- and, as discussed below, is tied to a retention obligation arguably broader than the proposed general “experienced auditor” standard -- the presumption would demand that the auditor attempt to foresee, and to document, any issue that could possibly be relevant in any future dispute, however immaterial during the course of the audit. Accordingly, while the presumption may punish the failure to document properly any issue that turns out to be relevant in future proceedings, the presumption will do little to ensure that material issues are documented properly at the time of the audit and before any proceedings are initiated.

Beyond failing to enforce the audit documentation requirement, the presumption would also diminish audit quality by shifting the primary focus of the audit team from the conduct of the audit to the preparation of documentation. An audit is a process consisting of a myriad of steps and judgments. The proposed presumption, however, is not limited to those issues that were material at the time of the audit. As such, the presumption attaches a sanction to any matter that is not documented and strips the auditor of any degree of judgment about the nature and extent of the audit documentation to be obtained, created and retained. An unqualified requirement to document procedures performed, evidence obtained, and conclusions reached without permitting auditor judgment about what is important to record,

establish rules governing the conduct of *audits* pursuant to Section 103 of the Act. Thus, when the Board’s audit standards are approved by the SEC and become part of federal regulation, those standards will preempt conflicting or inconsistent state standards. But the Board has no comparable authority to set evidentiary rules for other adjudicatory bodies (e.g., state regulatory authorities or the United States District Courts).

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together with a presumption that if it is not recorded it did not happen, will increase the volume of documentation, but not audit quality. If anything, by requiring excessive detail on matters not yet determined to be of significance from an audit perspective, the presumption will most likely cause the inefficient expenditure of resources on over-documentation and divert those resources from ensuring the accuracy and comprehensiveness of the actual audit.

In fact, the presumption makes the Board's audit documentation standard itself less clear and, thus, less effective and harder for the Board to administer fairly. The Release's general "experienced auditor" standard for required audit documentation is that an auditor must retain "sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, who performed it, when it was completed, and the conclusions reached."⁵ The special standard triggering the presumption, however, is broader: where the general standard for audit documentation requires only the retention of such material as will enable an experienced auditor to determine what occurred in an audit, the "rebuttable presumption" contains no such limitations. The "rebuttable presumption" requires instead that "auditors, including any specialists, should document the procedures performed, evidence obtained, and conclusions reached," whether or not documenting a certain procedure, for example, would be necessary for the "experienced auditor" standard.⁶ The presumption introduces disabling ambiguity into the Board's audit documentation standards and, for this reason as well, should not be retained.

c. The "Rebuttable Presumption" Would Threaten The Accuracy And Fairness Of The Board's Inspections And Disciplinary Proceedings

The presumption would threaten the accuracy and fairness of Board disciplinary proceedings in which the presumption would be applied by requiring that the Board and its staff ignore the best available evidence for determining what occurred during an audit.

For example, the Release states "the Board contemplates that oral explanation alone would not constitute persuasive other evidence" to rebut the presumption and invites comment on a requirement to *bar* expressly any consideration of oral testimony.⁷ By barring oral testimony from the accountants who performed the audit, or from employees of the audit company which participated in the audit process, that certain evidence was gathered or that certain procedures were performed, the Board would be unfairly rejecting, in advance, without consideration, the available information crucial to an understanding of the audit work performed. Because of the presumption, the Board may also not be able to weigh fairly circumstantial evidence—such as events contemporaneous to procedures or conclusions that the auditor claims were performed or reached—that would indicate that certain audit

⁵ Release at 4 (emphasis omitted).

⁶ Release at A1-4 ¶6.

⁷ See Release at 5.

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procedures had been undertaken. Nor would the Board necessarily consider and weigh appropriately documentation found in, for example, the issuer's files that reflects or memorializes that procedures were, in fact, performed.

The "rebuttable presumption" would also unfairly shift the burden of proof in Board proceedings. As fairness demands, the Board's enforcement staff must generally prove that a respondent firm violated a Board rule or professional standard in order to impose a sanction in a disciplinary proceeding.⁸ Even without adopting the presumption, the Board is authorized to demand any audit documentation from a registered accounting firm and to use that documentation to prove that a professional standard has been violated.⁹ If the proposed presumption is adopted, however, the Board may assert that a crucial procedure or conclusion lacks documentation and shift the burden from itself to the auditor, requiring the auditor to prove that the crucial event occurred. By minimizing the need for the Board initially to prove, rather than merely to assert, any flaw in the audit, the presumption reduces the enforcement staff's burden of proof and undermines this fundamental safeguard against arbitrary disciplinary action.¹⁰

d. The "Rebuttable Presumption" Would Also Threaten Other Judicial And Administrative Proceedings

The proposed presumption could also threaten the fairness of proceedings far beyond the Board's own disciplinary actions. Even if the Board clarifies that the application of the proposed presumption is explicitly limited to the Board's disciplinary proceedings, the presumption may still affect, and unfairly shift the burden of proof in, other judicial and administrative proceedings. To the extent a violation of the Board's rules is deemed a violation of the securities laws,¹¹ civil plaintiffs, government regulators, and prosecuting authorities may seek to use the presumption to establish the intermediate fact that the Board's rules have been violated, without the plaintiff otherwise meeting its burden of proof. Those parties could then use the *presumed*, but not proven, violation of the Board's rules to show that the auditor violated the securities laws. Similarly, if the Board's rules were invoked to establish the standard of care in a negligence action against the auditor, the application of the presumption could resolve the case against the auditor, by presuming from a lack of documentation that a procedure was not followed and, therefore, that a Board rule was violated. In such circumstances, parties attempting to impose liability on an auditor may never be required to prove any fact at all before obtaining judgment in their favor. Although courts have employed "rebuttable presumptions" in other contexts, triggering a presumption

⁸ Proposed Rule 5204(a).

⁹ Proposed Rule 5103.

¹⁰ The Board is statutorily required to have "fair procedures." Act § 105(a).

¹¹ Act § 3(b)(1).

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from so slight an initial showing by the party bearing the ultimate burden of proof is unfair and punitive and reinforces that the presumption would be arbitrary in practice.

Moreover, adverse findings by the Board, based on the presumption, may collaterally estop auditors from arguing that they complied with the Board's rules or the securities laws in civil proceedings, or may be used as evidence against the auditor in civil or criminal proceedings. The Board cannot reasonably view the presumption as only a means to facilitate its own adjudicatory process—the operation of the presumption, even if notionally limited to Board disciplinary proceedings, may have a legal significance that could distort or truncate proceedings in other jurisdictions as well. Because of the threat to the accuracy and fairness of these proceedings, the Board should not adopt the presumption in any form.

2. Multi-location Audits - Location of Audit Documentation

We strongly disagree with the requirement of paragraph 16 of the Proposed Standard to retain all audit documentation in the office issuing the auditor's report. This requirement is legally impossible in some countries, will not result in the intended improvement in audit quality, and will be detrimental to the quality control and inspection processes.

a. Legal Impediments

First and foremost, granting access to working papers within, and/or delivering working papers out of, the country is illegal in some jurisdictions, would subject foreign firms to criminal penalties including fines and imprisonment, is strictly regulated in other countries, and will place the auditor in the untenable position of choosing between (i) knowingly preparing audit working papers that will not meet required standards as to audit documentation and (ii) trying to convince others to break the laws of their home country.

As discussed in more detail in the comment letter on the Proposed Standard submitted by Linklaters, dated January 20, 2004, the principal legal impediments in non-U.S. jurisdictions that inhibit access to audit documentation involve issues relating to (i) data privacy laws; (ii) professional obligations under non-U.S. laws and professional standards, particularly relating to confidentiality; and (iii) laws specific to a particular client's business.¹² For example, with respect to data privacy, processing of personal data in member countries of the European Union is often governed by national laws implementing European Directive 95/46/EC of October 24, 1995. These national laws impose certain prohibitions on the person processing personal data. Processing includes the collection, retrieval, distribution and transfer to other countries of personal data. Personal data can be any information relating to an identified or identifiable natural person. Personal data to be found in audit documentation

¹² These legal impediment issues have previously been highlighted in our March 31, 2003 comment letter to the Board regarding the Board's proposed registration system and in numerous Rule 2105 opinions submitted in connection with the registration application of Deloitte & Touche LLP.

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include, among other things, details about the engagement team, details about the client team, information about client personnel, signature blocks and names in agreements, salary information traceable to persons, identity card numbers, confirmation lists with third party names, and registration numbers.

In addition, duties of confidentiality under both non-U.S. laws and professional standards in many countries restrict the ability of non-U.S. firms to provide the U.S. firm or the Board access to audit documentation. While client waivers can be obtained in some countries to address these impediments, in other countries the restrictions are absolute and client waivers would not serve to eliminate the impediment. Moreover, the ability of audit firms in certain countries to allow access to audit working papers is further restricted by impediments that arise from the nature of the client's business. For example, where an audit firm serves a client involved in the banking industry or the government contracting industry, the firm's ability to provide access to working papers are severely restricted by banking secrecy laws and national security laws, respectively.

We also strongly disagree with the requirements in the second sentence of paragraph 16 regarding the work of other auditors. As discussed above, obtaining the original or a copy of the other auditor's audit documentation might be prohibited by law or restricted by regulation. In addition, this obligation could be imposed by the Board in its standards, but only upon auditors registered with the Board. However, audit firms that do not play a substantial role in the audit of an issuer are not required to be registered. As a result, in addition to the reasons described in the preceding paragraphs, the principal auditor could be in an untenable position because he or she was being required to obtain documentation that another party has no obligation to provide.

The alternative presented in the third sentence of paragraph 16 of the Proposed Standard to "prepare and retain documentation of the work performed by other auditors" as a part of the review by the principal auditor is equally unworkable.¹³ We believe there are two different ways of interpreting this sentence, neither of which we believe to be feasible. It can be read to mean that the principal auditor's alternatives to obtaining originals or copies of the other auditor's audit documentation are to either (a) review and summarize the other auditor's work in sufficient detail to re-document each and every individual procedure performed and piece of evidence obtained (essentially reviewing and then transcribing all of the other auditor's audit documentation); or (b) reperform the work and assemble the audit documentation himself or herself. Under interpretation (a), because the result would be no different than obtaining a copy of the other auditor's audit documentation, the principal auditor would be subject to the legal and regulatory restrictions discussed in the preceding paragraph. With regard to interpretation (b), there might be legal, contractual, or business reasons why an entity engages another auditor to audit an affiliate. Even with client consent to duplicate the work and pay for the costs associated with this duplication of work, the principal auditor may not be able to do so in certain countries where he or she is not licensed or qualified to practice

¹³ Proposed Standard, paragraph 16, page A1-9.

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and, even if licensing or qualification is not an issue, the principal auditor would be subject to the legal and regulatory restrictions discussed in the preceding paragraphs. Additionally, the auditor would need to have knowledge of the language and local business customs and laws to perform the audit.

b. Impact on Audit Quality

In the Release, the Board states “This requirement would improve audit quality by enhancing the probability that *all* audit documentation will be prepared consistently with the same standards of audit quality,”¹⁴ but offers no rationale or even discussion to support this assertion. Audit quality is determined throughout the audit by the appropriateness of the planning, performance, and supervision of the audit. Assembling the final audit documentation in one location for storage will not per se improve audit quality.

An audit of a large multi-national company might include performing procedures at more than fifty locations around the country and throughout the world, involving tens of thousands of hours of work performed by many participating accountants. With appropriate planning and supervision, the review of this work is currently performed by the engagement team of the participating accountants, with matters highlighted as appropriate for consideration by engagement management from the office issuing the report. And although much of the audit documentation may be in electronic form, there is still a significant volume of hard copy documentation. Requiring that audit documentation from each and every one of these locations be shipped to one physical location would subject the audit documentation to risk of loss during transmittal, especially hard copies of evidence from third parties, such as confirmations. Additionally, the original audit documentation prepared by the participating accountants is, in many instances, in a language other than English and will be meaningless to any reviewer who does not read that language.

Further, if an affiliate of an issuer is also an issuer, and the audit report on that affiliate is issued from a different office, the Proposed Standard appears to require two complete sets of the audit documentation be retained, one in each office. This duplication also would not improve audit quality and would be entirely unnecessary.

Paragraph 16 of the Proposed Standard is also inconsistent with the Proposed Amendment with respect to work performed by other auditors in circumstances when the principal auditor does decide to make reference to the audit of the other auditor. In these circumstances, the principal auditor does not take responsibility for the work of the other auditor. Paragraph 16 should be revised to expressly state that the principal auditor has no responsibility for reviewing, or retaining copies of, the work of other auditors in circumstances where the principal auditor makes reference in his or her report to the work of the other auditor. As discussed in more detail in our comments relating to the Proposed Amendment, we also believe that the Proposed Standard and the Proposed Amendment should be clarified to

¹⁴ PCAOB Release, page 5.

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explicitly state that associated firms are excluded from the definition of “others” and “other auditors.”

We also believe that the final standard requires additional clarification regarding those instances where an SEC registrant’s financial statements are audited by joint auditors. There are certain situations outside the United States where the financial statements filed with the SEC are jointly signed by two different accounting firms. In these situations, neither firm is acting as the principal auditor and, although the audit work may not be equally shared, the responsibilities are jointly shared. In these situations, the financial statements filed with the SEC either may be signed by both firms or by only one of the joint auditors.

We believe that requiring the entirety of both firms’ audit documentation to be located at one or both firms in these situations would be unnecessarily duplicative. In addition, such sharing of documents would not be acceptable from a business and competitive standpoint. We recommend that audit documentation requirements for joint auditor situations be addressed in the final standard by requiring each firm to retain only its own audit documentation.

c. Detrimental to Quality Control and Inspections

Moving the audit documentation from the location where the audit work was performed, especially from country to country, to a central location will be detrimental to an auditor’s quality control process, as well as the Board’s inspection process, because it removes the quality reviewer or inspector from contact with the audit personnel who performed the work. It also appears to be contrary to the Board’s stated intention to “develop an efficient and effective cooperative arrangement where reliance may be placed, to the maximum extent consistent with the independence and rigor of the home country system, on an inspection of a non-U.S. registered firm conducted by such system.”¹⁵ Further, without maintaining audit documentation in the home country, inspection by the home country system cannot be effective.

In summary, due to the reasons stated above, we firmly recommend that paragraph 16 be deleted in its entirety, and replaced with a requirement that the auditor in the office issuing the report (the “referring office”) obtain documentation that (i) identifies the auditor responsible for supervising the work at each location, (ii) confirms that the audit procedures performed at each location were planned, performed, and supervised in accordance with auditing standards of the PCAOB, including the standards for audit documentation, as supplemented where appropriate by instructions from the referring office, (iii) confirms that matters have been highlighted as appropriate for consideration by engagement management from the referring office, and (iv) confirms that the location is responsible for retaining the audit documentation for the required period. We believe that this documentation could take the form of a summary memorandum, checklist, signed representation, or other form depending on the circumstances.

¹⁵ Proposed Rules Relating to the Oversight of Non-U.S. Public Accounting Firms, PCAOB Rulemaking Docket Number 13, at 8.

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We believe this recommendation would achieve the objective of understanding that appropriate work was performed and reasonable conclusions were reached and would be consistent with the PCAOB's intention of developing a cooperative arrangement with home country oversight systems.

In addition, we recommend that the PCAOB continue to develop a process to work with regulators in other countries, so that when the Board needs to get access to any audit documentation physically located in another jurisdiction, this can be facilitated through cooperation with these other regulators.

3. Experienced Auditor

Paragraph 5 of the Proposed Standard contains the requirement that audit documentation must contain sufficient information to enable an "experienced auditor with no previous connection with the engagement" to understand the procedures performed, evidence obtained and conclusions reached.

We believe the standard of an "experienced auditor" is an inappropriate concept on which to base the breadth and depth of content of audit documentation. We understand that this is a concept similar to that used by the General Accounting Office (the "GAO") in relation to audits subject to the GAO requirements. GAO audits are generally reviewed by GAO auditors or other auditors who, through their direct experience, are familiar with the issues associated with these particular audits. However, this concept is inappropriate to use in the broader context of all issuers, where the variety of industries makes it impractical for an individual to have adequate knowledge across all industries. We strongly believe that an auditor who is reviewing audit documentation specific to an audit engagement should be expected to have experience and knowledge consistent with the level of experience and knowledge that the auditor performing the audit is required to possess, including knowledge of the current accounting, auditing, and financial reporting issues unique to the industry in which the client issuer operates. We strongly recommend that this be expressly stated in the Proposed Standard.

4. Align the Proposed Standard with the SEC Rule

We are concerned that the Proposed Standard and the SEC Rule are inconsistent. Throughout our comments below, we point out instances where the Board's proposed standards deviate from those established by the SEC. For example, the Proposed Standard and the SEC Rule use different terminology, such as "significant findings or issues" and "significant matters," to describe what should be the same concept. In many of these instances, the Release neither expressly recognizes its departure from the SEC's existing rules nor explains the reasons for its departure. We believe that the Board and the SEC should have the same standard.

We recommend that the Board and the SEC undertake a joint effort to consider the inconsistencies between the Proposed Standard and the SEC Rule and propose revisions to one or both to bring them into alignment. If the Board believes that a complete alignment is

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not appropriate, the Board should present its reasons for that belief to the public and the SEC in the revised release.

5. Interaction with State Laws and Other Documentation Standards

The Board should clarify how its audit documentation standards will co-exist with the rules and statutes governing audit documentation established by state law. The Board has recognized that the mandate of Congress for the centralized regulation of public company audits may have the effect of preempting state laws that are inconsistent with the Board's task of developing a coherent nationwide standard. For example, the Board expressly recognized in prior rule releases that state laws guaranteeing accountant-client confidentiality are preempted in certain circumstances where information is required for the Board's registration and investigatory processes.¹⁶ The Board should make clear that the Proposed Standard is preemptive, and that states or other state-level regulators may not add to, subtract from, or in any way conflict with the Board's rules.

In paragraph 17, the Proposed Standard specifically contemplates that an auditor "also may be required to maintain documentation in addition to that required by this standard." We believe the Board should state clearly that the Proposed Standard displaces any differing audit documentation standards under state laws or regulations.

Paragraph 13 of the Proposed Standard sets a seven-year requirement for the retention of audit documentation, but specifically contemplates that the seven-year period may be extended if "a longer period of time is required by law." The Board should clarify that the retention period may not be extended by the requirements of state law pertaining to accountants. We certainly understand that the Board should be careful about displacing state laws governing the obstruction of investigations through the destruction of documents. But the Board's seven-year rule provides a uniform standard of conduct that should provide sufficient safeguard for state regulatory processes.

Finally, paragraph 1 states that the audit documentation standard in the Proposed Standard "does not supplant specific documentation requirements of other auditing and related professional standards." The Board should make clear that this language only relates to other documentation standards within the Board's own rules.

¹⁶ PCAOB Release No. 2003-0015, *Rules on Investigations and Adjudications*, at A2-33-34 (Sept. 29, 2003) (stating that certain state accountant-client non-disclosure laws are preempted under its rules and the Act); SEC Release No. 34-47990, *Notice of Filing of Proposed Rules Relating to Registration System*, 68 Fed. Reg. 35016-01, 35028 n.39 (June 11, 2003) (stating that any state laws that would prevent an accounting firm or associated person from giving the consents required by the Board's registration rules would be preempted by the Board's rules and the Act).

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6. Information Relating To Significant Findings Or Issues That Is Inconsistent With Or Contradicts The Auditor's Final Conclusions

Paragraph 12 of the Proposed Standard requires the auditor to retain information relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions. As proposed, this requirement is overly broad, unclear about what needs to be retained, and will result in the retention of a substantial volume of irrelevant information. The Proposed Standard is also inconsistent with the SEC Rule, both in terminology used and in describing the nature of inconsistent information that needs to be retained.

Inconsistent information is an ordinary fact of business, and is usually due to situations involving preliminary thinking, before all relevant facts have been gathered and considered. Even in situations that are new or unusual, controversial, and/or result in formal consultations, the requirement to retain all information that is inconsistent with or contradicts the auditor's final conclusion is overly inclusive and would lead to the accumulation of a significant volume of documentation without improving audit quality. While it may be necessary to include a discussion of the inconsistent or contradictory information, the significant procedures performed in response, and the conclusions reached, including resolution of differences in professional judgment, we believe it is unnecessary to retain each and every document, draft, analysis, or other scrap of information that the auditor receives or creates in the process.

We recommend that this paragraph be revised to require that the auditor document the material considerations, including material inconsistent information, and the final conclusions reached on significant findings or issues (see comments above on resolving inconsistencies with the SEC Rule and detailed comments below on paragraph 9 of the Proposed Standard).

7. Implementation Date

The proposed effective date of the Proposed Standard is for engagements completed on or after June 15, 2004. However, implementation of a new standard is difficult to properly manage when the effective date is dependent on the timing of completion of a process, rather than on a fixed date, such as a financial statement date. The effective date as proposed would require engagements already in progress to modify documentation practices subsequent to the initiation of an engagement (i.e., audit procedures for fiscal years ending June 30, 2004 have already begun and under the proposed effective date, documentation may need to be modified); such a construction for implementation creates several difficulties including having to anticipate what the final standard will require before it is approved. We strongly believe that the Proposed Standard should be effective based on the fiscal year being audited, rather than the completion date of the audit.

Additionally, auditors require a reasonable period after issuance of the final standard to identify how the standard changes current practice, implement the necessary changes to internal policies and procedures, and train their staff to comply with the new standard. We do

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not believe an effective date of engagements completed on or after June 15, 2004 provides sufficient time for implementation.

To allow a reasonable transition period and provide a more manageable effective date, we recommend the Proposed Standard be effective for audits of financial statements for periods beginning on or after 180 days following the SEC's approval of the final PCAOB standard. For example, if the final standard were approved by the SEC on March 31, 2004, its effective date would be "for audits of financial statements for periods beginning on or after September 30, 2004."

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II. OVERALL COMMENTS

1. Standard's Objective

We believe that each proposed standard issued by the PCAOB should clearly articulate and explain the objectives of the Board. However, the Board has not undertaken to do this. We believe an appropriate objective of the Proposed Standard would be to modify the existing standard to align it with the SEC's Rule; however, the Proposed Standard does not attempt to meet this objective. Therefore, it is difficult to understand what the objectives of the Proposed Standard are and why the current standard, AU 339, does not result in sufficient documentation to support the conclusions reached. In order for the public and interested parties to fully understand the basis for the Proposed Standard, the PCAOB should provide specific objectives of the Proposed Standard.

2. Clear Communication of New Requirements

We believe issuing proposed standards that specifically and effectively highlight changes from the current standards is essential to the understanding and application of all auditing standards. The most effective means of identifying changes is by using the current text of interim standards, striking through text to be deleted and underlining text to be added. An alternative would be to provide a summary of how proposed standards modify the interim standards.

3. Ownership and Confidentiality of Audit Documentation

The Proposed Standard fails to address the issues of ownership and confidentiality of audit documentation. The current standard expressly recognizes that audit documentation is the property of the auditor and that the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information. We believe the language currently in AU 339 continues to be applicable and we recommend that a section on "Ownership and Confidentiality of Audit Documentation" be integrated into the Proposed Standard.

Additionally, while the Proposed Standard indicates certain guidance is superceded, this indication of superceded guidance does not refer to AU sec. 9339, *Audit Documentation: Auditing Interpretations of Section 339*, which contains information on "providing access to or copies of audit documentation to a regulator." We believe that information contained in AU sec. 9339 continues to be applicable and that this guidance should be included within the text of the Proposed Standard.

4. Incremental Time and Cost

Implementing the Proposed Standard would increase the costs of audits. Also, the additional documentation requirements under the Proposed Standard will further aggravate the time constraints under which audits are executed. For the many reasons stated throughout this

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comment letter, we believe the incremental cost would not yield the requisite benefit in terms of improving audit quality.

5. Implementation Guidance

Because of the complexity and importance of properly implementing the Proposed Standard, we believe that a substantial number of questions will arise and that interpretation will be necessary as implementation of the final standard occurs. Therefore, we strongly recommend that the Board establish a formal process for responding to implementation questions from auditors.

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III. COMMENTS RELATED TO SPECIFIC PARAGRAPHS

Paragraph 1—Applicability of Proposed Standard

The Proposed Standard extends to “any engagement conducted in accordance with auditing and related professional practice standards.” This could be interpreted as extending beyond audits and reviews of interim financial information, and may be read to include uncompleted (terminated) engagements, comfort letters, or agreed upon procedure engagements. We understand the Proposed Standard only applies to completed audits and reviews of interim financial information and, therefore, we suggest including an explicit statement that clarifies that the Proposed Standard applies only to “completed audits and reviews of interim financial information of issuers (as defined in PCAOB Rule 1001(i)(iii)).” While this may be described in an over-arching document by the PCAOB, the inclusion of a simple reference may avoid confusion by both the general public and auditing firms.

Paragraph 2—Objectives of Audit Documentation

Paragraph 2 uses the terms, “auditor’s conclusions,” “auditor’s significant conclusions,” and “conclusions reached by the auditor.” These and similar terms are used throughout the remainder of the Proposed Standard. It is unclear whether the use of different phrases has no significance or whether the Proposed Standard is referring to different levels of some unknown hierarchy. We suggest that the Board be consistent in the use of its terminology and use the phrase “the auditor’s final significant conclusions” throughout the entire Proposed Standard or define each term in a manner that more clearly articulates the hierarchy to facilitate compliance with the Proposed Standard.

Paragraph 3—Audit Documentation is Reviewed by the Engagement Team and Others

Throughout paragraph 3, the use of the present tense (i.e., “review,” “reviews,” or “is reviewed” instead of “must/should/may” as described in PCAOB Proposed Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards* (“Proposed Rule 3101”)) leaves the requirements or expectations of the Proposed Standard unclear. For example, subparagraph 3a states “auditors who are new to an engagement review the prior year’s documentation...” However, under current auditing standards, auditors who are new to an engagement are not required to review prior year’s documentation.

We recommend that the Proposed Standard be revised to replace the “is reviewed” and “reviewed” or “reviews” with “may be reviewed” and “may review,” as grammatically appropriate within each phrase of paragraph 3. We believe the consistent application and appropriate use of PCAOB terminology as defined in Proposed Rule 3101 is required and would provide clarity to the requirements of the Proposed Standard.

Subparagraph 3d of the Proposed Standard states “A successor auditor reviews a predecessor auditor’s audit documentation,” although successor auditors are not always permitted to

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review a predecessor's audit documentation. It is unclear whether this statement is intended in the context as something that might occur or whether a new requirement is subtly being established. Such a review is not the general practice outside of the United States and, in some countries, successor auditor review of predecessor audit documentation is not permitted due to confidentiality laws. Even in the United States, a review of the predecessor auditor's audit documentation is not always feasible or permitted. Additionally, even if such a review is performed, the review may be limited to only certain working papers. Accordingly, we recommend that the Board acknowledge that interim auditing standards exist that apply to the review of predecessor auditor working papers, and that such a review is not a required step which supersedes existing standards.

Additionally, subparagraph 3f indicates that "others might review audit documentation" but does not indicate any purpose for such review. This might be interpreted to mean that the audit documentation is expected to be sufficient for the purposes of any such review, which would require compliance with an unknowable standard. We recommend that subparagraph 3f be deleted.

Paragraph 4—Content of Audit Documentation

The first sentence of paragraph 4 states that the auditor must prepare audit documentation in connection with "each engagement." Similar to our comments on paragraph 1, we believe that the use of the term "each engagement" should be clarified to include only completed engagements (not terminated or uncompleted engagements) for audits and reviews of interim financial information, and not other services.

The second sentence of this paragraph states that "audit documentation ordinarily consists of memoranda, correspondence, *schedules*, and other documents created or obtained in connection with the engagement." This is slightly different from the terminology used in the SEC Rule, which states that records relevant to the audit or review that should be retained include "workpapers and other documents that form the basis of the audit or review, and memoranda, correspondence, *communications*, other documents, and records, which (1) are created, sent or received in connection with the audit or review, and (2) *contain conclusions, opinions, analyses, or financial data related to the audit or review.*" The Proposed Standard uses the term "schedules" instead of "communications", and does not limit audit documentation to items which "contain conclusions, opinions, analyses, or financial data related to the audit or review".

We are very concerned about the lack of consistency between the two sets of definitions. Having multiple definitions of the content of audit documentation will make implementation of the Proposed Standard confusing and the application inconsistent. We firmly believe it is not effective, efficient or practical to have two different standards and recommend aligning the definitions.

We also note that "audit programs" are not included among the list of items ordinarily included in audit documentation. Because "written audit programs" are currently required by

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AU sec. 311, *Planning and Supervision*, paragraph 5, and because we believe that audit programs are an important means of documenting audit procedures and conclusions, we recommend that they be explicitly referred to in paragraph 4 of the Proposed Standard.

Additionally, the phrase “other documents created or obtained in connection with the engagement” is extremely broad and could lead to wide variations in interpretation. Some practitioners may interpret this phrase as requiring that all items received from an issuer client should be retained (for example, the general ledger, accounts receivable detail, support for management’s assertion on the effectiveness of internal control used by the auditor in conjunction with the audit of internal control), which could be very voluminous but unnecessary. Furthermore, others could interpret it to mean that it would also require retention of items representing preliminary thinking, incomplete information, drafts or superseded versions, because all such items would have been “created in connection with the engagement,” even though the retention of this information would not be consistent with the SEC Rule. We strongly recommend that the nature of documentation required to be retained be more clearly described, that the requirements of the Proposed Standard and the SEC Rule be the same, and that the standard explicitly recognize that the content of audit documentation is a matter of the auditor’s judgment about what is necessary to support the auditor’s report.

Paragraph 5—Date Such Work Was Completed

Subparagraph 5b contains the phrase “date such work was completed”. For increased consistency in practice, we recommend that the Board explicitly define “completed,” in order to provide clarity (perhaps in the form of some examples) as to what should be done in order to conclude that “work has been completed” (e.g., “substantially complete,” “procedures performed but not reviewed,” or “reviewed and review notes cleared”). See similar comments related to paragraphs 13, 14 and 15.

Paragraph 6 – Specialists

The first sentence of paragraph 6 states that in addition to auditors, “specialists should document the procedures performed, evidence obtained, and conclusions reached.” It is not clear how the Proposed Standard could be applied to a specialist who is not registered with the PCAOB, such as a third party actuary engaged by the auditor. We recommend that the reference to specialists be eliminated from this sentence, if the paragraph is retained at all (see our comments above under “Rebuttable Presumption”).

Paragraph 7—Audit Documentation Provides Principal Support

The requirements of paragraph 7 are unclear, which will cause significant difficulties in implementation. Our comments are as follows:

We believe that the requirement in subparagraph 7a that audit documentation should demonstrate how the audit complied with not only auditing, but also related professional practice standards, is vague and too far-reaching. The purpose of audit documentation is to

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support the audit and the conclusions reached, not to prove compliance with other professional practice standards. Firms often support compliance with other professional practice standards primarily at the office-wide or firm-wide level, outside of engagement-specific audit documentation. Accordingly, we recommend that the phrase “and related professional practice” be deleted from this subparagraph. We also recommend the word “how” be changed to “that.” Documenting “how” the audit complied with auditing standards is simply not practicable because the level of detail necessary to describe the process by which certain audit procedures and other audit-related tasks were performed would be extensive and is unnecessary. As a result, this subparagraph would read as follows: “Demonstrate that the audit complied with auditing standards.”

The requirement in subparagraph 7b that audit documentation should support the basis for the auditor’s conclusions concerning “every material financial statement assertion” implies a one-to-one relationship of assertion to conclusion, which is inconsistent with AU sec. 326, *Evidential Matter*. While the auditor considers the assertions embodied in the financial statement components in developing audit objectives and designing tests, the purpose of the audit is to form a basis for an opinion regarding the financial statements taken as a whole. We disagree with the requirement that audit documentation should be oriented toward a conclusion regarding each financial statement assertion for each individual account balance, class of transaction, or disclosure. For example, the Proposed Standard appears to require five conclusions as to whether fixed assets (1) exist, (2) are complete, (3) are the rights of the entity, (4) are valued appropriately, and (5) are presented and disclosed appropriately. Auditors should not be required to document five separate conclusions for each individual account balance, class of transaction and disclosure. We believe this subparagraph should be revised to state, “Support the basis for the auditor’s conclusions regarding the financial statements taken as a whole.”

We agree with the requirement in subparagraph 7c which states that the auditor should demonstrate that the underlying accounting records agreed or reconciled with the financial statements.

Paragraph 8 —Documentation of Certain Matters in a Central Repository

We agree with the statement in paragraph 8 that matters such as auditor independence and staff training and proficiency may be more efficiently managed, and therefore documented, on an office-wide or firm-wide basis rather than at the engagement level. It is not clear, however, what form of “reference to the central repository” is called for by paragraph 8, what would be considered sufficient cross-referencing, or why such a reference is necessary at all. Separate requirements exist in other professional standards with respect to appropriate documentation of compliance with independence rules and training requirements.

Requiring audit documentation for each engagement to include information relating to auditor independence or staff training for individuals participating on the engagement is duplicative and we do not agree that this is useful or necessary.

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Because paragraph 8 refers to documentation of information outside audit documentation, we recommend that it be deleted all together.

Paragraph 9—Significant Findings or Issues

The overall construction of paragraph 9 on “significant findings or issues” is too complex, is difficult to understand, and contains numerous vague or undefined terms (see further discussion below). As stated in the overall comments, we strongly believe that the documentation requirements and the terminology used to describe significant findings or issues should be aligned with the SEC Rule. The term “significant findings or issues” is not defined in this paragraph, but is illustrated by examples that are inconsistent with the SEC Rule. However, we believe that the terminology should be clearly and unambiguously defined, so that the requirements can be clearly understood and correctly implemented. We recommend that the standard define “significant findings or issues” as matters that the auditor is required to, or determines that he or she should, report to the audit committee pursuant to AU sec. 380, *Communication with Audit Committees*. We believe that the illustrative subparagraphs could then be deleted.

As currently written, we have the following significant concerns with paragraph 9 and subparagraphs 9a through 9h in the Proposed Standard. If the Board does not adopt the recommendation in the preceding paragraph, the following comments should be addressed.

The first sentence of this paragraph establishes an unconditional responsibility (“must”) to document every action taken with respect to a significant finding or issue. The auditor may take a number of actions in reaching a conclusion with respect to a significant finding or issue (e.g., thinking, discussions, research, obtaining or preparing documents); however, documenting each action, particularly less critical actions, would be impracticable. Failure to document even the slightest action on a significant finding or issue could place the auditor in violation of the Proposed Standard even though the auditor has documented the most significant actions that resulted in the auditor’s final conclusion. We firmly believe that the auditor should be permitted to exercise judgment in determining the critical actions that should be documented, and recommend that the concept of professional judgment be included in the Proposed Standard.

Subparagraph 9a

In subparagraph 9a, we suggest the Board clarify whether it intends to include “all” accounting estimates or only “significant” accounting estimates. Because this section is referring to “significant findings or issues,” we recommend revising this phrase to “significant accounting estimates,” because some accounting estimates are less important than others and some might be clearly inconsequential.

Subparagraph 9c

The definition of “audit adjustment” in this paragraph is inconsistent with the definition in AU sec. 380, *Communication with Audit Committees*, and seems to combine the definitions of “audit adjustment” with “uncorrected misstatements” as described in AU sec. 380. The use of

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inconsistent definitions within the Board's standards creates uncertainty and the potential for inadvertent noncompliance. If the Board intends to make conforming changes to AU sec. 380 or other sections of the interim standards, these changes should be clearly set forth in the Proposed Standard.

However, there are two concepts that do not seem to be contemplated within the Proposed Standard's definition of audit adjustment – whether or not the audit adjustments have been recorded by management, and whether or not the adjustments are material, either individually or in the aggregate. If the Board intends to revise the definition of audit adjustment and uncorrected misstatements within all sections of the interim standards, we strongly recommend that the definitions clearly distinguish between these concepts in order to achieve a common understanding, by both the public and auditors, and consistency in application. However, we do not believe redefining the terms audit adjustment or uncorrected misstatement would be appropriate or prudent. We believe audit adjustment should be defined in the Proposed Standard as a proposed correction of the financial statements, whether or not recorded by management, which, in the auditor's judgment, may not have been detected except through the auditing procedures performed.¹⁷ A modifier (e.g., “material audit adjustments”) could then be used when the population to which a particular requirement is intended to apply is less than the entire population of the defined term. Using this structure, we would recommend the use of the term “material audit adjustment” in subparagraph 9c.

Subparagraph 9d

The meaning of “disagreement” is unclear and may be inconsistent with the SEC Rule. Because the Proposed Standard does not differentiate between preliminary thinking and final conclusions, some may interpret this subparagraph to mean that temporary differences of opinion because of incomplete information or preliminary conclusions by less experienced staff might be required to be documented under this subparagraph as written, but not under the SEC Rule. We believe documentation of disagreements should only be required if a disagreement continues after the relevant information has been gathered and considered by the engagement team, including any consultation with “national office” or others, and a final conclusion is reached that is not acceptable to a member of the engagement team or other individual consulted. Accordingly, we recommend that the phrase “about conclusions reached” be changed to “about final conclusions reached.”

Subparagraph 9e

Because of the lead-in sentence to the subparagraphs, this subparagraph is a circular definition. We recommend that this subparagraph be deleted and the concept be added to the lead-in sentence to the subparagraphs, to clarify that documentation is required for matters identified during the review of interim financial information as well during the annual audit, as illustrated below.

¹⁷ This definition is consistent with AU 380.09.

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Subparagraph 9f

“Circumstances that cause significant difficulty in applying auditing procedures” seems overly broad to serve as an example of a significant finding or issue. Many events (such as management or staff turnover, lack of management preparedness, or storms or other natural events) could cause difficulties, while having no ultimate impact on the audit conclusions reached. We recommend that this example remain as it is described in AU sec. 339.09, *Audit Documentation*, “Circumstances that cause significant difficulty in applying auditing procedures the auditor considered necessary,” which enables the auditor to exercise his or her professional judgment in such circumstances (for example, to perform alternative audit procedures to achieve the audit objective).

Subparagraph 9h

The phrase “any other matters” in this subparagraph implies that all of the matters in the preceding subparagraphs would result in modification of the auditor’s report, when this would not be true. Additionally, “modification” of the auditor’s report could result from adding an emphasis of matter paragraph, which may not necessarily be a significant finding or issue. Accordingly, we recommend that this paragraph be revised to read “Matters that could result in a qualified or adverse opinion in the auditor’s report.”

Although our recommendation is to revise paragraph 9 as described in the first paragraph of this section and delete the subparagraphs, the following illustrates the implementation of the comments on individual subparagraphs above, should our recommendation not be adopted (additions are shown in “bold underline” and deletions are shown in “strikethrough”):

*9. The auditor ~~must~~**should** document significant findings or issues, actions taken to address them, (including additional evidence obtained) and the basis for the conclusions reached. Significant findings or issues **may** include, ~~but are not limited to,~~ the following **(and relate to matters identified either during the annual audit or review of interim financial information)**:*

*9a. Significant matters involving **Disagreements between the auditor and management regarding** the selection, application, and consistency of accounting principles, including related disclosures.*

9b. ~~Such significant matters include a~~ Accounting for complex or unusual transactions.₂

*9c. **Significant** accounting estimates, ~~and uncertainties as well as related management assumptions.~~*

*9d. ~~Results of auditing procedures that indicate a need for~~ **9d.** ~~s~~ Significant modification of planned auditing procedures.₂*

*9e. ~~or the existence of m~~ **Material misstatements or omissions in the financial statements (proposed by the auditor, but not recorded by management).***

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9f. Material audit adjustments (proposed by the auditor and recorded by management).

~~9g. or the existence of s~~**Significant deficiencies in internal control over financial reporting.**

~~9c. Audit adjustments and the ultimate resolution of these items. For purposes of this standard, and audit adjustment is a proposed correction of a misstatement of the financial statements that could, in the auditor's judgement, either individually or in the aggregate, have a material effect on the company's financial reporting process. Audit adjustments include corrections of misstatements, of which the auditor is aware, that were or should have been proposed based on the known audit evidence.~~

~~9d~~**9h. Disagreements among members of the engagement team or with others consulted on the engagement about the auditor's final significant conclusions reached on significant accounting or auditing matters.**

~~9e. Significant findings or issues identified during the review of quarterly financial information.~~

~~9f~~**9i. Circumstances that cause difficulty in applying auditing procedures the auditor considers necessary.**

~~9g~~**9i. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.**

~~9h~~**9j. Any other ~~m~~Matters that could result in modification of a qualified or adverse opinion in the auditor's report.**

Paragraph 10—Engagement Completion Memorandum

We believe paragraph 10 calls for an unnecessary duplication of effort by requiring the re-documentation of all significant findings or issues in an engagement completion memorandum, especially if the scope of "significant findings or issues" is not narrowed as recommended above. While a summary of key issues is often useful for supervision, review, and consultation purposes, the matters to be covered and the extent to which they need to be described will vary depending on circumstances and should be a matter of the auditor's judgment. The requirement that the completion memorandum be "as specific as necessary for a reviewer to gain a thorough understanding" will require repeating in the engagement completion memorandum a substantial portion of the audit documentation included in other working papers. Duplication to this extent is unnecessary and will dilute the usefulness of the engagement completion memorandum.

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This requirement also creates an unwarranted compliance trap for the auditor. The unconditional obligation to include “all significant findings or issues” means that an audit will be substandard as to audit documentation if the auditor overlooks even one “significant finding or issue” in compiling the engagement completion memorandum, even if the matter is fully documented elsewhere in the audit documentation.

We recommend that this paragraph be revised to provide that “An audit summary memorandum should be prepared for each audit engagement to document the auditor’s major findings and conclusions on matters, which in the auditor’s judgment, are considered to be important auditing, accounting, and reporting issues.” The Proposed Standard could also describe certain minimum elements of the completion memorandum, such as the auditor’s overall conclusion about uncorrected errors, matters that resulted in substantial changes to the audit plan, and identified material weaknesses in internal controls over financial reporting.

Paragraph 11—Identification of Items Tested

The second and third bullet items in footnote 2 to paragraph 11, which would permit the auditor to simply describe the scope and population of a sample or the starting point and the sampling interval, are inconsistent with the requirement within paragraph 11 that “documentation...should include identification of the items tested.” If either the auditor, in applying a sample, or a reviewer, in reproducing a sample, misapplied the parameters of the selection criteria (e.g., inadvertently skipped an item), the auditor's and the reviewer's samples would be different. Identifying items examined solely by documenting sampling parameters is also problematic in a computer database environment where a static record, such as a physical sales journal, does not exist. We believe the only way to include "identification of the items tested" would be to list the items. Accordingly, we recommend that the text of the first bullet in footnote 2, which requires that the documentation include identifying characteristics, be inserted in paragraph 11 in place of the footnote reference, and that the footnote be deleted.

Paragraph 12 – Information Relating to Significant Findings or Issues That is Inconsistent with or Contradicts the Auditor’s Final Conclusions

See comments in the following sections of this comment letter:

- I. Most Significant Comments, 6. Information Relating To Significant Findings Or Issues That Is Inconsistent With Or Contradicts The Auditor’s Final Conclusions;
- I. Most Significant Comments, 4. Align the Proposed Standard With The SEC Rule; and
- III. Comments Related to Specific Paragraphs, paragraphs 4 and 9.

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Paragraph 13, 14 and 15—Dates

Paragraphs 13, 14 and 15 use similar terms to describe different dates in the audit process (i.e., completion of the engagement, date of auditor's report, time the auditor grants permission, reasonable period of time), and such inconsistency makes it unclear as to what activities should occur before certain dates or should not occur after certain dates. We recommend that the following three key dates be defined with respect to the activities discussed in these paragraphs and used consistently throughout the Proposed Standard:

- “Report date,” which is defined in AU sec. 530, *Dating of the Independent Auditor's Report*, as “the date of the completion of the field work.”
- “Issuance date,” which we recommend to be defined as the date of delivery of the auditor's report to the client. We believe this would ordinarily be the earlier of (i) the date on which the auditor clears the final printer's proof of a client-printed document including the auditor's report or (ii) the date on which the entity files a document with the SEC including the auditor's report.
- “Documentation completion date,” which we recommend be defined as the date, ordinarily not more than 45 days after the issuance date, on which the auditor has completed the assembly of a complete and final set of audit documentation for retention.

In addition to defining the dates, we strongly recommend including examples in the Proposed Standard of what auditing procedures should, or should not, occur before or after the above dates. For example: a) prior to the report date, substantially all audit procedures should have been performed, including auditing procedures on the disclosures to the financial statements; b) prior to the issuance date, all review notes should be cleared and all conclusions supported; c) prior to the document completion date, all final documentation should be assembled; and d) no *final* audit documentation should be deleted or discarded after the documentation completion date.

Paragraph 13—Seven Years After the Report Date

Paragraph 13 requires that audit documentation be retained for seven years “from the date of the auditor's report”. We believe that the issuance date is a more relevant date than the report date for purposes of the seven-year retention requirement because that is the date the report is available for distribution to the public. We recommend that the paragraph be revised to read “seven years from the issuance date of the auditor's report”.

We also recommend that footnote 3 to this paragraph be revised to clarify that it relates to completed engagements for which no report is issued (e.g., quarterly reviews), and state clearly that the Proposed Standard does not apply in situations where the engagement is terminated before completion of the audit or review.

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Paragraph 14—Assembly of Final Audit Documentation

The phrase “first time the auditor grants permission to use the auditor’s report in connection with the issuance of the company’s financial statements” has not previously been used in auditing standards and is vague. We recommend replacing the phrase with a more recognized term, such as “issuance date of the auditor’s report” and defining the term as recommended above.

Certain activities, such as cross-referencing the final version of the financial statements as issued to specific working papers, cannot take place until after the date of issuance of the auditor’s report. In addition, documentation relating to procedures performed and evidence obtained prior to the report date might be finalized after the issuance date for inclusion in the final audit documentation. For example, documentation of a discussion between the auditor and management that took place prior to the report date may be summarized in a memorandum after the issuance date for inclusion in the audit documentation. Accordingly, we recommend that guidance be added to this paragraph to clarify that “assembly” of audit documentation during the period after issuance of the report might include inserting final documents in place of drafts (including removal of the drafts) as well as the addition of documents. However, consistent with the views of the Board, we do believe that all changes (editorial changes, additions, or removals) made after the issuance date should indicate the nature of the change, the date of the change, by whom the change was made, and the reason for the change.

Paragraph 15—Subsequent Changes to Audit Documentation

The first sentence of paragraph 15 acknowledges that circumstances may require subsequent additions to the audit documentation, but this sentence does not specify the timing contemplated for making such additions.

Additionally, the third sentence of this paragraph states that audit documentation must not be deleted or discarded, but does not specify from which date this would apply. We believe it should be revised to clarify that *final* audit documentation must not be deleted or discarded subsequent to the “documentation completion date”. In accordance with our previous comments above, we recommend that this sentence be revised to read “Final audit documentation must not be deleted or discarded after the documentation completion date.”

Paragraph 16 – Multi-location Audits – Location of Audit Documentation

See comments in “I. Most Significant Comments, 2. Multi-location Audits – Location of Audit Documentation” and in “III. Comments Related to Specific Paragraphs, Proposed Amendment to Interim Standards: Part of Audit Performed by Other Independent Auditor.”

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Paragraph 17—Additional Audit Documentation Requirements

This paragraph is less clear than the second sentence of the existing AU sec. 339.02 “Specific documentation requirements may be included in other standards (for example, government auditing standards), laws and regulations applicable to the engagement.” We recommend that this paragraph be revised to adopt the existing language. As recommended in the overall comments, the Board should coordinate with the SEC so that the standard adopted by the Board and the SEC Rule on audit documentation are the same. We strongly recommend that the footnote to this paragraph be deleted.

Proposed Amendment to Interim Standards: Part of Audit Performed by Other Independent Auditors

We believe there is some confusion about the definition of the term “other auditor” in the Proposed Amendment because of the first sentence of paragraph 16 of the Proposed Standard, which states “(including documentation of work performed by others, such as affiliated firms)”. In practice, we have not considered AU sec. 543, *Part of the Audit Performed by Other Independent Auditors*, to include associated firms within the definition of “other auditors.” There has been a concerted effort by the global firms to align methodologies and quality control processes to enable a uniform approach to all audits. Considering associated firms as “other auditors” for purposes of applying AU sec. 543 contradicts the efforts of these firms to achieve some form of international convergence. Accordingly, we strongly recommend that the Board explicitly define “other auditors” in the Proposed Amendment as excluding associated firms.

In the first sentence of this Proposed Amendment to interim auditing standards, the phrase “to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed” might be interpreted to mean that all documentation should be reviewed to exactly the same extent. We believe the extent of review should depend on the level of staff experience and the subject matter being reviewed. The purpose of the review of the other auditor’s audit documentation is for the principal auditor to reach a conclusion about whether the other auditor’s work is sufficient for the principal auditor to use the other auditor’s report as a basis, in part, for the principal auditor’s report. We recommend that the sentence be revised to provide that the principal auditor’s review should be sufficient to reach such a conclusion and allow for auditor judgment in determining this sufficiency.

We believe that the documentation requirements in the second sentence of the Proposed Amendment are unworkable. The second sentence states, “Sufficient audit documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor to meet all the requirements of PCAOB Auditing and Related Professional Practice Standards No. X, as if the principal auditor had performed the work himself or herself.”

As discussed above in “I. Most Significant Comments, 2. Multi-location Audits – Location of Audit Documentation”, obtaining the original or a copy of the other auditor’s audit

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documentation might be prohibited by law or restricted by regulation. The alternatives to obtaining a copy of the other auditor's audit documentation, (a) review and summarize the other auditor's work in sufficient detail to re-document each and every individual procedure performed and piece of evidence obtained (essentially reviewing and then transcribing all of the other auditor's audit documentation), or (b) reperform the work and assemble the audit documentation himself or herself, are also not feasible because of the same prohibitions and restrictions.

Accordingly, we recommend that the second sentence of the Proposed Amendment be deleted and the following be substituted: "The principal auditor should document the review of the other auditor's documentation in a memorandum. The memorandum should include the principal auditor's conclusion that the other auditor's work is sufficient for the principal auditor to use the other auditor's report as a basis, in part, for the principal auditor's report, and should include a summary of the other auditor's major findings and conclusions on important auditing, accounting, and reporting issues."

The third sentence of the Proposed Amendment, in merging the considerations set forth in AU sec. 543.12, *Part of the Audit Performed by Other Independent Auditors*, subparagraphs b and c, has lost the timing distinction between the two concepts presented in the current literature. The review by the principal auditor of the other auditor's audit programs and the issuance of instructions to the other auditor as to the scope of work, if considered necessary, should take place during the planning of the audit and not in connection with the review of the audit documentation, which ordinarily would take place near the end of the engagement. We suggest that this sentence be revised to restore this distinction in timing.

We appreciate the opportunity to comment, and would be pleased to discuss these issues with you further. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579 or John A. Fogarty at (203) 761-3227.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: William J. McDonough, Chairman of the PCAOB
Kayla J. Gillan, Member
Daniel L. Goelzer, Member
Willis D. Gradison, Jr., Member
Charles D. Niemeier, Member

**PCAOB RULE MAKING DOCKET MATTER NO. 012
PROPOSED AUDITING STANDARD ON AUDIT DOCUMENTATION**

Clarification needed

Paragraph 5 tracks Section 103 of the Act and in so doing drops the Government Auditing Standards' requirement to document "judgments" as well as "conclusions". As a result it may not be clear whether or not the judgments that are integral to conclusions need to be documented. For example, the evidence relating to auditors' conclusions on materiality and risk will be documented, but the judgments, i.e. the thought processes and logic that were applied to the evidence, may not be documented.

**Donald H. Chapin, CPA
December 12, 2003**

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January 20, 2004

Mr. J. Gordon Seymour
Acting Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

**PCAOB Rulemaking Docket Matter No. 012
Proposed Auditing Standard—Audit Documentation**

Dear Mr. Seymour:

We are pleased to comment on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Proposed Auditing Standard - *Audit Documentation* (the "Proposed Standard") and Proposed Amendment to Interim Auditing Standards - *Part of Audit Performed by Other Independent Auditors* ("the Proposed Amendment"), collectively referred to as "the Proposal."

As a preliminary matter, we support the Board's effort to adopt a comprehensive standard consistent with Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act, which requires that the Board adopt a standard that registered public accounting firms "prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report." We also agree with the Board's general statements in its Release about the significance of the audit documentation standard - namely, that this standard is "one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest." PCAOB Release No. 2003-023 (November 21, 2003) ("Release") at 2.

Indeed, it is because of the importance of this issue that we are providing detailed, paragraph-by-paragraph comments as an attachment to this letter. These comments are made with one clear objective: the standard ultimately adopted by the Board should improve audit quality and help restore public trust in the integrity of the audit process. Our firm, and we believe the accounting profession as a whole, is very focused on these goals. Our ultimate clients - the investing public - depend on the thoroughness and conscientiousness of our work.

Despite our fundamental support for the Board's agenda, we are concerned with several aspects of the Proposal. The Proposal purports only to deal with the narrow question of audit documentation, but its scope is actually much broader, extending beyond what Congress mandated in Section 103 of the Sarbanes-Oxley Act. The Release does not explain why the

Mr. J. Gordon Seymour

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Board has taken this approach, what problems the Proposal is intended to address, or whether the Board has considered less far-reaching and expensive alternatives.

In particular, Paragraph 16 of the Proposed Standard would require that non-U.S. audit working papers for audits of U.S. issuers be shipped into the U.S. Further, the Proposed Amendment would amend AU Section 543 to require that auditors at the U.S. firm's office that is signing the audit opinion (*i.e.*, the principal auditor) review the audit documentation of others, including auditors in affiliated firms, who audit a subsidiary, an affiliate or a division of the SEC issuer (unless the principal auditor refers to the other auditor in its auditor's report). While we share the Board's apparent objective of improving the quality of audits on multinational corporations, we do not believe this Proposal is the appropriate means of doing so. In fact, the Proposal could actually undermine audit quality by reducing the relevance of global quality control systems and by limiting issuers' flexibility to engage other auditors with unique industry expertise or service capabilities in particular parts of the world. In addition, the Proposal raises serious conflict of law issues with respect to foreign data protection and other legal restrictions. Moreover, the Proposal would increase audit costs and would be impractical – for instance, a U.S. audit partner cannot be expected meaningfully to review work papers prepared in foreign languages. It also would create unnecessary roadblocks to the SEC's new accelerated filing deadlines.

Paragraph 16 of the Proposed Standard and the Proposed Amendment also seem to conflict with the Board's recent statement, in its Release on Oversight of Non-U.S. Public Accounting Firms, that it "seeks to become partners with its non-U.S. counterparts in the oversight of the audit firms that operate in the global capital markets." PCAOB Release No. 2003-024 (Dec.10, 2003) at 3. Further, the Board has emphasized the need to establish "an efficient and effective cooperative arrangement" with foreign regulators. *Id.* We are committed to doing everything that we can to facilitate such arrangements and to strengthen the development of non-U.S. regulatory bodies so that they can succeed in exercising effective regulation of the accounting profession. We urge the Board to modify its Proposal so that the final standard is consistent with the Board's stated objective.

In addition, we have significant concerns about Paragraph 6 of the Proposed Standard, which would establish a "rebuttable presumption" that failure to document audit work indicates that procedures were not applied, evidence was not obtained, and conclusions reached were not suitably supported. Unlike other paragraphs of the Proposed Standard, which refer to "significant" findings or issues (*see* Paragraphs 9 and 10), Paragraph 6 does not have such a threshold. An auditor makes hundreds of inquiries in the course of performing an audit and, in doing so, continuously evaluates audit evidence and representations of client personnel that affect additional procedures that might be necessary. It would be unnecessary, time-consuming, and potentially counterproductive to require the auditor to make a written record of everything he or she does during the audit, including procedures that are not significant to the overall audit results. In addition, the Release states that it "contemplates" adding to the standard a statement that "oral explanation alone would not constitute persuasive other evidence" to rebut the presumption. Release at 4. This Proposal would make the "presumption" essentially irrebuttable – if there is no written record, then oral explanation would almost always be the only evidence. Accordingly, we strongly recommend against this additional possible amendment.

Mr. J. Gordon Seymour

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The Proposed Standard focuses so much on the sufficiency of audit documentation that an unintended consequence could be that the volume and completeness of audit documentation becomes the measure of audit quality, rather than the quality of the procedures, evidence and professional judgments made throughout the audit. The Proposed Standard does not acknowledge the role of the auditor's professional judgment in the determination of the quantity, type, and content of audit documentation. Professional judgment is exercised throughout the audit process, and it certainly should be a consideration in decisions regarding audit documentation. We believe the focus of the PCAOB's audit documentation standard should be to promote performance of high-quality audits through documentation of the significant procedures performed and professional judgments made, and not on the volume of documentation.

With respect to the issues raised by Paragraph 16 and the Proposed Amendment, we do offer alternative proposals that we believe would improve audit quality. For example, the Board might consider requirements for documentation of the supervision and control of the work performed by other affiliated firms that should reside in the office issuing the auditor's report.

Our other comments and suggestions also are set forth in the attachment, and we hope they will be useful to the Board in its consideration of this very important proposal. We note that the Board has only recently begun to inspect registered accounting firms, and is still in the early stages of dealing with the complex legal and practical issues relating to multinational audits. We respectfully submit that the Board should only mandate broad changes in the conduct of such audits when there is a strong factual basis for such changes, and only after trying to resolve conflict of law issues in cooperative arrangements with foreign regulators. We look forward to providing the Board with any assistance we can offer in these areas.

We would be pleased to discuss any of these issues with the Board or members of its staff.

Respectfully submitted,

The signature is written in a cursive, handwritten style. It reads "Ernst & Young LLP". The "E" is large and loops around the "r". The "Y" is also large and loops around the "o". The "LLP" is written in a smaller, more straightforward cursive.

Attachment

ATTACHMENT TO ERNST & YOUNG COMMENT LETTER

Our paragraph-by-paragraph comments are as follows:

Proposed Standard:

Objectives of Audit Documentation

Paragraph 1—We recommend that the Board clarify that the scope of the Proposed Standard applies only to audit reports of issuers filed with the SEC. PCAOB Rule 3100 generally requires the auditor to adhere to the Board’s auditing standards in connection with the preparation or issuance of “any audit report” for an issuer and in their auditing and related attestation practices, which we interpret would not apply to reports of issuers not filed with the SEC (*e.g.*, statutory reports, reports for other regulators, SAS 70 reports, pension reports not filed in Form 11-K).

Paragraph 3—Three of the six examples of the purposes of audit documentation appropriately relate to the needs of auditors in performing the audit. However, the other three examples (d., e., and f.) relate to the needs of others, indicating that audit documentation exists for purposes other than supporting the audit. We are concerned that these examples alter existing interim auditing standards to provide that auditors must prepare audit documentation considering the needs of these third parties, a requirement that could needlessly increase the cost of an audit.

In addition, in the case of examples d. and f., there is a presumption that third parties are entitled to review the audit documentation. This is contrary to existing auditing standards (AU Section 339.10-12), which make clear that audit documentation is the property of the auditor; that the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information; and that the auditor should adopt reasonable procedures to prevent unauthorized access to the audit documentation. While auditors often grant access to their audit working papers to third parties as a convenience to their clients, there is no requirement that they do so (absent compulsory process such as a court subpoena). In any event, working papers are typically provided to third parties only when the audit client’s management so authorizes and only after the third party provides a letter to the auditor stating, among other things, that it understands the audit documentation was not prepared with the needs of the third party in mind, and that in agreeing to provide access to the audit documentation the auditor accepts no professional responsibility to such third party.

Accordingly, we recommend that examples d., e., and f. be deleted from Paragraph 3. If the Board nonetheless determines to keep such examples in the Proposed Standard, we suggest doing so under a different section heading (*e.g.*, *Other Uses of Audit Documentation*) to clearly distinguish this discussion from the performance requirements of the Proposed Standard.

Content of Audit Documentation

Paragraph 4—We recommend that the Board conform the language in the second sentence of Paragraph 4 to include the qualifying phrase found in SEC Rule 2-06(a). Thus, the second sentence of the paragraph would state: “Audit documentation ordinarily consists of memoranda,

correspondence, schedules, and other documents created or obtained in connection with the engagement **that contain conclusions, opinions, analyses, or financial data related to the audit or review.**” Absent this additional language, paragraph 4 suggests that the auditor would need to retain all documents created or obtained in connection with the audit, including documents that do not contain “conclusions, opinions, analyses or financial data related to the audit or review.”

The Proposed Standard also does not acknowledge the role of the auditor’s professional judgment in the determination of the quantity, type, and content of audit documentation. Professional judgment is exercised throughout the audit process, and it certainly should be a consideration in decisions regarding audit documentation. We recommend the PCAOB’s final standard include language similar to the language in Paragraph 7 of the interim standard on audit documentation, which states:

“In determining the nature and extent of the documentation for a particular audit area or auditing procedure, the auditor should consider the following factors:

- Risk of material misstatement associated with the assertion, or account or class of transactions
- Extent of judgment involved in performing the work and evaluating the results
- Nature of the auditing procedure
- Significance of the evidence obtained to the assertion being tested
- Nature and extent of exceptions identified
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed”

Paragraph 5—This paragraph requires that audit documentation contain sufficient information to enable “an experienced auditor, having no previous connection with the engagement” to understand the procedures that were performed, conclusions reached, and other important information. As drafted, there is no requirement that such an auditor also have a thorough understanding of the business of the company, the industry in which the company operates, or the audit firm’s policies and procedures.

In our view, the “experienced” auditor also should be expected to have recent experience auditing companies in the same industry and sufficient familiarity with the audit firm’s audit methodology and electronic tools. In addition, we would expect the “experienced” auditor to have gained a sufficient understanding of the audit client and its operations and systems through discussions with members of the audit engagement team.

We also think it is reasonable to presume that an experienced auditor, having no previous connection with the engagement, would require oral explanations from members of the audit engagement team to facilitate an effective review of the team’s written audit documentation. The nature and extent of the audit documentation and conclusions will be influenced by the collective experience of the engagement team members in auditing similar companies and their

overall knowledge of the particular client and its industry. Review of audit documentation and discussions with engagement team members are among the procedures registered accounting firms perform in monitoring compliance with their quality control policies and procedures. While discussions with engagement team members are not a substitute for appropriate audit documentation, an experienced auditor with no previous connection with the engagement (even when he or she is knowledgeable of industry matters) generally will need to discuss the audit documentation with engagement team members to fully understand all of the team's conclusions.

We also are concerned that this paragraph creates an unconditional obligation regarding documentation in that it does not refer only to "significant" matters, unlike Paragraph 9, which refers to "significant findings or issues." The focus of the PCAOB's audit documentation standard should be on the performance of high-quality audits through documentation of the significant procedures performed and professional judgments made, and not on the volume of documentation.

Paragraph 6—We do not support the "rebuttable presumption" that failure to document work performed indicates that procedures were not applied, evidence was not obtained, and the conclusions reached were not suitably supported. This is particularly troublesome because the paragraph does not limit the documentation requirement to "significant" matters, unlike Paragraph 9, which refers to "significant findings or issues." Our concerns are still greater if the Board were to add another sentence to Paragraph 6 as "contemplated" in the Release – that "oral explanation alone would not constitute persuasive other evidence." Release at 4.

We are concerned that implementation of the proposed requirements would inappropriately focus the attention of auditors on the volume and clerical completeness of the audit documentation rather than the quality of the procedures, evidence and professional judgments made throughout the audit. Auditors literally make hundreds of inquiries in the course of performing an audit and, in doing so, continuously evaluate audit evidence and representations of client personnel that affect additional procedures that might need to be performed. The responses to inquiries, or the auditor's impressions of the quality of the audit evidence obtained, may cause the auditor to consider whether certain potential auditing, accounting, or financial reporting issues exist, which in turn might lead the auditor to perform additional procedures. Auditors should document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached during the audit process, as described in paragraph 9. But we are concerned that Paragraph 6 as drafted could be misinterpreted and misapplied, particularly in a hindsight challenge of the auditors' compliance with PCAOB standards.

We assume that it is not the Board's intent to require that the auditor document each and every inquiry or thought process during an audit, but we suggest the Board clarify this point. Such a requirement would be impossible to comply with and would set the auditor up for failure. Moreover, such a requirement would detract from the audit process by, in effect, forcing the auditor to allow documentation considerations drive the selection of procedures. This would result in the development of and reliance on standardized checklists and extremely detailed

forms for all aspects of the audit for fear that to do otherwise would result in insufficient documentation. Auditors currently use checklists to address matters common to all companies (e.g., internal control and fraud consideration checklists, disclosure checklists). However, using a checklist approach in many other aspects of the audit would serve to make the audit too mechanical and would foster a form-over-substance audit approach, which would not facilitate the performance of higher quality audits.

For example, an auditor would typically ask many questions when obtaining an understanding of the flow of a particular type of transaction through the accounting system, and would document the individuals interviewed, documents examined, and the manner in which the transaction is processed based on the inquiries. The specific, question-by-question set of detailed questions would typically not be documented. Likewise, AU Section 316 states that the auditor should make inquiries of others throughout the entity but does not require that the auditor document each inquiry. The auditor is, however, required to document meaningful evidence from those inquiries that should be considered in assessing the risks of material misstatement due to fraud. We recommend that the PCAOB retain this concept of requiring that “significant” issues be recorded and make clear that every specific question or inquiry need not be documented unless it is “significant” to the audit.

In addition, the possible inclusion of a restriction on the use of an “oral explanation” would be a very harsh and unwarranted prohibition. It would essentially make the “rebuttable” presumption altogether “irrebuttable,” because oral explanations are almost certainly necessary where the working papers lack a written explanation. This is particularly troublesome because the Board’s standard is an auditing standard, so it would be applicable not only in regulatory investigations or inspections but also in private litigation.

Paragraph 7(b) — This paragraph includes the statement that “[audit documentation should] support the basis for the auditor’s conclusions concerning every material financial statement assertion.” Paragraph 9 of the Proposed Standard requires that the auditor document “significant [audit] findings or issues.” We believe the language in paragraph 9 is consistent with the other references to the sufficiency of audit documentation throughout the Proposed Standard and recommend the Board delete the phrase “concerning every material financial statement assertion” from paragraph 7(b).

Paragraph 8—The requirement that the audit documentation for each engagement contain a reference to the central repository regarding matters common to all audit engagements, such as auditor independence and staff training and proficiency, is unnecessary and would not enhance audit quality or audit documentation. The lead audit partner and other audit engagement team executives rely upon the firm’s quality control standards and processes to determine that assigned staff have satisfied relevant training and other requirements. This is an essential element of a cohesive accounting firm partnership – the ability of a line audit partner to rely on the firm’s common system of quality control. The proposed requirement would shift quality control responsibilities – that is, making sure that audit staff have the correct training, meet independence requirements, and so on – from the national offices to each individual partner.

That is not where such a responsibility should reside. And having a team member make standard, boilerplate cross-references in the engagement working papers to central repositories would not bring a sharper focus on such important quality controls with respect to the specific engagement. Accordingly, we recommend the Board simplify this paragraph and retain only the third sentence, which would require that the audit documentation include matters unique to the particular engagement.

Paragraph 12—We recommend that the Board clarify how “information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor’s final conclusions” differs from “information or data, relating to a significant matter that is inconsistent with the auditor’s final conclusions regarding that matter or the audit or review” as set forth in SEC Rule 2-06(c). Because of the differing language, we are uncertain whether the Proposed Standard imposes a different definition for such information.

We also note a redundancy in that the requirement that the auditor retain documentation of consultations on, and resolution of, differences in professional opinion is addressed in item (d) of Paragraph 9 and is repeated in Paragraph 12.

Retention of and Subsequent Changes to Audit Documentation

Paragraphs 13 and 15—We recommend that the Board refer to the issuer’s filing date in these paragraphs for determining the completion of the audit. We note that the SEC, to eliminate confusion about the commencement and completion dates of audit engagements in its “cooling off” rule adopted in 2003 as part of new auditor independence rules, decided to use the date that the issuer files its annual report with the Commission as the end of the audit engagement period. *See* Strengthening the Commission’s Requirements Regarding Auditor Independence, 68 Fed. Reg 6006, 6009 (Feb. 5, 2003) (to be codified at 17 C.F.R. pt. 210).

Paragraph 13 establishes the “completion date” of an audit as the date of the auditor’s report. Current practice is for the auditor to date the auditor’s report as of the date when substantially all fieldwork has been completed. In some situations this date could be several weeks prior to the required filing date of the company’s annual report with the SEC and the date when the auditor will need to grant permission to use the auditor’s report in connection with the issuance of the company’s financial statements. Often there are several necessary but routine auditing activities that take place after the date when fieldwork has been substantially completed but prior to the filing of the financial statements and issuance of the auditor’s report. Paragraph 15 requires that the auditor follow the protocols of Paragraph 15 for adding, deleting, or discarding audit documentation after “completion.” Accordingly, Paragraph 15, together with paragraph 13, would require that the auditor follow the procedures set forth in Paragraph 15 for any additions or deletions to the audit documentation after completion of the fieldwork (*e.g.*, identifying who made the changes, and explaining the reason for them), which seems unnecessary with respect to routine procedures that are performed during this intervening period. We recommend the Board establish the company’s filing date as the completion date for the audit so as not to impose

additional procedural requirements with respect to routine audit procedures performed after the completion of fieldwork but prior to the client's filing of the audit report.

Paragraph 16—Paragraph 16 would require that “[a]udit documentation sufficient to meet the requirements of paragraphs 4-12 (including documentation of work performed by others, such as affiliated firms) must be retained by the office issuing the auditor’s report.” We submit that this Proposal would result in very significant changes to audits of major U.S. and foreign SEC registrants without a corresponding increase in audit quality. Moreover, certain aspects of the Proposal would be either unworkable or impractical; would add to the cost of the audit with little, if any, benefit to users of the financial statements; and would unreasonably and unjustifiably increase audit firm liability.

We strongly support measures by the Board to enhance the quality of audits and to hold auditors accountable for that quality. The Board’s Proposed Standard, however, does not identify the deficiencies in audit quality that Paragraph 16 is intended to address or describe how the requirements of this paragraph otherwise enhance audit quality. It is not known whether the Board’s intent is to facilitate its inspections by making all of the working papers of any particular audit available in one office within the U.S.; to improve the quality of audit performance outside the United States; to shift greater responsibility or liability to U.S. firms for work done outside the U.S.; or to achieve some other goal or goals. Before adopting requirements having such great significance, the Board should explain its objectives and why this change in auditing standards is necessary to meet those objectives.

By way of background, we believe it might be useful to review some elements of the approach to audits of multinational corporations by Ernst & Young and other major accounting firms.

Many large U.S. and foreign SEC registrants have worldwide operations and conduct business in dozens of countries. While these companies have highly sophisticated means of transmitting summarized financial information to their corporate headquarters to prepare consolidated financial statements and disclosures, the source documents are not routinely shipped to the company’s corporate headquarters. Instead, they are retained at the subsidiary location. In the case of operations in foreign countries, the source documents are typically not written in English or translated into English.

Ernst & Young and other major auditing firms have developed methodologies, processes, and practices to summarize results of audit procedures performed at the various subsidiary locations and to transmit audit findings to the office issuing the auditor’s report on the consolidated financial statements. Audit procedures carried out at the subsidiary locations are conducted by local auditors in the local language and, in the case of foreign locations where English is not the primary language, substantial portions of the work is not typically written in English or translated into English. This audit work (whether foreign or domestic) is subject to appropriate levels of review and other quality control procedures at the location where the work is performed, and it provides the basis for the summary audit findings that are transmitted in English to the office issuing the auditor’s report.

To promote consistent quality in audits of large U.S. or foreign SEC registrants, the larger auditing firms have formed global networks of auditing firms. Members of these networks generally have adopted common audit methodologies and tools and similar quality control procedures, including quality assurance review programs. In addition, member firms frequently share communication networks, technical materials, and staff development and training programs.

Engagement teams for large U.S. or foreign SEC registrants design and utilize a variety of techniques to promote consistency and quality in each phase of the annual audit. These techniques have been refined over a number of years, principally in response to changes in the client environment and advancements in information technologies. Examples of these techniques include:

Engagement Planning—global planning meetings to establish worldwide audit scope; dissemination of detailed engagement planning instructions, time and resource planning templates, materiality thresholds, information concerning key business risks and significant accounting and auditing matters potentially affecting the company, and communication protocols; site visits by auditors from the headquarters engagement team to discuss and review audit planning documents at different locations; submission of audit planning documents to the headquarters office for review and comment.

Engagement Execution—dissemination of audit programs, electronic working paper templates, visitation by auditors from the headquarters engagement team to review audit programs and to discuss the audit procedures performed and the results of such procedures.

Engagement Results—common reporting packages and other communication protocols, visitation by auditors from the headquarters engagement team to review and discuss audit findings, submission of audit summarization documents (*e.g.*, engagement completion memorandums) to the headquarters office to enable the office issuing the auditor's report to understand and evaluate significant findings and issues at the locations.

To further promote consistency and quality in audits of large U.S. or foreign SEC registrants, the U.S. and other member firms in the global networks have relocated experienced auditors from the U.S. to major offices of their foreign, affiliated audit firms. These individuals are assigned to the audits of major U.S. or foreign SEC registrants, possess in-depth knowledge of U.S. accounting and auditing standards, and, among other things, assist the auditors from the headquarters engagement team in dealing with potential language barriers.

These and other audit techniques and practices employed by the global network provide the headquarters engagement team the ability to leverage the skills of auditors around the world to consistently perform a high-quality audit of a multinational SEC registrant's financial statements.

Rather than adopting the proposed requirements of Paragraph 16 for affiliated firms, we recommend that the PCAOB consider requirements for documentation of the supervision and control of the work performed by other affiliated firms that is to reside in the office issuing the auditor's report. Such requirements could include the scope of the affiliated firm's work deemed necessary in connection with the audit of the entity's consolidated financial statements, circumstances that caused the affiliated firm to depart from the scope of the work outlined by the issuing office, audit adjustments whether recorded or unrecorded, a description of significant accounting and auditing matters and conclusions reached, and a representation that the quality control procedures of the firm were followed. Likewise, we recommend that the PCAOB consider whether changes are needed to the quality control standards to provide better guidance regarding documentation that should be maintained by the U.S. firm pertaining to global issues such as independence and training in U.S. accounting and auditing standards applicable for auditors in affiliated firms who audit a subsidiary, an affiliate or a division of an SEC issuer. We would be pleased to work with the PCAOB in developing these proposals.

We suggest these alternatives because of our serious concerns about Paragraph 16, which are as follows:

1. The proposed requirements of Paragraph 16 do not seem to take into account the global audit coordination and quality-control efforts of the major accounting firms or the nature of multinational audits and, in fact, could make them irrelevant. The office issuing the auditor's report should be able to rely on review and other quality control procedures performed by affiliated firms that subscribe to the quality control policies of a common global network and issue the auditor's report without redundant review.

We believe that requiring redundant reviews generally would not be feasible and would not contribute to improving audit quality. SEC reporting requirements make it necessary to complete the audit shortly after year-end. As a result, significant portions of the annual audit are conducted over a relatively short period of time. Therefore, quality control procedures necessarily must be performed on-site, as the audit procedures are being performed. The relevant quality control procedures (on-site supervision and review by experienced auditors) need to be performed by auditors from the other audit firms with oversight from the headquarters engagement team. It is not practical for the office issuing the auditor's report to subsequently "review in" quality after the audit procedures at the various other locations are performed and the audit documentation is forwarded to the issuing office. This would become even more of an issue as the SEC reporting deadlines are shortened from 75 to 60 days after year-end.

Further, in many situations the senior engagement team members from the office issuing the auditor's report will not be able to read the foreign audit documentation. Having possession of all audit working papers prepared at every location participating in the audit will not enhance quality when much of the documentation is not in English.

2. The proposal would increase audit costs. While it is a common perception that today's audit documentation is electronic, and therefore easily transferred and stored, a significant portion of

the audit documentation is in hard copy form, and will be for the foreseeable future. This is because the evidence gathered generally comes from external sources or from the issuer in hardcopy form. Examples include written confirmations received from third parties, copies of account statements obtained from the issuer's files, signed letters of representation, letters from attorneys, summary pages from computer print-outs, copies of contracts and other legal documents. The auditor often documents the audit procedures performed directly on the hardcopies and the hardcopies become part of the audit documentation.

Accordingly, the proposal would require that huge quantities of documents, many written in languages other than English, be shipped from foreign offices into the United States. Shipping and storage costs by themselves would be significant. In addition, we generally avoid sending original copies of working papers through the mail or delivery services because of the risk of loss or theft, so significant copying expenses also would be incurred. And the process of copying (for which outside copying services might be necessary in some countries), packaging, and shipping working papers would increase the likelihood of lost or misplaced documents.

3. The requirement of Paragraph 16 that audit documentation "must be retained by the office issuing the auditor's report" will raise significant liability issues both for U.S. and the non-U.S. firms irrespective of whether a quality audit was performed. The elimination of a privity requirement in shareholder lawsuits, the acceptance of the fraud on the market theory, and other legal developments in the federal courts have created an environment in which accounting firms are potentially exposed to billions of dollars of liability every time the firm signs an audit opinion on a large publicly traded company. As the Board is aware, the result of these developments is that massive damages claims can be, and routinely are, asserted against the major accounting firms. Even where they lack merit, such lawsuits often cost millions of dollars to defend. While the Board appropriately should adopt rules that further its ability to fulfill its regulatory obligations, we believe that the Board should be hesitant when those measures also would unjustifiably exacerbate private liability exposure.

Among other things, Paragraph 16 would facilitate the assertion of frivolous claims in the U.S. against foreign accounting firms (which typically are organized as separate partnerships from the U.S. firm), as well as against the international umbrella organizations of the major accounting firms, such as Ernst & Young Global. Naturally, our foreign firm affiliates are concerned about any proposal that might sweep them into the U.S. litigation environment – an environment that has no parallel elsewhere in the world. Yet the Paragraph 16 could do precisely that.

4. The proposed requirements raise significant conflict of law concerns. As the PCAOB is aware from comment letters, roundtables, and meetings with foreign regulators, many foreign countries have data privacy, bank secrecy and other laws that would prohibit the disclosure of certain information to the PCAOB and to others. Certain of these legal protections can be waived by the audit client, and, pursuant to Section 102 and 106 of the Sarbanes-Oxley Act, our firm and other large accounting firms are currently in the process of seeking appropriate client consents and waivers. (We note in this regard that we will be filing a comment letter on the Board's proposal with respect to oversight of non-U.S. firms within the next week, and in that letter we will be describing the waivers/consents in some detail.) However, waivers and

consents are not a universal solution – their effectiveness varies from jurisdiction to jurisdiction. Accordingly, even if we are successful in obtaining waivers and consents from relevant non-U.S. accounting firms and audit clients, we still could not comply with the proposed standard – which is very broad with respect to the type of documentation that must be sent to the issuing firm’s office – without potentially violating the laws of many foreign countries. The Proposal does not address this issue.

In order to provide the PCAOB with a more detailed discussion of foreign conflict of law issues, the major accounting firms have retained the law firm of Linklaters, headquartered in London, England, to submit a legal memorandum to the Board. Linklaters submitted a similar letter on behalf of the major firms as part of the commenting process on the Board’s rule on registration of foreign accounting firms, and we expect that the Board will find their legal analysis helpful. The Linklaters letter describes conflict of law issues stemming from the European Union directive on data privacy. We suggest that, although the law relating to that directive is still developing and its precise effects are not yet known, the Linklaters analysis provides guidance to potential legal impediments.

It is also important to note the apparent inconsistency between the Board’s proposed requirements in Paragraph 16 and other current proposals and activities of the Board. The Board has previously acknowledged the foreign conflict of law issue and has sought solutions so that the Board can properly fulfill its statutory mandate with respect to the regulation of both U.S. and foreign accounting firms. Thus, the Board attempted to accommodate foreign legal conflicts by including Rule 2105 in its registration rules. That rule permits a foreign registering firm to obtain a legal opinion describing legal conflicts that exist in its jurisdiction and that thereby preclude the firm from providing certain information that is required by the Board’s registration rules. Likewise, the Board has described its efforts to establish a “partnership” and “cooperative relationships” with foreign regulators in order to solve foreign legal conflicts and in order to work together on inspections and investigations of foreign accounting firms. *See* PCAOB Release 2003-024 – Proposed Rules Relating to the Oversight of Non-U.S. Accounting Firms (Dec. 10, 2003).

Paragraph 16 seems to bypass all of these other efforts being made by the Board. It would simply require that all foreign audit working papers be shipped into the United States, where they presumably would be available for inspection or review by the PCAOB, without regard to any foreign law issues. This would be at odds with the PCAOB’s other efforts in the international context and would require the registered accounting firms to choose either to risk violating many foreign laws or to violate the PCAOB’s auditing standard.

5. The Board’s Release does not describe the reasons or rationale for the requirements proposed in Paragraph 16, but it would appear they are intended at least in part to facilitate the Board’s inspection and investigative processes. But under Section 102 of the Act and the Board’s rules, a registered U.S. accounting firm must obtain agreements from foreign accounting firms that participate in the audit that the firm will cooperate with the Board in an inspection or investigation. In addition, under Section 106(a) of the Act and the Board’s rules, foreign firms

that sign reports on issuers, or that play a “substantial role” in the audits of issuers, must themselves register. Finally, Section 106(b) of the Act requires consents for the production of working papers from foreign firms that issue audit opinions or that perform “material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report.”

Because of these several, and redundant, statutory provisions, foreign firm audit working papers must be made available to the Board by the foreign accounting firm (consistent, of course, with the foreign conflict of law issues discussed previously). Thus, the Board need not require that working papers be shipped into the U.S. pursuant to an auditing standard to facilitate its inspection and investigation of audits of multinational issuers.

Implementation Date

Paragraph 18—The Proposed Standard would apply to “engagements completed on or after June 15, 2004.” Audits of certain engagements that will be completed on or after June 15, 2004 have already commenced, and many engagements will have commenced prior to the time when the PCAOB adopts a final standard that is approved by the SEC. Thus, to the extent the Proposed Standard would change existing audit documentation standards, auditors may not be in compliance with the Proposed Standard. It is not practical to apply these new requirements retroactively. We therefore suggest that the Board make the implementation date of the final standard prospective (*e.g.*, for audits of financial statements for periods beginning on or after June 15, 2004, which would likely provide sufficient time for the Board to issue a final standard and for the SEC to approve the standard).

Proposed Amendment to AU Section 543.12

Along with the proposed changes in audit documentation standards, the Board is proposing to amend AU Section 543.12, which, similar to the proposed requirements set forth in Paragraph 16, would result in very significant changes to audits of major U.S. and foreign SEC registrants and, we submit, would not improve audit quality. We also are concerned that the Proposed Amendment would, in many instances, be unworkable.

AU Section 543.04 describes the situation under which the principal auditor may rely on the work of other auditors without referring to the other auditors in the audit report. It states, “If the principal auditor is able to satisfy himself as to the independence and professional reputation of the other auditor and takes steps he considers appropriate to satisfy himself as to the audit performed by the other auditor, he may be able to express an opinion on the financial statements taken as a whole without making reference in his report to the audit of the other auditor. If the principal auditor decides to take this position, he should not state in his report that part of the audit was made by another auditor because to do so may cause a reader to misinterpret the degree of responsibility being assumed.”

Audits of large, multinational SEC registrants generally are conducted by global networks of auditing firms. In these situations, the principal auditor “satisfies himself as to the independence and professional reputation of the other auditor” with the knowledge gained from member firm activities, including sharing common audit methodologies, similar quality control procedures, and other activities described previously in this letter. The principal auditor “takes steps he considers appropriate to satisfy himself as to the audit performed by the other auditor” by considering whether to perform one or more of the procedures described in existing paragraph AU Section 543.12.

We have the following specific comments on this proposal:

1. The Proposed Amendment would require the principal auditor to review the work of the other auditors in all instances, and in more detail, regardless of the principal auditor’s satisfaction as to the independence and professional reputation of the other auditors or the nature and extent of the other procedures the principal auditor might choose to perform to satisfy himself as to the audit performed by the other auditors. Reviewing the working papers of the other auditors is one of the considerations currently described in AU Section 543.12; however, it does not require the principal auditor to review the audit documentation of the other auditors “to the same extent and in the same manner [as] the audit work of all those who participated in the engagement is reviewed,” which the proposed amendment would require. Auditors generally elect to review the work of the other auditors in such a manner when the work is significant to the overall audit or presents unusual risks, the principal auditor is less familiar with the professional reputation of the other auditors, or the other procedures currently described in AU 543.12 do not provide the necessary evidence. We believe the principal auditor should be permitted to continue to exercise professional judgment in determining the nature and extent of procedures necessary to rely on the work of other auditors.
2. For many of the same reasons discussed above with respect to Paragraph 16, the Proposal would be impractical and unworkable. It does not adequately recognize how large, multinational engagements are conducted or issues relating to increasingly shorter year-end audit periods and considerable language difficulties.
3. The “review” proposal would essentially deny the principal auditor the ability to place any reliance on the quality control procedures of other auditors because it would require the principal auditor to review the audit documentation of the other auditor to the same extent and in the same manner as the audit work of all those who participated in the engagement is reviewed. This would have the effect of subjecting the work of other auditors to quality control procedures of both the principal auditor and the other auditors, resulting in higher audit costs without any corresponding benefit. Where practical, SEC issuers and their principal auditors would likely elect not to engage other auditors to avoid these higher costs. This outcome potentially would weaken audit quality in that it would serve to limit the choices of issuers as to the auditing firms they might engage on a global basis. Issuers frequently engage other auditors to audit segments of their business due to industry expertise or service capabilities in geographic locations. The added cost of requiring the principal auditor to review the audit documentation of the other

auditors to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed would have a dampening effect on such arrangements.

We note that the PCAOB might appropriately consider less far-reaching alternatives that could have a positive effect on audit quality and could be implemented without practical difficulty. One possibility is to impose the “review” requirement on situations where the other auditor is not a registered accounting firm subject to inspection by the PCAOB, or is not an affiliated firm that subscribes to the quality control policies of a common global network.

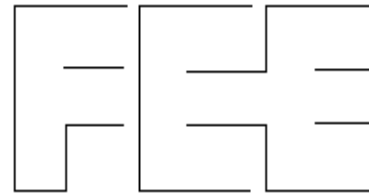
Date
20 January 2004

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Dear Sirs,

Re: PCAOB Rulemaking Docket Matter No. 012 – “Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards”

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased, as the representative organisation of the European accountancy profession, to comment on the exposure draft released by the PCAOB on 21 November 2003 on “Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards” (referred to as “the proposed standard”).

Because of the importance of the issues raised by the proposed standard we are sending a copy of our response to the International Auditing and Assurance Standards Board (IAASB) and the European Commission.

In addition to our overall comments on matters of principle, this letter includes comments on specific paragraphs.

Overall comments

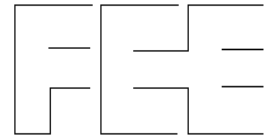
Worldwide repercussions of proposed standard

The proposed standard will have a very wide impact not only on US-based auditors, but also on auditors throughout the world serving:

- (1) SEC foreign registrant companies who choose to be listed in the US; and
- (2) the relevant subsidiaries of US domestic SEC registrants which fall under the same requirements as the US domestic portion of the entity.

The auditors of both types of registrants will be required to prepare and maintain audit documentation in accordance with the proposed standard and as noted below under “Multi-location audits and data protection issues” there is serious doubt about whether the proposed standard could be applied in practice.

We request the PCAOB to give due consideration to the impact its proposal will have on the IAASB’s global auditing standards. In particular, we strongly encourage the PCAOB to consider how the proposed standard fits in with International Standards on Auditing (ISAs). It is our understanding that the IAASB will consider ISA 230 ‘Documentation’ for revision in the first half of 2004. The resulting revised ISA on documentation may prompt calls for revisions to the proposed standard and should be carefully considered by the PCAOB.



Primary purpose of audit documentation

The primary and most important purpose of audit documentation is to support the conclusions reached in an audit. The requirements for audit documentation included in the proposed standard are overly prescriptive and will result in unnecessary audit procedures and preparation of unnecessary audit documentation for the purposes of compliance only, resulting in a deterioration, and not an improvement, of audit quality. Although we recognise the need for the PCAOB to fulfil its mandate to inspect public accounting firms to assess the degree of compliance by firms with applicable standards, laws and regulations, the proposed standard is overly focused on the regulatory requirements supporting the PCAOB in executing such inspections and should have been more practically oriented towards prompting audit quality.

Reviewability standard

This proposed standard introduces a new requirement that audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, who performed it, when it was completed and the conclusions reached. This experienced auditor also must be able to determine who reviewed the work and the date of such review.

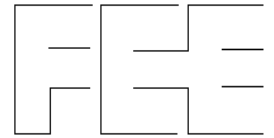
We do not believe such a requirement to be cost effective or necessary. It is normal for a reviewer to develop an understanding by discussion as well as review of the working papers. We do not support the PCAOB arguments in favour of this approach: "This has been an important requirement in the field of government auditing because government audits have long been reviewed by GAO auditors who, although experienced in auditing, do not participate in the actual audits. Public company audits will now, under the Act, be subject to review by PCAOB inspectors, and therefore a documentation standard that would enable such an inspector to understand the work that was performed in the audit seems appropriate." It is the experience of certain European Union Member States that enquiry and discussion play a major role in reviews by independent inspectors and that reviews do not require the documentation standards proposed by the PCAOB. We would encourage the PCAOB to study experience beyond the US government sector before finalising its proposed standard.

Rebuttable presumption

The proposed standard creates a rebuttable presumption that the failure to document work performed indicates that the work was not performed. The proposed presumption could be rebutted by persuasive evidence that the procedures were applied, the evidence was obtained, or sufficient support was provided for the conclusions reached. Oral explanation alone would not constitute persuasive other evidence.

We agree that if there is no documentary evidence of any kind that an audit procedure was performed, this should result in a rebuttable presumption that the procedure was not performed. However, we do not agree that oral explanation does not constitute persuasive evidence. Oral explanations and communications are an integral part of the audit process and oral explanations often supplement written audit documentation. It is quite impossible to perform audit procedures, review audit files or communicate effectively with the audited entity *without* oral explanations, but it is ineffective and burdensome to document each and every detail of oral explanations.

Additionally, the rebuttable presumption that no audit procedures were performed if there is no documentary evidence may in fact place the burden of proof on the auditor which may be in contradiction with company law in a number of Member States of the European Union. We therefore disagree with this requirement as we believe it will not be effective in attaining its purpose.



Assembly of audit documentation

The proposed standard will require that audit documentation must be assembled for retention within a reasonable period of time, ordinarily not exceeding 45 days, after the auditor's report is released.

We agree that audit documentation should be assembled within a reasonable period of time. However, we do not believe that a period of 45 days is reasonable, particularly in the light of the proposed requirements related to the retention of all audit documentation at the office of the principal auditor. Such a short period might also have adverse consequences for audit quality where the finalisation of the audit work and its related documentation is performed under undue time pressure.

We are in favour of principle-based standards that allow the auditor to use professional judgement to determine a reasonable period of time to assemble audit documentation as long as the auditor documents the justification of the chosen period.

Multi-location audits and data protection issues

The auditor issuing the report is expected to retain the original audit documentation or copies of such documentation with respect to the audit documentation related to the work performed by others. He may also prepare and retain audit documentation of the work performed by others as a part of the review of such work. In our understanding, these two alternatives effectively require the same level of documentation.

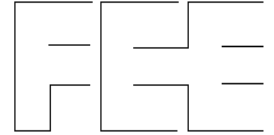
It is indicated that this requirement will improve audit quality by enhancing the probability that all audit documentation will be prepared consistently with the same standards of audit quality. We do not agree with this assumption. The mere retention of audit documentation prepared by other auditors by the office issuing the report will do little to enhance the quality of work that has already been performed. Standards of audit quality must be enforced long before audit documentation of the audit procedures performed is prepared. This is achieved during the early stages of the audit planning by means of a proper assessment by the principal auditor of the independence, competencies and standards of other auditors before decisions are taken to use their work, and by clear instructions to, and communications with, the other auditors whilst they perform their audit work.

This requirement also does not recognize that the vast majority of the audits of components of a group of undertakings are performed by audit firms of the same network. The whole point of network firms is to adhere to the same high quality standard to avoid such burdensome and costly retention of working papers or review of audit work. In the case of network firms, the principal auditor is commonly provided with a detailed questionnaire demonstrating the audit work performed by the other auditor and an interoffice audit report provided by the other auditor for the purposes of the group audit. It should also be noted that the logistical difficulties and cost implications involved in obtaining audit documentation on a timely basis for multi-national audits should not be underestimated.

Additionally, confidentiality requirements and data protection legislation are likely to conflict directly with the proposed requirements. The impossibility of obtaining the relevant consents to share information casts serious doubt on the ability of *any* audit firm to comply with the proposed standard on *any* multinational audit. This could have a severe impact on investor confidence, the credibility of audited financial statements and the standing of the PCAOB. The risk that working papers prepared by other auditors could be used without their consent in legal proceedings and for other purposes could further deter other auditors from cooperating fully with the principal auditor. This is not conducive to enhanced audit quality and investor protection.

Using the work of other auditors

The proposed standard indicates that if a firm decides to serve as the principal auditor, then the firm must decide whether to make reference in the auditor's report to the audit performed by the other



auditor. This implies that the proposed standard allows for divided responsibility (as distinct from joint responsibility) for auditors in the case of a group audit of consolidated financial statements. While FEE recognises that there are often good reasons to appoint different audit firms to perform the audits of a group of entities, FEE believes that this should not result in divided responsibility for the group auditor. FEE is a long standing opponent of divided responsibility for financial statement audits and strongly favours the auditor of the consolidated financial statements having sole responsibility for his report on the group accounts. Investors have a right to understand who is ultimately responsible for the audit of group financial statements.

Implementation date of the proposed standard and related amendment

The proposed standard and related proposed amendment will apply to engagements completed on or after 15 June 2004.

This means that it is expected to be retrospective for a significant number of March 2004 year-end audits. We object in principle to a requirement that is retrospectively applicable. As a practical point, we also encourage the PCAOB when finalising the implementation date of the proposed standard to have appropriate transitional measures so that completed audit planning documentation will not require to be reperformed in order to be compliant with the proposed standard.

Problems with definitions

For our comments on the use of certain terms in the PCAOB standards as stated in the statement of authority included in the proposed standard, we refer to our comment letter on the exposure draft released by the PCAOB on 12 November 2003 on "Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board" attached to the current comment letter.

Comments on specific paragraphs

Objectives of Audit Documentation, Page A1 – 4, Paragraph 3.

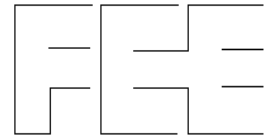
It is indicated that "audit documentation is reviewed by members of the engagement team performing the work ...". We suggest to include further clarification of this statement as it might be understood that an auditor can review his own work.

Objectives of Audit Documentation, Page A1 – 5, Paragraph 3. d.

It should be noted that the review of a predecessor auditor's audit documentation by a successor auditor is not always practical. In certain European Union Member States predecessor auditors have no legal or ethical obligation to provide information to the successor auditor and in practice do not normally allow them access to their working papers. In such cases, documentation might be limited to the alternative procedures the successor auditor was able to perform.

Objectives of Audit Documentation, Page A1 – 5, Paragraph 3. f.

It should be noted again that in certain European Union Member States, there is no legal or ethical obligation to provide information or access to working papers and audit documentation to "others, including advisors engaged by the audit committee ...". Confidentiality requirements and data protection legislation across Europe are likely to conflict directly with this proposed requirement.

**Content of Audit Documentation, Page A1 – 5, Paragraph 4.**

Correspondence of the auditors in connection with the audit engagement is considered to be an integral part of the audit documentation. The proposed standard does not indicate that it requires the retention as audit documentation of all of the vast amount of correspondence and communications which the audit of an entity entails. This would be very burdensome and not practical or cost effective. However, further clarification of what is meant would be helpful. We suggest having a principle supporting the documentation of correspondence and communication of material importance to the audit engagement and of correspondence and communication between the auditor and those charged with governance.

Content of Audit Documentation, Page A1 – 5, Paragraph 6.

The proposed standard requires auditors, *including specialists*, to document the procedures performed, evidence obtained, and conclusions reached. The specialists on whom an auditor relies for the performance of an audit engagement vary considerably and may include third party specialists like actuaries, real estate appraisers, surveyors, banks, financial institutions, insurance companies, etc. To our knowledge, the PCAOB is not empowered to impose the provisions of its standards on persons who are not members of the accounting profession and therefore, improved clarification on the practical application of this requirements would be useful. We do not believe that the auditor can be expected to be able to impose on such specialists the documentation requirements as required by the proposed standard.

Content of Audit Documentation, Page A1 – 6, Paragraph 9.

The term 'significant' is frequently used whereas the term 'material' is only used occasionally. Further guidance in respect of the term 'materiality' is included in a footnote to SEC Staff Accounting Bulletin No. 99. However, there is no guidance or reference on how 'significant' is to be understood and how it is related to 'material'. We believe that further clarification of these terms would enhance the relevance and readability of the proposed standard.

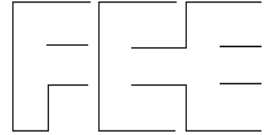
Paragraph 9. d. states that disagreements among members of the engagement team or with others consulted on the engagement about conclusions reached on significant accounting or auditing matters are expected to be part of the audit documentation. We consider it also to be necessary to document how the disagreement was resolved.

Content of Audit Documentation, Page A1 – 7, Paragraph 10.

The proposed standard requires that all significant findings or issues are to be identified in an engagement completion memorandum, which needs to be specific enough for a reviewer to gain a thorough understanding of the significant findings or issues including cross-references to other supporting audit documentation. We believe such requirements to be too specific by dealing with the location of audit evidence rather than its substance. Also, in an effort to avoid duplication of work, some global audit firms have modified their audit methodologies and no longer prepare such a memorandum which is a mere repetition of the conclusions already included in the more detailed audit documentation.

Content of Audit Documentation, Page A1 – 8, Paragraph 12.

The proposed standard requires that information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions must also be included in the audit documentation. If such information is expected to be part of the audit documentation, we consider it also to be necessary to document how the inconsistencies and contradictions were resolved.



It is common audit practice to remove initial findings from the audit file that are subsequently found to be incorrect. The dividing line between what is incorrect, and what is inconsistent or contradictory is not clear. Keeping such incorrect information included in the working papers will confuse both internal and external reviewers of the audit file. Such information is not conducive to audit quality and does not support audit conclusions.

Retention of and Subsequent Changes to Audit Documentation, Page A1 – 9, Paragraph 15.

The proposed standard requires that subsequent changes can be made to the working papers after completion of the engagement but need to be documented without deleting or discarding the original documents.

We agree with the possibility to make subsequent changes to the working papers but we object to keeping all original documentation included in the working papers. In the light of the previous comment, we believe that initial findings that are subsequently found to be incorrect should be removed from the audit file to avoid confusion and facilitate the audit file review.

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If you have any further questions about our views on these matters, do not hesitate to contact us.

Yours sincerely,

David Devlin
President

Enclosure: FEE comment letter on the exposure draft released by the PCAOB on 12 November 2003 on "Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board"

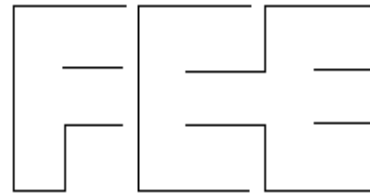
Date
4 December 2003

Secrétariat
Général

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des Experts
Comptables
Européens
AISBL

Rue de la Loi 83
1040 Bruxelles
Tél. 32 (0) 2 285 40 85
Fax : 32 (0) 2 231 11 12
E-mail : secretariat@fee.be

Office of the Secretary
Public Company Accounting Oversight Board (PCAOB)
1666 K Street, NW
USA - Washington D.C. 20006-2803



Dear Sirs,

Re: PCAOB Rulemaking Docket Matter No. 010 – “Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board”

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased, as the representative organisation of the European accountancy profession, to comment on the exposure draft released by the PCAOB on 12 November 2003 on “Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board” (referred to as “the proposed standard”).

We are commenting on the use of certain terms in the PCAOB standards as stated in the statement of authority included in the proposed standard. We are not commenting on the references in auditors' reports to the standards of the PCAOB.

Because of the importance of the issues raised by the proposed standard we are sending a copy of our response to the International Auditing and Assurance Standards Board (IAASB) and the European Commission.

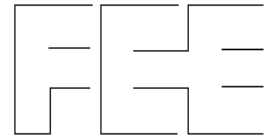
We are delighted that both the PCAOB and the IAASB are working hard towards achieving clarity in terms and definitions used in their standard setting. In the light of the considerations below, we believe that the PCAOB's rulemaking on this subject would be greatly enhanced by coordinating its efforts with the IAASB. The projects currently undertaken by both standard setters should be finalised within a similar timeframe. In particular, we note that a 90 day consultation period would be expected under the IAASB's normal due process in respect of any exposure draft issued following the IAASB meeting later this month.

Worldwide repercussions of proposed standard

The statement of authority in the proposed standard will have a very wide impact not only on US-based auditors, but also on auditors throughout the world serving:

- (3) SEC foreign registrant companies who choose to be listed in the US; and
- (4) the relevant subsidiaries of US domestic SEC registrants which fall under the same requirements as the US domestic portion of the entity.

We request the PCAOB to give due consideration to the impact its proposal will have on the IAASB's global auditing standards. In particular, we strongly encourage the PCAOB to consider how the proposed standard fits in with International Standards on Auditing (ISAs). There are inconsistencies with definitions contained in current ISAs and it is also our understanding that the IAASB is currently considering wording issues crucial to the development of future standards. New definitions to be



applied in future ISAs should be carefully taken into account and integrated in the proposed standard of the PCAOB.

Problems with definitions

The use or definition of certain terms in PCAOB standards should be in line with the ISAs which will be adopted by firms in the European Union in 2005. Inconsistencies will have considerable practical consequences for the adoption of global standards, not least for the translation of English language standards into multiple European languages.

A proposed exposure draft of a proposed IAASB Policy Statement in respect of "Authority of, and Conventions Used in, International Standards and Practice Statements Issued by the IAASB" is included in the agenda of the IAASB board meeting to be held on 8 to 12 December 2003. It includes the terminology used to describe professional requirements.

The definition of "should" indicates under the proposals of both the PCAOB and the IAASB, requirements or obligations that are presumptively mandatory. However the more detailed interpretation of the definitions is substantially different. The proposed IAASB definition states that if a standard provides "... that an action or procedure is one that the professional accountant "should consider," the consideration of the action or procedures is presumptively mandatory, while the action or procedure is not" thus allowing for the exercise of professional judgement in the context of a principle based framework.

The proposed PCAOB definition indicates that the "...auditor must comply with the requirements of this nature specified in the Board's standards unless the auditor can demonstrate, by verifiable objective and documented evidence, that alternative actions that he or she followed in the circumstances were sufficient to achieve the objectives of the standard and serve adequately to protect the interests of investors and further the preparation of informative, fair, and independent audit reports." This definition effectively makes "should" into an imperative and will foster a rules-based approach. The call for "verifiable objective and documented evidence" will discourage the use of professional judgement or the consideration of any alternative options.

FEE is firmly in favour of principle-based auditing standard setting which allows and encourages the auditor to use professional judgement. We believe that it also serves the public interest and would be in the long term interest of the PCAOB in discharging its responsibilities.

The PCAOB uses the words "may", "might" and "could" or other terms and phrases to describe actions and procedures that a professional accountant might consider performing in certain circumstances. Such actions and procedures, also called explanatory material, are characterized as a separate category of professional responsibility by the PCAOB. Under the IAASB proposal, such explanatory material only provides *guidance* or *explanatory material* on other possible procedures and actions. The professional accountant has a responsibility to read and consider such guidance, but there is no general obligation to carry out other procedures and actions that are specifically intended to act as guidance. We do not believe that the description proposed by the PCAOB is consistent with the nature and intended use of explanatory material, and may inadvertently result in confusion over the responsibilities of the professional accountant.

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If you have any further questions about our views on these matters, do not hesitate to contact us.

Yours sincerely,

David Devlin
President

Fitch Ratings

January 20, 2004

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

Re: PCAOB Rulemaking Docket #012

Ladies and Gentlemen:

Fitch, Inc. is pleased to have the opportunity to comment on the exposure draft of the *Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards* (Proposed Standard). Audit documentation is an area of great concern to investors and other users of financial statements in light of recent developments. It is of particular concern to Fitch since we rely so heavily on audited financial statements and other financial reports in our work. Fitch does not audit or verify the truth or accuracy of such information, nor are we in a position to do so.

Fitch believes that accounting information cannot effectively serve investors and other users in the absence of a rigorously engaged auditing profession that applies the highest standards of audit testing and documentation. This is particularly important in an increasingly complex financial reporting environment. We are in support of the Proposed Standard, and believe it will provide an important enhancement to current practice. Having said this, we have several specific comments that we would like to ask the PCAOB to consider:

Review Standard for Audit Documentation (Paragraph 5a)

Fitch believes that the Proposed Standard will provide much needed direction to auditors regarding not only the need for third parties (such as the PCAOB) to be able to review audit documentation, but the conduct of the audit work itself. A robust documentation standard improves audit quality by discouraging careless or incomplete testing. Requiring auditors to record, in detail, the documents that were inspected and the oral representations made to them by management will not only help to facilitate the PCAOB's inspection process, but should also contribute to higher quality audits, thereby improving the transparency and reliability of audited financial statements. Hence, the Proposed Standard should clarify not only that, 1) an experienced auditor should be able to understand the nature, timing, extent, and results of the procedures performed but also,

2) *to the extent possible, documentation should be sufficient to allow repetition of such procedures.* This would be consistent with other requirements of the Proposed Standard, and we believe this should be explicit from the outset.

Documentation sufficient to allow detailed procedures to be repeated would help ensure that audit testing is conducted in a rigorous and thoughtful manner and, of course, would contribute to the efficiency and effectiveness of the PCAOB's inspection process. In fact, we believe that requiring repeatable testing will be the most reliable way to allow PCAOB inspectors to verify that Generally Accepted Auditing Standards have been adhered to in audits of public companies.

Rebuttable Presumption (Paragraph 6)

We support the notion that lack of documentation of audit work creates a presumption that the work was not performed, and that such a presumption should be rebuttable. However, the wording of the Proposed Standard suggests that upon rebuttal of the presumption, there would be no violation of the rule. We ask the PCAOB to consider the potential unintended consequence that auditors may omit documentation, with the knowledge that they could successfully rebut the presumption. If this were to occur, it could greatly hinder the PCAOB's inspection process by requiring inspectors to engage in time-consuming procedures to ascertain whether audit work was actually done. We believe the PCAOB should consider taking steps to prevent intentional omission, which would also serve the objective of increasing the overall quality of audit documentation.

Contents of Documentation (Paragraph 7)

We agree that audit documentation provides the principal support for the audit report and that, as such, audit documentation should demonstrate compliance with professional standards, support conclusions regarding financial statement assertions, and show that the financial statements agree or reconcile with the underlying accounting records. However, although it is implied in the Proposed Standard that audit documentation should demonstrate how the audit satisfied all general and transaction-related *audit assertions*, as well as financial statement assertions, we believe the Proposed Standard should state so explicitly. Obviously, the PCAOB will address requirements related to the support of audit assertions in future proposals, but we believe that it is important to include the topic in the documentation standard.

Further, the PCAOB should consider going beyond the requirements of AU 339, by requiring that audit documentation demonstrate that the underlying *audited* accounting records agreed or reconciled with the financial statements, *and that amounts presented in the financial statements are clearly linked to testing performed.* We are concerned about situations in which audit documentation does not clearly establish a linkage between testing and amounts presented in the financial statements. For example, consider a situation in which an auditor agrees the financial statements to a consolidating trial balance, but does not reconcile the trial balance to the detailed testing performed on lower level accounting records – in other words there is a break in the linkage between

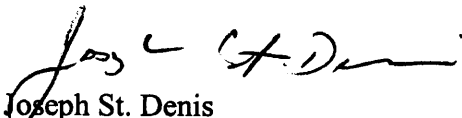
detailed testing and amounts presented in the financial statements. This would not appear to be a violation of the Proposed Standard, as the requirement to agree the underlying accounting records (in this case the consolidating trial balance) to the financial statements has apparently been met. We believe that a requirement to link audit testing with the financial statements is necessary in order to demonstrate that audit and financial statement assertions have been adequately supported, and would be an important clarification to the Proposed Standard.

Audit Checklists

Checklists can provide auditors with an effective means of ensuring that certain accounting and disclosure standards have been adhered to, but if not applied in a thoughtful and diligent manner, they may be of little use, particularly in the hands of inexperienced auditors. Therefore, we would ask the PCAOB to consider revising the Proposed Standard to require auditors to clearly reference related audit documentation and financial statement disclosures when utilizing checklists. We believe this is consistent with the review standards established in the Proposed Standard and will help facilitate the PCAOB's inspection process.

We appreciate the PCAOB's timely effort to address the critical issue of audit documentation and hope our comments will be of value in finalizing the standard. If you would like to speak with Fitch about this letter or any other matter of concern, please contact Joseph St. Denis at (212) 908-0293.

Sincerely,



Joseph St. Denis
Senior Director – Credit Policy
Fitch, Inc.

Cc: Robert Grossman
Charles Brown
Roger Merritt
Kim Olson



January 20, 2004

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington, D.C. 20006-2803

Re: Rulemaking Docket Matter No. 012 (PCAOB Release No. 2003-023) – Proposed Auditing Standard on Auditing Documentation and Proposed Amendment to Interim Auditing Standards

Dear Board Members:

The Audit and Assurance Services Committee (Committee) of the Illinois CPA Society is a voluntary group of CPAs from public practice, industry, education, and government. We take an active role in the standards setting process and have spent considerable time over the past few years responding to audit-related exposure drafts issued by the AICPA, the GAO, the SEC, and other professional organizations.

We welcome the opportunity to comment on the proposed auditing standards being considered by the Public Company Accounting Oversight Board (PCAOB or Board). Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of our Committee are outlined in Appendix A to this letter.

Comments on Proposed Auditing Standard – Audit Documentation

General Commentary

As with each proposed standard, we encourage the Board to critically evaluate the costs and benefits associated with some of the more significant proposed requirements. Our Committee members see value in each of the proposed requirements but also recognize that there are significant cost drivers in each of these requirements that will impact the economics of both the auditor and the company being audited.

Although the PCAOB draft document liberally abstracts both concepts and examples from Statement on Auditing Standards No. 96, *Audit Documentation*, (SAS No. 96), we noted that the concept of auditor professional judgment is not specifically addressed in this exposure draft. While we acknowledge certain provisions of a reviewability standard and rebuttable presumption mandate, we believe that auditor professional judgment is a very significant essential element of the audit documentation process, cannot be disassociated with the concepts addressed herein, and should be addressed in this proposed auditing standard. We support the concept resident in the first paragraph of SAS No. 96 stating “The quantity, type and content of audit documentation are matters of the auditor’s professional judgment.” (AU 339.01)

The proposed standard provides little guidance on documentation requirements associated with using the work of internal auditors, whose work is integral to many public company audits.

We suggest that Appendix A of SAS No. 96, or something similar, be incorporated into the new standard since it provides a useful summary of other documentation requirements.

Introduction

Paragraph 1. We suggest that a footnote or other explanation be added to provide clarity around the reference to “and related professional standards.” This term is utilized throughout the standard but may be misinterpreted by auditors, especially in this transitional period.

Objectives of Audit Documentation

Paragraph 3(f). This paragraph states that others who might review audit documentation are “representatives of a party to an acquisition”. Reviews of this nature often create confusion about the ownership and scope of working paper documentation. The proposed auditing standard should address ownership and confidentiality of audit documentation. As highlighted in SAS No. 96, audit documentation is the property of the auditor, and some states recognize this right of ownership in their statutes. (AU339.10)

The list of examples should include the fact that audit documentation may be required to be made available (and copies provided) to others by law or regulation.

Content of Audit Documentation

Paragraph 5. The description of the audit documentation should include information to enable the “experienced auditor having no previous connection with the engagement” to understand the risks of material misstatement that the auditor has identified as part of the process of developing other procedures to be performed. The proposed standard is not clear on whether that information is part of the intended content. We believe that having such information will allow an “experienced auditor” to understand the auditor’s thought process and the reasons why certain procedures were selected rather than guessing about the auditor’s thought process.

Paragraph 5b. There needs to be further definition and clarification around the “date that work was completed” and “date of such review”. Traditionally in an audit, staff complete work which is then reviewed. There may be a period of time that occurs around this review process, which might require further effort around a particular area of documentation. Therefore, clarification on dating requirements is needed.

Paragraph 6. The proposed standard should include examples of the types of “persuasive other evidence” that an auditor could use on an after-the-fact basis to demonstrate that procedures were applied, evidence was obtained, or conclusions were supported. Further, many of our committee’s members believe that an oral explanation could constitute persuasive other evidence, especially if that information is obtained from several sources. For example, if an auditor inadvertently forgets to document something, but can support it with testimony of others, that auditor has provided persuasive evidence that the procedure was performed.

The first sentence of paragraph 6 reads as if it were establishing standards for specialists as well as auditors. We suggest rewording this sentence so that it clearly explains the auditor’s

responsibility for reviewing the specialist's documentation, obtaining copies of the documentation, or other documentation requirements.

Paragraph 7a. This paragraph states that appropriate audit documentation should address the manner in which the audit complies with auditing and related professional standards. A literal interpretation of this could easily be seen as requiring an auditor to document how the audit complied with each element of auditing and related professional practice standards. Therefore, compliance with this mandate could be accomplished through a comprehensive checklist of each provision of auditing standards with complimentary explanations of how the standards were complied with or why they were not relevant to the engagement. We do not view this exhaustive review of auditing standards as enhancing the support for the conclusion in the auditor's report.

Paragraph 7b. The proposed auditing standard states that *every* material financial statement assertion "should be" (meaning "presumptively mandatory") supported by audit documentation. This statement should also address (or clarify if that is the intention) the concept of the risk of material misstatement associated with the assertion as indicated in SAS 96 (AU339.06).

Paragraph 8. "Unique" is difficult to define. In theory, all engagements are different or unique as they are for different entities. To minimize the potential ambiguity, please provide examples of what could be documented in the central repository vs. the audit documentation of the pertinent engagement.

Paragraph 10. The engagement completion memorandum should also include *a brief summary of the resolutions* to all significant findings or issues, cross-referenced to the supporting audit documentation.

The meaning of the word *reviewer* in this context should be defined. Does it refer to the "experienced auditor having no previous contact with the engagement" (as mentioned in paragraph 5), or a partner or manager that is part of the engagement team? Depending on the meaning of *reviewer*, it may be unnecessary to have an engagement completion memorandum if issues are properly documented in the workpapers. This requirement may cause unnecessary effects on the efficiency of an audit by repeating such documentation in a completion memorandum.

Paragraph 11. The ability to retrieve the information on items tested should also be a consideration. If there is a reasonable expectation that the client document retention policies would provide for the ability to retrieve a critical document for the indicated period of time, we believe the standard should indicate that it is unnecessary to retain copies of every document tested. However, if the items tested cannot (or there is a reasonable possibility that it may not be able to) be regenerated at a later date, we believe that the audit documentation should include copies of the items tested.

Paragraph 13. This paragraph indicates that the seven year time period for retention begins on the date of the auditor's report. However, the SECPS, when providing guidance on the SEC document retention rules, suggested that this date is meant to begin on the date of the filing which includes such financial statements. The board should consider this alternative date prior to releasing the final standard.

Paragraph 16. The wording of this paragraph should be changed so that it is clear that these requirements only apply when the principal auditor elects not to make reference to the other auditor. Also, please more carefully define the meaning of "others" as used in the first sentence.


Paragraph 18. The effective date may not be operable as there may be engagements in scope that are already in process.

Comments on Proposed Amendment to Interim Auditing Standards – Part of Audit Work Performed by Other Independent Auditors

The proposed amendment to AU sec. 543.12 should include a specific reference to paragraph 16 of the proposed standard No. X since this explains the two alternatives for documenting the work performed by other auditors.

The members of the Audit and Assurance Services Committee of the Illinois CPA Society thank you for the opportunity to respond to this proposal.

Sincerely



William P. Graf, Chair
Audit & Assurance Services Committee



Simon Petravick, Chair
Comment Letter Subcommittee

APPENDIX A

ILLINOIS CPA SOCIETY
 AUDIT AND ASSURANCE SERVICES COMMITTEE
 ORGANIZATION AND OPERATING PROCEDURES
 2003 - 2004

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of auditing standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of auditing and attest standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:**Large:**

James A. Dolinar, CPA	Crowe Chizek & Co. LLP
Kurt Gabouer, CPA	KPMG LLP
William P. Graf, CPA	Deloitte & Touche LLP
G. W. Graham, CPA	Grant Thornton LLP
James P. McClanahan, CPA	Altschuler, Melvoin & Glasser LLP
Michael J. Pierce, CPA	American Express Tax & Business Services

Medium: (more than 40 employees)

Sharon J. Gregor, CPA	Selden, Fox and Associates, Ltd.
Gary W. Mills, CPA	Kupferberg, Goldberg, & Neimark, LLC
Stephen R. Panfil, CPA	Bansley & Kiener LLP

Small: (less than 40 employees)

Antonio Davila, Jr., CPA	Hill, Taylor LLC
Jeffrey M. Goltz, CPA	Rosen, Goltz & Associates
Loren B. Kramer, CPA	Kramer Consulting Services, Inc.
Andrea L. Krueger, CPA	Corbett, Duncan & Hubly P.C.
Ludella Lewis, CPA	Ludella Lewis & Company
JoAnne M. Malito, CPA	McGreal, Johnson and McGrane
Robert W. Owens, CPA	Wermer, Rogers, Doran & Ruzon
Richard E. Spiegel, CPA	Steinberg Advisors, Ltd.

Government:

Scott P. Bailey, CPA	Metropolitan Pier & Exposition Authority
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Educators:

Simon P. Petravick, CPA	Bradley University
Oliver R. Whittington, CPA	DePaul University

Staff Representative:

C. Patricia Mellican, CPA	Illinois CPA Society
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INSTITUT
DER
WIRTSCHAFTSPRÜFER

IDW

January 19, 2004

Public Company Accounting Oversight Board
(PCAOB)
Office of the Secretary
1666 K Street, N.W.,
Washington, D.C.
20006-2803

USA

By E-Mail: comments@pcaobus.org

Dear Sir(s):

Re: PCAOB Rulemaking Docket No. 012

IDW Comments on the PCAOB Proposed Auditing Standard “Audit Documentation” and the Proposed Amendment to Interim Auditing Standards “Part of Audit Performed by Other Independent Auditors”

We would like to thank you for the opportunity to comment on the PCAOB Proposed Auditing Standard “Audit Documentation” (hereinafter referred to as the “proposed Standard”) and the Proposed Amendment to Interim Auditing Standards “Part of Audit Performed by Other Independent Auditors” (hereinafter referred to as the “proposed Amendment”). The Institut der Wirtschaftsprüfer represents approximately 85% of the German Wirtschaftsprüfer (German Public Auditor) profession. The German Wirtschaftsprüfer profession seeks to comment on the proposals by the PCAOB noted above because we believe that this proposed PCAOB Standard and Amendment will affect not only audit documentation in the United States, but also the further development of auditing standards relating to audit documentation on a worldwide basis. Furthermore, a significant number of German Wirtschaftsprüfer will be subject to PCAOB auditing standards due to their involvement in the audits of financial statements of SEC registrants. We have divided our comments into general matters applicable to both the proposed Standard and Amendment, and general comments

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Geschäftsführender Vorstand:
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Dr. Gerhard Gross
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on the proposed Standard, specific comments on the proposed Standard, and general comments on the proposed Amendment.

General matters

1. Access to Working Papers

We are extremely concerned that the PCAOB together with EU authorities have not yet resolved the problems resulting from data protection and privacy laws, etc. in Germany. A number of our members are currently placed in an extremely difficult and uncertain position until these issues are clarified. The PCAOB has recognized the existence of this problem and has permitted certain exemptions as far as registration of non-U.S. public accounting firms is concerned, in cases where the submission of information would contravene local country law. The Board has further extended the registration period in respect of non-U.S. public accounting firms, such that the deadline is currently set at July 19, 2004.

Hence, in connection with the registration of foreign audit firms, it has become apparent that there are legal problems severely limiting the ability of local audit firms in some foreign jurisdictions to agree to the requirements associated with registration – in particular in relation to requirements for the production of working papers under the Sarbanes-Oxley Act. Audit firms in Germany are subject to local data protection, privacy, confidentiality, secrecy and national security obligations under German law. Based upon drafts of legal opinions to which we have become privy, it appears that certain requirements in both the proposed Standard and the proposed Amendment with respect to the use of other auditors by U.S. audit firms appear to require German auditors to violate these German laws just like the production of working papers would violate these laws. Legal counsel appears to have strong grounds for believing that attempts to circumvent the law by having U.S. audit firms obtain the documentation either directly or indirectly will suffer from the same legal impediments as having German audit firms produce audit working papers to the PCAOB. However, if the PCAOB were to issue the proposed Standard and Amendment, with which all registered auditors must comply, while at the same time, German auditors are subject to laws that will prevent them from complying therewith, the position forced upon German auditors will be intolerable.

On this basis, the portions of the proposed Standard and Amendment ought to be revised so that they do not conflict with local law. In any case, we expect that a more thorough legal analysis of these problems will be submitted to you.

However, the logistical problems associated with the provision of the relevant information by redacting the material to eliminate anything that could constitute a breach

of local law would constitute a significant administrative burden that should not be underestimated.

We would like to point out that these problems need to be resolved **before** the proposed Standard and Amendment are issued in final form.

2. The international context and convergence

Since SEC registrants as a whole have operations around the globe, auditing standards issued by the PCAOB will affect the conduct of audits of financial statements of SEC registrants' operations throughout the world and hence affect the international auditing community in a far-reaching manner. We accept that the PCAOB may regard itself as primarily concerned with the U.S. capital market, but would respectfully suggest that this is a rather narrow contention fraught with oversimplification. It is entirely inconsistent for the PCAOB to insist, on the one hand, that its rules, regulations and standards must be applied to SEC registrants and those involved with them throughout the world, but on the other hand to take a predominantly U.S.-based view of the environment within which SEC registrants and the auditors of their financial statements operate. In this sense the PCAOB must accept that it has assumed the role of a leading authority on the conduct of audits of financial statements used in global financial markets and therefore recognize that the auditing standards it issues must be capable of functioning in different jurisdictions across the globe.

With respect to auditing standards, this role is, de facto, to some extent shared with the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). Nevertheless, there are significant differences between the roles and remits of the PCAOB and the IAASB. In particular, the PCAOB agenda operates under, and is driven by, the pressures of its legislative mandate in the U.S., whereas the IAASB has achieved some general recognition on a global basis as *the* international standards setter for auditing standards. In addition, the agreement reached with regulators on the oversight structure for IFAC public interest activities will serve to strengthen the IAASB's acceptance as *the* global standards setter. However, the fact remains that both institutions develop and issue auditing standards that are applied at an international level.

In our opinion, convergence of auditing standards and their requirements to the maximum extent possible is highly desirable, such that comparability of, and underlying trust in, the audit function can be enhanced on an international level. We understand that the IAASB recognizes the need to minimize substantive differences for convergence purposes. We hope that this objective is shared by the PCAOB in substance, which would mean that the PCAOB regards convergence as a two-way street

in which both standards setters try to move towards one another, rather than as an exercise designed to have the IAASB move towards the PCAOB, regardless of the strength of the IAASB's case.

Recent events in both the U.S. and Europe have demonstrably re-enforced the need for a set of global auditing standards upon which the public can rely. Currently, because standards differ from jurisdiction to jurisdiction there is considerable room for uncertainty within the global financial community. As we have stated in previous correspondence, we support the overall objective of the PCAOB to improve the current position of audits in relation to financial statements for SEC registrants, but would also like to underline the desirability of ensuring international agreement as to precisely what an audit can and should achieve. It follows that there is urgent need for convergence between leading regulators and standards setters if this is to be achieved both successfully and satisfactorily.

3. Consultative Procedures

Following on from our above comments, we are concerned that the consultative procedures relating to development of this PCAOB Auditing Standard does not adequately address their international impact. For instance, participants invited by the Board to the roundtable discussion concerning the proposed Standard were not geographically representative of the international financial community. This contrasts greatly with the geographical spread of comments generally provided in response to PCAOB Rulemaking Dockets. The state of California, in particular, is referred to in the Briefing Paper issued prior to the Roundtable discussion, was represented at that discussion and is referred to in subsequent release papers. We suspect that such honors have not been accorded to representatives from the financial community of major industrial countries where major or a large number of SEC registrants – including so-called “global players” – are based.

We urge the PCAOB to consider the impact of its Rules and Standards from both an international and national standpoint. We would welcome increased participation of other international standards setters and representatives of the financial community (including auditors, preparers and users) and more intensive discussions with such parties as the IAASB, FEE, etc.

4. Deadlines

We have previously noted our disappointment that exposure periods are exceedingly short in respect of PCAOB Docket Matters. This equally applies to this Docket Mat-

ter. While we note that the exposure period for this Docket Matter concerning auditing standards exceeds the 45 days of the previous Docket Matter, inclusion of the Christmas and New Year holiday season (in which many often take longer vacations) within that period negated the longer time period. Furthermore, in an international environment, those submitting comment letters may require more time to consult their constituents. As we have stated previously, normally 60 to 90 days is an appropriate exposure period for new standards unless there are unusual circumstances (such as a holiday period). However, for standards of a fundamental nature (such as those covering documentation or other fundamentals of audits) or of unusual complexity (e.g., audit of internal control or audit risk) 120 to 180 day periods may be more appropriate.

5. Overprescription

By including a rebuttable presumption that audit procedures not documented have not been performed, together with other documentation requirements (see 7 (a)), the proposed Auditing Standard appears to suggest that audit documentation should allow reperformance of virtually the entire audit. This would lead to a significant increase in the nature and extent of audit documentation required. In our view, it is questionable whether such stringent audit documentation requirements are necessary, and in fact, we believe that they may be counterproductive.

At the roundtable discussion in September 2003 auditor representatives strongly contended that they recognize a danger, that if too much emphasis is placed on documentation, it could lead to concentration on that aspect to the detriment of other aspects, and that the PCAOB should not be overly prescriptive. Another participant made the point that it would be virtually impossible for an auditor to “get all the information inside his head into the documentation” and that therefore a rebuttable presumption that work was not done where there is a failure to document procedures applied, evidence obtained and conclusions reached would be too strong. Neither point appears to have been accorded due consideration in the drafting of the proposed Auditing Standard. In our opinion, both are valid and we strongly suggest that the rebuttable presumption and the requirement in 7 (a) are, in fact, overly prescriptive. In this respect, we believe that the currently proposed Standard does not appropriately take the process by which practitioners exercise professional judgment into account. This, in turn, may lead to dysfunctional auditor behavior.

a) *The nature of professional judgment and its relationship to documentation*

We believe that the prescriptive nature of the proposed Standard does not properly recognize the nature of professional judgment and how it is exercised by a practitio-

ner in the field. It should be recognized that documents, books of record, physical assets, etc. are not audit evidence in themselves, since audit evidence is information, as both the current IAASB auditing standard on “Audit Evidence” and the FEE Issues Paper “Principles of Assurance: Fundamental Theoretical Issues With Respect to Assurance in Assurance Engagements” (the “FEE Paper”) point out. Hence, audit evidence exists only “in the eye of the beholder”, or more precisely, in the mind of the recipient – the auditor. In relation to this, the application of professional judgment by practitioners in the field involves the eclectic use of their associative memory, created by previous experience in the conduct of audits, and takes place within an auditor’s stream of consciousness. In the end, only the main results of that process, which will include only the major conclusions reached with only an outline of the reasoning used to support these, can be documented after the fact (i.e., after the application of professional judgment has taken place). Given the extreme volumes of information that auditors receive and that they must assess as part of an audit, the process involving the application of professional judgment often involves heuristics based upon experience, commonly known as “hunches”. However, it should be noted that it is these “hunches” that usually lead good auditors to perform high quality audits – not the after-the-fact documentation justifying the reasoning behind their decisions.

On this basis, while we recognize that good audit documentation can improve the conduct of audits by ensuring a certain discipline in the performance of the work, overemphasis of documentation requirements can actually hinder the performance of high quality audits. The question is one of trying to obtain an appropriate balance of documented vs. undocumented reasoning processes to optimize the quality of audits, where “quality” is defined as a reasonable likelihood that audit risk has been reduced to an acceptably low level. In this respect, quality can be improved through internal reviews of audit work and through internal firm inspections to ensure that quality control systems are functioning. The performance of such reviews and internal inspections are predicated upon adequate audit documentation, but it should be remembered that documentation is a means – not an end in itself and that it should not hinder the appropriate application of professional judgment.

b) *The dysfunctional effects of overly prescriptive documentation requirements*

We also recognize that audit documentation is important to the performance of inspections and investigations performed by the PCAOB and forms an important basis for the work of litigation lawyers and court decisions in relation to audits of financial statements. However, the fact that audit documentation is also used as a basis for professional and regulatory sanctions and in courts of law does not imply that stringent documentation requirements will turn bad auditors into good ones. Auditing standards are supposed to drive auditor behavior. However, we believe that overly

prescriptive requirements will drive the wrong behavior: they will simply cause bad auditors to make bad audits appear to meet the formal documentation requirements, and may have the dysfunctional effect of turning good auditors into bad ones by having them overemphasize documentation, which leads to a “tick the box” and “cover your back” mentality at the expense of the application of sound professional judgment. In the end, bad auditors can always be selective about documenting what they have seen or heard. More importantly, not only bad, but good auditors may be led to perform more of the audit by sight and verbal discussions alone and then to discuss some serious issues only verbally (i.e., instead of by e-mail or other means of written communication) in the hope of channeling or limiting the resulting audit documentation to help prevent the risk of sanctions or legal liability. No law in any country can effectively force auditors to document everything they have seen or heard.

Somewhat out of context, in relation to bad audits one is reminded of the three monkeys “hear no evil, see no evil, speak no evil”, to which the proposed documentation standard would appear to add a fourth monkey: “write no evil”! Such an auditing standards setting strategy is not particularly effective in improving the quality of audits.

Consequently, the application of the proposed Standard (and in particular, the rebuttable presumption) may lead to dysfunctional behavior that could reduce, rather than increase, audit quality.

6. Conceptual Framework

The second paragraph on page 2 of the Release dated November 21, 2003 states “The Board’s standard on audit documentation will be one of the fundamental building blocks on which both the integrity of audits and the Board’s oversight will rest.” Whilst we accept the latter contention as valid, in our opinion, the integrity of an audit cannot be said to rest upon an auditor’s ability to follow instructions on how to document, but, as noted above, rather on the appropriate application of professional competence and judgment, of which, the ability to document forms a comparatively small, but indispensable, part. This leads us to question whether the PCAOB is relying on a conceptual framework relating to the topic of auditing. To state that the standard on audit documentation will be one of the fundamental building blocks presupposes an overview or concept. What form do the other or complementary ‘building blocks’ take? It appears to us that, given the lack of a conceptual framework for audits (such as noted in the FEE Paper), the PCAOB may not have a sound basis for its assertion about what the fundamental building blocks of audits might be.

7. Implementation Date

The proposed date does not appear to be practicable, as most large audit engagements to be completed on, or near to June 15, 2004 will be well under way by the time the standard is finalized. It is impossible to require an auditor to comply with requirements not known to him or her at the planning stage, or commencement of an audit. In any case, little time will have been allowed for any practical changes which may result from application of the standard within an audit firm – staff training and systems changes amongst others. The problem of data security and privacy, which we have outlined will require more time before it can be resolved, which has further implications for those foreign audit firms intending to register with the PCAOB.

General Comments on the Proposed Auditing Standard “Audit Documentation”

Rebuttable presumption

The Board has specifically invited comments on the addition of a rebuttable presumption that (in line with the state of California’s statute on audit document) the failure to document work performed indicates that the work was not performed and further that oral evidence alone will not constitute persuasive other evidence. We are concerned that this may place an unduly heavy burden on auditors as it will lead to attempts to document absolutely every thought, conversation, etc. which hitherto may not have been considered necessary. The danger resultant from this requirement was discussed at the roundtable meeting, as we have noted above. We have also noted the dysfunctional effects of excessive emphasis on documentation caused by overly prescriptive documentation requirements.

We would also like to mention that personal verbal testimony is considered a powerful form of evidence in courts of law (and may overturn documentary evidence), and on this basis question the contention that oral explanation alone could not constitute persuasive other evidence in appropriate circumstances.

**Specific Comments on the Proposed Auditing Standard “Audit Documentation”
by Paragraph**

3. This paragraph in connection with paragraph 5 appears to suggest that an experienced auditor, having no connection with the engagement, should essentially be in a position to reperform the audit. In our view, an auditor who has not been involved in the audit can never obtain the same degree of knowledge about the business and accounting of a particular enterprise as the auditor that had performed the audit. Furthermore, in connection with the inherent limitations on documentation that we have addressed above, an experienced auditor having no connection with the engagement will need to engage in inquiries of those who were directly involved in the audit to obtain a true and full understanding of the audit performed.
4. The second sentence appears to suggest that “all” correspondence, schedules, or other documents created or obtained in connection with the engagement would be included under the term “audit documentation”. We consider this requirement to be unduly onerous, since some correspondence or documents created or obtained in connection with the engagement may turn out not to be relevant to the performance of the engagement. In these cases, such documents need not be included in the term “audit documentation”, which is subject to retention and other requirements.
5. We suggest that the terms ‘experienced auditor’ and ‘understand’ be defined to avoid misunderstandings.
- 5(b) Some tests may require more than one day in their execution, but be documented as one audit procedure, so it will be necessary for the Board to define what is intended by the use of the term ‘date’, i.e., DD MM YY or MM YY.
6. The first sentence states that auditors should document the procedures performed. Taken on its own without qualifiers, this statement appears to suggest that everything the auditor sees and hears ought to be documented, since inspection and inquiry are both procedures. We would like to suggest that this is unreasonable. Rather, the auditor should be required to document those procedures and the results of those procedures that are material to the process by which audit conclusions are drawn. We have addressed the rebuttable presumption above.
- 7(a) We are concerned that the requirement for audit documentation to demonstrate compliance with auditing and related professional practice standards may lead to additional unnecessary ‘cover-your-back’ documentation or the

excessive use of lengthy checklists resulting in time and cost wastage. Furthermore, it is not clear as to what extent documentation on an individual engagement can include matters which are generally of a firm-wide nature, e.g., staff training, centralized independence registers etc. Does the PCAOB intend, for example, that each and every engagement working papers file contain a statement to the fact that the firms staff are adequately trained, plus a cross reference to the documentation held by a central training department or similar? This would result in considerable duplication and inefficient use of staff resources on each audit engagement. Consequently, we believe that 7(a) should read "Form a basis for demonstrating how..."

- 7(c) While we accept that the auditor should either ensure that the reconciliation of the underlying accounting records with the financial statements performed by the management of an entity is accurate, or perform such a reconciliation him/herself and document this audit procedure, it is not the purpose of audit working papers to demonstrate such reconciliation. This responsibility rests with management, as they alone are responsible for the preparation of financial statements and for the correctness, accuracy and propriety of the underlying bookkeeping. In the event that a reconciliation or agreement cannot be achieved, the auditor would be required to consider the matter on the merits of the individual circumstances, document accordingly and draw his or her conclusions for the audit opinion.
8. We believe that auditors should be in a position to rely on the quality control systems that their firms have established and should not be made responsible for deficiencies in these unless they are part of the firm's management body. Consequently, references to central repositories are redundant.
10. In our opinion, the requirement is too exacting. It may be extremely difficult and impractical from an administrative point of view for an auditor to set out all such matters in one memorandum. In our opinion the PCAOB is correct in requiring that these matters be documented, but not in stipulating where. Compliance with this requirement will lead to duplication of documentation and inefficient use of staff resources.
16. The requirements of this paragraph pose significant logistical problems for those firms who audit large global entities – especially that documentation (original or copies) must be retained by the office issuing the auditor's report. The legal issues relating to data security and privacy, etc. raised above must be satisfactorily resolved before audit firms in Germany will be in a position to comply. We again emphasize this issue, which ought to be recognized as constituting an issue of immediate priority for the PCAOB.

General Comments on the Proposed Amendment to Interim Auditing Standards “Part of Audit Performed by Other Independent Auditors”

We refer to our general point concerning data protection and privacy legislation, etc. within Germany and the logistical and administrative problems we have noted.

The proposed Amendment suggests that the principal auditor should review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed. In our view, this is an ambiguous requirement because it does not define the level of review. For example, in the audit of a large one-location audit, the lead engagement partner does not and should not review every single working paper. Rather, the lead engagement partner might review key working papers containing critical issues, and other partners on the team will have reviewed some of the other important working papers. Furthermore, the remaining working papers of lesser importance may only have been reviewed at audit manager or supervisor level.

When using the work of another auditor, the question is what level of review needs to be undertaken by the principal auditor – particularly when the working papers of the other auditor will have already been reviewed at partner level within the other audit firm. In our view, there is no need for the principal auditor to review every single working paper and other documentation – regardless of relative importance. Rather, the working papers of another auditor that have already been subject to partner review in the other audit firm (and also an engagement quality control review by an “independent” internal engagement quality control reviewer as currently proposed by the draft ISQC1 by the IAASB) should be subject to review at a higher level of authority (i.e., at partner or audit manager level, as necessary). This is consistent with a risk-driven audit approach. Only if the review at a senior level indicates that important issues may not have been resolved to the satisfaction of the reviewer, need the principal auditor’s review be undertaken in greater depth and detail. The notes made about the review at this senior level need not be of greater detail or extent nor at a lower level of authority than those that a partner or audit manager might make for the review of an audit performed in their own firm. The proposed Amendment should therefore clarify that the review of another auditor’s work should take place at a senior level (audit partner or manager) depending upon the level and nature of review that has already been performed by the other auditor.

We realize that certain points raised by us are critical, and would like to assure the PCAOB that we do not intend our comments to undermine the work undertaken by the Board members and staff. We hope, rather that our comments will be of value in the establishment of PCAOB Auditing Standards which fulfill the objectives of the Sarbanes Oxley Act while at the same time being practicable and capable of application by all those public accounting firms required to be registered with the PCAOB. We hope that you have found our comments useful. If you have any questions about our comments, we would be pleased to be of assistance or to meet with you.

Yours very truly,



Wolfgang Schaum
Executive Director



Wolfgang P. Böhm
Special Advisor to the Executive Board

494/541



20 January 2004

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington DC 20006-2083
USA

Dear Sirs

PCAOB Release No. 2003-023: Rulemaking Docket Matter No. 012

Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards

The Institute of Chartered Accountants in England & Wales is pleased to provide a letter of comment in response to the PCAOB's proposed standard on audit documentation and proposed amendment to interim auditing standards.

The Institute is the largest body of professionally qualified accountants in Europe with over 125,000 members operating under a Royal Charter. Individual members are engaged in many sectors in business, the public sector, and in practice.

We are cognisant of the challenges faced by the PCAOB in preparing this proposed auditing standard. Audit documentation is crucial to audit quality. Balancing the requirements of the Sarbanes-Oxley Act, cost-benefit considerations, and the needs and views of investors, regulators and external auditors requires careful consideration.

We hope that the PCAOB will give due consideration to the impact of its proposals on the IAASB's global auditing standards and will recognise the growing significance of those standards in discharging its responsibilities in issuing this standard.

This letter contains key comment on the purpose of audit documentation, group audits, inconsistent or contradictory information, the 'rebuttable presumption', and on the assembly of audit documentation. Further specific comments are also provided.

If you require any further information, please do not hesitate to contact me.

Yours sincerely

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Key Comments

Purpose of audit documentation

Whilst we recognise the need for the PCAOB to fulfil its mandate to inspect public accounting firms to assess the degree of compliance by firms with applicable standards and laws, we emphasise the *primary* and most important purpose of audit documentation which is to provide the principal support for the representations in the auditor's report. There is a risk that consideration of regulatory requirements may be self-defeating in that it may overshadow the primary purpose and shift the focus of audit documentation *away* from audit quality. We believe that there is a very real danger that overly prescriptive requirements for audit documentation will result in 'defensive auditing', by which we mean the performance of unnecessary audit procedures and the production of unnecessary audit documentation for the purposes of compliance only. It is similar to what is often described as 'defensive medicine'.

Group audits

We are particularly concerned about the proposals for the review and retention of documentation for group audits (paragraph 16 of the proposed standard and the proposed amendments to AU section 543.12). The logistical and confidentiality issues noted below when taken together make the proposals unworkable as they stand. The proposals fail to recognise the mechanisms used by all networked firms on multinational audits to achieve audit quality and avoid costly and onerous multiple reviews and duplication of documentation. The proposals would result in the retention of documentation for compliance purposes only, with little or no improvement to audit quality. Indeed, it is possible that these proposals would actually result in deterioration in audit quality as firms diverted their resources from genuine quality control activities to compliance activities.

Principal auditor: obtaining and maintaining audit documentation

The proposals do not address the logistical difficulties and cost implications involved in obtaining and maintaining audit documentation on a timely basis for multi-national audits. The definition and description of 'audit documentation' in paragraphs 2 and 4 can be read as requiring the retention of a great deal of administrative information (such as details of hotel bookings) that is normally discarded in practice because it is wholly irrelevant to audit quality and we believe that the requirements are likely to be interpreted inconsistently in practice.

Confidentiality

Data protection legislation across Europe, together with other statutory requirements and professional and common law obligations, conflicts directly with the proposed requirements. European legislation does not permit personal information (about staff, customers or suppliers for example) to be divulged to anyone without the consent of the individual. Obtaining all-embracing consents would be impossible in practice.

The risk that working papers prepared by other auditors could be used without their consent in legal proceedings and for other purposes is likely to deter other auditors from co-operating fully with the principal auditors and hamper an effective working relationship. This is not conducive to enhanced audit quality or investor protection and there are many situations in which for legal or constitutional reasons, it is not possible to avoid having different auditors within a group.

It is argued that the requirements will improve audit quality by enhancing the probability that all audit documentation will be prepared consistently to the same standards of audit quality. We question this assumption. Standards of audit quality must be enforced *before* audit documentation is prepared. This is achieved by means of a proper assessment by the principal auditor of the independence, competencies and standards of other auditors before a decision is taken to use their work, and by clear instructions to, and communications with, the other auditors whilst the work is performed. The mere retention of audit documentation prepared by other auditors by the office issuing the report will do little to enhance the quality of work that has already been performed. Furthermore, the requirement for the principal auditor to review such documentation creates a double review requirement which is both costly, not least because of the requirement for translations, and unnecessary.

We fear that it is perfectly possible that the requirements will become self defeating in some jurisdictions because companies and auditors may be tempted to avoid excessive documentation and duplication of review by referring to multiple separate audit reports in the group audit report. This cannot be a desirable outcome in terms of clarity and accountability.

Inconsistent or contradictory information

Paragraph 12 of the proposed standard requires that information identified relating to significant findings that is inconsistent with or contradicts the auditor's final conclusions must be included in audit documentation.

Whilst we appreciate the Sarbanes-Oxley Act and SEC Rules have detailed requirements on the retention of documentation, the intention of paragraph 12 is unclear and may be interpreted inconsistently. Auditing standards already require the resolution of issues arising from contradictory audit evidence, but it is common practice to remove initial findings from the audit file where they are subsequently found to be incorrect. The dividing line between what is incorrect, and what is inconsistent or contradictory is not clear. Keeping such incorrect information on file would be potentially confusing and might hamper the work of reviewers within firms as well as external regulators, neither of which is conducive to audit quality. Such information does not 'support audit conclusions' and adds unnecessarily to the volume of information on file.

Rebuttable presumption

Paragraph 6 of the proposed standard introduces a rebuttable presumption that failure to document work performed indicates that the work was not performed. The presumption is rebuttable by persuasive other evidence that the procedures were applied and that evidence was obtained.

The presumption recognises that audit documentation serves as the principal support for the auditor's work and that there will be legitimate cases in which auditors should be permitted to support conclusions with additional documentary and oral evidence. But we strongly object to wording in the introduction to the standard which suggests that that oral explanations alone would not constitute 'persuasive other evidence' to rebut the presumption. Not only does this suggestion defeat the proposals as a whole, which describe audit documentation as the *principal* support for the auditor's work, and not as the *only* support, it runs contrary to practice in other areas of law and regulation in which oral evidence is permissible and often essential. All advanced legal systems admit oral evidence and we are very doubtful as to the legitimacy of this apparent attempt to overturn a fundamental legal principle.

Auditing standards have long recognised that oral explanations may have less value than documentary evidence, but there has never been any suggestion that such explanations have no value at all. Oral explanations and dialogue are an integral part of the audit process; it would be impossible to perform audit procedures, review audit files (either internally or externally) or communicate effectively with the audited entity without oral explanations. A requirement to document each and every detail of oral explanations would be both ineffective and burdensome. Furthermore, it would be perverse to ‘disallow’ oral explanations where they are used in the review of audit documentation with a view to its improvement.

Assembly of audit documentation

Paragraph 14 of the proposed standard requires that audit files must be assembled for retention within a reasonable period which should not ordinarily be more than 45 days.

We note that different US States have different requirements for the assembly of audit documentation and we support the proposal that assembly should take place within a reasonable period of time. We do not, however, consider that a period of 45 days is necessarily or even ordinarily ‘reasonable’, particularly in the light of the proposed requirements relating to the retention of all audit documentation at the office of the principal auditor. Such deadlines may in practice result in the finalisation of audit documentation in a hurry, simply to meet the deadline, with adverse consequences for audit quality. In many cases, a deadline of 45 days is simply unachievable as a result of the need to transport paper files physically from those parts of the world in which electronic audit files will not become the norm for many years to come. We suggest that either:

- the determination of what is a reasonable period be left to the judgement of the auditor (who would then be required to justify the period); or
- a longer period be permitted.

Further Specific Comments

1. Paragraph 3 of the proposed standard, under the heading ‘Objectives of audit documentation’ refers to reviews by, amongst others, successor auditors and others including advisors engaged by the audit committee and representatives of parties to an acquisition. It is very uncommon for successor auditors to review their predecessor’s documentation in either the UK or Europe because of confidentiality requirements. Furthermore, audit working papers are not prepared for the benefit of third parties or with their needs in mind. We therefore object to the inclusion of items (d) and (f) in paragraph 3 and would like to see some reference made to audit documentation being the property of the auditor and to professional confidentiality requirements.
2. Paragraph 5 of the proposed standard requires that audit documentation should contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, who performed it, when it was completed, and the conclusions reached. No mention is made of the need for discussions with the engagement team which are absolutely essential in practice for such reviews to be effective. Nor is there any mention of the level or nature of experience required. In order for the proposal to be workable, we believe that the ‘experienced auditor’ must be assumed to have the experience comparable to that of the auditor performing or reviewing the work, to have appropriate specialist knowledge and experience, and to be fluent in the languages and accounting practices of group companies where appropriate. This is unlikely in practice which emphasises the need to recognise the importance of discussions with the engagement team.
4. Paragraph 7 (b) states that audit documentation should support the auditor’s conclusions concerning every material financial statement assertion. Whilst we agree with the requirement in paragraph 9 to document the basis for conclusions on significant findings, documenting every individual assertion would be costly, complex and unnecessary. A better and clearer requirement which would avoid confusion would be a requirement reach a single conclusion on the financial statements as a whole.
5. Paragraphs 9 and 10 of the proposed standard require that auditors document ‘significant findings or issues, actions taken to address them and the basis for conclusions reached’. Eight examples of significant findings are provided. All significant findings or issues are to be identified in an engagement completion memorandum. We do not believe that it is necessary to mandate the ‘geography’ of such matters.
6. Paragraph 14 requires that a ‘complete and final’ set of audit documentation be assembled. This would appear to preclude the necessary subsequent changes recognised by paragraph 15.



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January 19, 2004

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington
DC 20006-2803

Via Email

Re: PCAOB Rulemaking Docket Matter No. 012

Dear Sirs

Staff of IFAC's International Auditing and Assurance Standards Board (IAASB) appreciates this opportunity to comment on the PCAOB's Proposed Auditing Standard, *Audit Documentation* ("Proposed Standard").

Whilst the IAASB has also started a project to revise its standard on audit documentation, it has not yet given full consideration to the issues that need to be addressed. Accordingly, the following represents the IAASB Staff's reaction to the PCAOB's proposals. The comments contained herein do not necessarily represent the views of the IAASB.

We support the PCAOB's efforts to raise the standard of auditor performance with regard to audit documentation. We agree that the integrity of the audit depends in large part on the existence of a complete and understandable record of the work that the auditor performed, of the conclusions that the auditor reached, and of the evidence that supports those conclusions. However, we do have some specific concerns, as set out below, regarding certain matters that the Proposed Standard seeks to address. In addition, whilst our comments are based upon a standard setter's perspective, we recognize that the PCAOB has a regulatory role beyond standard setting. Accordingly, it may be appropriate to deal with certain regulatory aspects outside auditing standards.

Rebuttable Presumption

Paragraph 6 states that "Auditors, including any specialists, should document the procedures performed, evidence obtained, and conclusions reached. Failure to do so creates a presumption that the procedures were not applied, the evidence was not obtained, and the conclusions reached were not suitably supported. This presumption is rebuttable by persuasive other evidence that the

procedures were applied and the evidence was obtained to provide sufficient support for the conclusions reached.”

Our main concern with this paragraph is the very high hurdle that it places on the rebuttal of the presumption. There will be instances in practice where auditors will have significant difficulty producing persuasive evidence that they did perform the work. As a result, we view the imposition of this rebuttable presumption as potentially leading auditors to document an inordinate amount of detail that is of minor or no consequence to the final conclusions, just to avoid the charge that they did not perform the work or that the performance of their work did not meet the required standard. This obligation may have the unintended consequence of diverting auditors’ efforts from performing “thinking” audits to documenting detail to excess. Instead of improving audit quality, this would have the opposite effect.

In our view, it would be more important for the Proposed Standard to emphasize the principle that auditors should document significant matters identified, the procedures performed to address them, the evidence obtained, the conclusions reached and the bases for the conclusions.

We also believe that this principle should be more appropriately reflected in the section on objectives of audit documentation. This section, as drafted, seems to provide more a statement of what documentation is than a proper statement of its objectives.

Retention of Audit Documentation

The Proposed Standard introduces a new requirement that the audit documentation must be assembled for retention within a reasonable period after the auditor’s report is released. Such period ordinarily should not exceed 45 days. We do have a number of concerns regarding this requirement:

- a) It is unclear what the objective of this requirement is, since it is not stated.
- b) The question arises as to why this should be an audit standards requirement, since it is not critical to the auditor’s opinion.
- c) It is unclear whether the office issuing the auditor’s report (“issuing office”) would be subject to the same 45-day requirement with respect to assembling documentation of work performed by other auditors in a multi-location audit.
- d) It is unclear as to what is meant by “assembling”. For example, this proposed requirement might be interpreted as requiring offices of the same firm in different cities in this country to physically or electronically dispatch all their audit documentation relating to a multi-location audit to the issuing office. Given that all such offices would be expected to have the same audit methodology and quality control systems, the benefit to the quality of the audit as a whole of having such a requirement would appear limited.
- e) Having an arbitrary 45-day rule raises the question of how adherence to the rule can be verified in practice.

- f) The Proposed Standard gives no guidance regarding the circumstances under which it would be acceptable for audit documentation to be assembled after 45 days.

We suggest therefore that the Board reconsiders this proposed requirement in the light of the concerns above.

Multi-location Audits

The Proposed Standard introduces a new requirement for audit documentation (whether in original form or copies thereof) of work performed by other auditors to be retained by the issuing office. In our view, this proposal will likely face potential client confidentiality issues if, as it appears intended, it covers other auditors based in overseas jurisdictions. The Proposed Standard gives no guidance as to what the issuing office should do in that situation.

In addition, what appears burdensome, if for some reason the issuing office cannot obtain copies of the other auditors' documentation, is the apparent requirement in paragraph 16 for the issuing office to create the documentation that, in recording the other auditors' work, do so to the same standard as should have been done by the issuing office. Rather, we believe that the principle to be emphasized should be that the issuing office should be required to document its own work according to these standards, not other auditors'.

Also, there may be confidentiality or other reasons where the issuing office simply cannot have access to the other auditors' work. In France, for example, the law prohibits auditors from sharing audit documentation. We are concerned that the Proposed Standard would, in such cases, imply an obligation on the issuing office to create the necessary documentation itself, and in so doing, to perform work that could potentially amount to arriving at a second independent audit opinion.

Thus, apart from the inevitable increase in administrative and audit costs that this proposal will cause, we question whether it places a fair burden on auditors in the issuing offices. Also, in the context of multi-location audits that involve division of responsibility, the Proposed Standard would appear to extend the responsibility of the issuing office beyond that intended in such situations.

Cross-referencing to a Central Repository

The Proposed Standard introduces a requirement that where certain matters, such as independence and staff training and proficiency, are documented in a central repository for the firm or the particular office participating in the engagement, the audit documentation should contain a reference to the central repository. This requirement does not appear related to an audit standards issue, since the matters that it seeks to address relate more to quality control. We would therefore suggest that the Board considers addressing this in its quality control standards. In addition, audit teams are normally entitled to rely on their firms' quality control systems with regard to matters such as staff training and proficiency. This proposed rule would appear to impose a requirement that such matters be documented for each and every audit engagement by cross-referencing to the central repository. The rationale behind this proposal is not apparent to us.

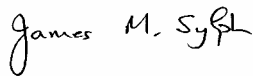
Engagement Completion Memorandum

The Proposed Standard requires that the auditor identify all significant findings or issues in an engagement completion memorandum. Whilst we presume that such a document would include examples of the matters deemed significant as described in paragraph 9, we are concerned that the Proposed Standard does not give due regard to the inherent limitations of human judgment. For example, a specific matter might not have been deemed significant at the time the audit was performed, but with the benefit of new information after the completion of the audit, it would now be considered significant. The benefit of such hindsight would imply that the Proposed Standard, as written, was in fact breached at the time of the audit, when in actuality it was not, based on the facts available and judgments made at the time. We recommend that the Board modifies the wording to require that all identified significant findings and issues be included in the engagement completion memorandum.

In addition, we are concerned at the level of detail that would be required in such a document, as seems to be suggested by the second sentence of paragraph 10, which appears not to envisage that the reviewer might ever talk to others.

Should the above matters require any clarification, I would be pleased to discuss them with PCAOB Staff before the Proposed Standard is finalized.

Very truly yours

A handwritten signature in cursive script that reads "James M. Sylph".

James M. Sylph
Technical Director, IAASB



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January 20, 2004

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 012 Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards

Dear Mr. Secretary:

KPMG appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (Board) Proposed Auditing Standard, *Audit Documentation* (Proposed Standard), and proposed amendment to the interim auditing standards. KPMG fully supports the Board's efforts to improve financial reporting, corporate governance and audit quality with the objective of furthering the public interest and restoring confidence in our capital markets system. In addition, we believe that enhancing guidance regarding audit documentation will serve to improve overall audit quality. Our comments outlined below represent matters for consideration by the Board as it deliberates a final standard on this subject.

This letter is organized by first providing our key points on the Proposed Standard. Less significant and editorial comments and suggestions are included in Appendix A to this letter.

Scope

Paragraph 1 of the Proposed Standard indicates that, "This standard establishes general requirements for documentation the auditor should prepare and retain in connection with *any engagement* conducted in accordance with auditing and related professional practice standards". This statement of scope, read literally, indicates that the Board's documentation standard would apply to all engagements performed by registered public accounting firms for any issuer. Registered public accounting firms often perform services pursuant to the Board's interim standards for issuer non-audit clients, and for issuer audit clients other than financial statement audits, audits of internal control over financial reporting and reviews of interim financial information. We recommend that the Board's final standard clearly define the intended scope of the provisions of such



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standard. For example, will the provisions of the final standard apply to engagements to provide comfort letters (issuer audit clients), to perform attestation engagements (issuer audit and non-audit clients), and to issue reports on the processing of transactions by a service organization (issuer audit and non-audit clients)?

Multi-Location Audits

We understand paragraph 16 of the Proposed Standard to require that the office of the registered public accounting firm that issues the auditors' report retain audit documentation sufficient to meet the requirements of the Proposed Standard. This requirement extends to documentation prepared by personnel of other offices of the same registered public accounting firm (i.e., offices located in the same country), of affiliated and member firms (i.e., offices in other countries), and, in certain instances, of other public accounting firms (domestic or foreign, assuming that the principal auditor does not refer to the participating auditor in his or her auditors' report). In addition, the Board's proposed amendment to AU Section 543.12 would require the principal auditor, who decides not to make reference to the audit of another auditor, to "review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed as if the principal auditor had performed the work himself or herself." These requirements present a number of professional and practical concerns that are more fully addressed in the following paragraphs.

Review Responsibility

For companies with multiple locations, it is common for the audit team responsible for issuing the auditors' report (the primary audit team) to request the assistance of its other domestic offices, affiliated or member firms, and other public accounting firms (participating audit teams) in performing audit procedures for certain subsidiaries, divisions, etc. . Typically, the primary audit team will distribute detailed instructions to the participating audit teams. The participating audit teams perform procedures and prepare documentation consistent with standards established by the Board, subject to supervision and review by the participating audit team personnel, and the participating audit teams provide to the primary audit team documentation summarizing the participating audit teams' findings and conclusions. The participating audit teams' summarized findings and conclusions include information responsive to the primary audit team's detailed instructions and other matters identified during the course of the engagement. It has been our experience that this summarized information generates considerable discussion and interaction between the primary audit team and the participating audit teams, and requests for additional information. Additionally, in our experience, the primary audit team visits the participating audit teams' locations, based on the primary audit team's professional judgment of the risk of significant misstatement associated with the audit client's businesses.

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We believe that, as written, the Proposed Standard would require audit documentation prepared by same-firm personnel, affiliated- and member-firm personnel, and, in certain instances, other-firm personnel be retained in the office of the firm issuing the report and require that the audit team in the office of the firm issuing the report review audit documentation prepared by affiliated- and member-firm personnel and, in certain instances, other-firm personnel. To illustrate, assume that an audit of a multi-national issuer headquartered in Chicago involves participation by same-firm and member- or affiliated-firm audit teams in Los Angeles, Houston, Atlanta, Boston, London and Tokyo. In addition, other-firm participating audit teams located in Berlin, Toronto, Shanghai, and Paris perform audit procedures at the direction of the primary audit team in Chicago and report findings and conclusions to the Chicago team. Assuming that the principal auditor does not intend to make reference to the other auditors in his or her report, the Proposed Standard would require that audit documentation (originals or copies) from each of the locations noted above be retained in Chicago, and that all documentation prepared in London, Tokyo, Berlin, Toronto, Shanghai and Paris be subject to review by the primary audit team in Chicago.

We do not believe it is necessary or practical to require that the primary audit team review audit documentation prepared by participating audit teams. In addition to the obvious duplication of effort and cost, many participating audit teams in foreign locations do not prepare audit documentation in English. Generally, the language used in preparing audit documentation is the same language used by the company in maintaining its financial records in a particular location. Maintenance in the U.S. of audit documentation not prepared in English and, accordingly, not realistically reviewable by a U.S. primary audit team does not enhance audit quality. In addition, the possibility of mistranslation and misinterpretation of information runs counter to the objective of improving audit quality.

Further, requiring duplicate reviews of audit documentation will result in incremental costs to issuers' shareholders and may result in unnecessary delays in completing audits, issuing auditors' reports, and publishing audited and reviewed financial information, thereby inhibiting an issuer's ability to meet the accelerated filing requirements imposed by the SEC. In addition, while affiliated registered public accounting firms generally employ consistent audit methodologies and documentation protocols, these methodologies and protocols are not consistent between firms (e.g., KPMG vs. Ernst & Young), thereby drawing into question the effectiveness of resulting duplicative reviews that may be required by the Proposed Standard. While all such methodologies and protocols are designed to meet the Board's standards, they are different. Consequently, the standard in AU Section 543.12 that requires the principal auditor to incorporate in his or her own audit documentation, sufficient audit documentation from the other auditor that meets the requirements of the Proposed Standard, as if the principal auditor had performed the work himself or herself, is neither realistic nor practical.

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An unintended consequence of requiring duplicative reviews of audit documentation may be that a registered public accounting firm will not assume responsibility for the work performed by participating firms. This would result in the firm issuing the auditors' report referring to the other firms' reports, without regard to the significance of the audit procedures performed by the participating firm. This form of reporting likely will result in incremental costs to issuers' shareholders and may result in issuer delays in filing documents with the SEC and accessing the capital markets, without any corresponding enhancement to audit quality (e.g., multiple firm involvement in document reviews, multiple consent requests, etc).

For the reasons noted above, we strongly recommend that the Board reconsider the proposed amendment to AU Section 543.12.

Retention of Audit Documentation

The release announcing the Proposed Standard indicates that the proposed audit documentation retention requirements would "...improve audit quality by enhancing the probability that *all* audit documentation will be prepared consistently with the same standards of audit quality." We do not believe that audit quality is enhanced simply by requiring that the primary audit team maintain audit documentation prepared by a participating audit team. In fact, retention of two separate copies of audit documentation or retention of audit documentation in a location other than that associated with the audit team performing the procedures may result in unintended consequences that hinder the enhancement of audit quality.

We believe that there should be only one copy of audit documentation that supports the auditor's conclusions, and that such documentation should be retained by the office of the audit team responsible for performance of the audit procedures. Maintenance of audit documentation by the audit team responsible for performance of the audit procedures facilitates effective subsequent reviews of such documentation by auditors who are new to the engagement and successor auditors. Further, maintaining multiple copies of audit documentation would increase the risk that client confidentiality would not be protected and that audit documentation would be lost or destroyed in shipment, and would inevitably result in instances where changes made to original or copies of documentation (in accordance with the Proposed Standard) are not reflected in other copies. These unintended consequences run contrary to the overarching goal of enhancing audit quality.

Foreign Participating Auditors – Legal Matters

Requiring a U.S. primary audit team to retain original or copies of audit documentation prepared by participating audit teams located in other countries introduces a number of legal problems regarding data privacy laws and various specific legal constraints (e.g., those arising under banking secrecy laws and national security laws) that bear on the workability of the requirements in paragraph 16 of the Proposed Standard. We understand that these specific legal matters are addressed in detail in a letter commenting

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on the Proposed Standard submitted to the Board by the law firm Linklaters, dated January 20, 2004. We refer the Board to the Linklaters letter for further consideration of legal matters affecting foreign participating auditors. Following is a general discussion of matters addressed in the Proposed Standard that present particular concerns for non-U.S. public accounting firms and, consequently, for domestic registered public accounting firms that rely on their work.

There are legal impediments imposed by the laws of virtually all foreign countries that could arise should a foreign public accounting firm provide its audit documentation to the office of the auditor issuing the auditors' report. Specifically, potential conflicts involving duties of confidentiality, data privacy laws and various specific legal constraints are relevant in a number of foreign jurisdictions. We encourage the Board to gain a full understanding of these potential conflicts and take appropriate steps to resolve these matters prior to issuance of a final standard on audit documentation.

Data privacy laws exist in many foreign jurisdictions. Pursuant to these laws, data subject to restriction may only be shared with a third party for a purpose that is deemed to be lawful (e.g., when the sharing is necessary to carry out a task in the foreign country's public interest) and are subject to strict restrictions on export from one country to another. This situation is more complicated than the deliberations encountered in conjunction with the registration of foreign public accounting firms (which, as noted below, are permitted to avoid conflicts with non-U.S. law) on the "deemed consent" of access to non-U.S. work papers under Section 106 of the Sarbanes-Oxley Act of 2002. As a consequence, both the export and disclosure issues may prevent certain foreign public accounting firms from providing the audit documentation necessary to permit the U.S. registered public accounting firm from complying with the provisions of the Proposed Standard.

In most jurisdictions, certain data privacy matters can be overcome by obtaining consents of the client, employee or other third party to whom a duty of privacy is owed. However, in the case of audit documentation, the consent would be in relation to future information of a non-specific nature and, given that audit documentation often makes reference to numerous employees, customers, suppliers, etc., the ability to gain such consents (other than a consent related to the protected information of the client itself) would be impossible to achieve as a practical matter. These legal impediments would apply equally to information gathered in a foreign country if U.S. firm personnel were to perform audit procedures there and export the related documentation to the U.S.

We believe the Board also should consider whether the Proposed Standard is consistent with Board release 2003-007, "Registration System for Public Accounting Firms," which allows registered public accounting firms to withhold information from an application, where disclosure of the information would cause the applicant to violate non-U.S. laws. We believe that the Board should analyze the legal impediments to foreign public

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accounting firms' compliance with the Proposed Standard and consider incorporation of a rule similar to Rule 2105, "Conflicting Non-US Laws" (PCAOB release 2003-007, "Registration System for Public Accounting Firms") in any final standard requiring the sharing of audit documentation across national borders.

Pursuant to Section 106 of the Sarbanes-Oxley Act of 2002, non-U.S. public accounting firms that provide audit opinions or material services on which a registered public accounting firm relies are deemed to have consented to provide access to their work papers supporting such work to the Board and the SEC. Additionally, the terms of registration will provide the Board or its equivalent non-U.S. regulator with the ability to inspect, investigate and discipline non-U.S. registered public accounting firms and their personnel. Accordingly, we recommend that the Board rely upon these already-existing alternatives in finalizing its auditing standard on documentation.

Other Independent Auditors

The last sentence of paragraph 16 of the Proposed Standard provides that, as an alternative to retaining documentation prepared by others, "...if the auditor considers it necessary in the circumstances, the auditor issuing the report should prepare and retain audit documentation of the work performed by others as a part of the review required by paragraph 12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, as long as the audit documentation complies with paragraphs 4-12 of this standard." It is unclear to us what is meant by requiring the auditor to "prepare and retain audit documentation of the work performed by others," and when an auditor should consider it necessary to do so. For example, does the Board contemplate that the primary audit team would document, or even reperform, the procedures performed by the other auditor? This requirement seems to run contrary to the last sentence in AU Section 543.03 that states, "[r]egardless of the principal auditor's decision [to make reference], the other auditor remains responsible for the performance of his own work and for his own report."

Summary

For the reasons outlined in the preceding paragraphs, we strongly recommend that the Board not require retention of audit documentation prepared by participating auditors in the office of the firm issuing the auditors' report. In addition, we strongly recommend that the Board not require the principal auditor to review audit documentation of other auditors when such documentation has been subject to the appropriate level of review by the participating audit team members. Central retention of audit documentation and requiring duplicate reviews of such documentation will, in many cases, result in irresolvable conflicts with non-U.S. laws, and likely will result in unnecessary delays to the audit process, and increased costs to issuer shareholders without a corresponding enhancement to audit quality.

Alternatively, we suggest that the Board consider requiring that the auditor issuing the report obtain documentation from each participating audit team outlining procedures,

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findings and conclusions, including uncorrected misstatements, and a conclusion that the procedures performed by the participating audit team were consistent with instructions received from the primary audit team. Such information could be assembled in consideration of data protection laws imposed on the non-U.S. audit team, and protected data could be omitted from the documentation provided to the principal auditor. Further, we recommend that the Board consider undertaking a project to provide additional guidance to primary audit teams in those instances where audit procedures are performed in multiple physical locations. The provision of additional guidance regarding instructions to participating audit teams and communication among the teams would assist in providing more consistency in the performance of audit procedures in multi-location environments that would result in achieving our shared goal of improved audit quality. We note that the IAASB recently approved for exposure an International Standard on Auditing entitled, “The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements.” We recommend that the Board consider leveraging the activity of the IAASB on its project in determining whether, and to what extent, a similar standard may be appropriate for use by auditors of issuer financial statements. We would be pleased to participate on a working group or ad hoc task force to assist the Board in this regard.

Reviewability Standard

Paragraph 5 of the Proposed Standard requires that audit documentation “....contain sufficient information to enable an *experienced* auditor, having no previous connection with the engagement: to understand the nature, timing, extent, and results of the procedures performed, evidence obtained and conclusions reached...” We believe that further clarification of the term “experienced auditor” is necessary.

The first general standard states that, “[t]he audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor” (AU Section 210.01). The third general standard states that, “[d]ue professional care is to be exercised in the planning and performance of the audit and the preparation of the report” (AU Section 230.01). Further, AU Section 230.06 indicates that, “[t]he auditor with final responsibility for the engagement should know, at a minimum, the relevant professional accounting and auditing standards and should be knowledgeable about the client.” We believe that the characteristics defining an “experienced auditor” should be consistent with those expected of the auditor with final responsibility for the engagement noted above. Relevant and appropriate accounting and auditing knowledge are prerequisites to serving as an auditor with final responsibility and, accordingly, we believe that an “experienced auditor” should be defined as meeting similar qualifications.

Rebuttable Presumption

Paragraph 6 of the Proposed Standard indicates that failure to document the audit procedures performed, evidence obtained and conclusions reached creates a rebuttable

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presumption that the procedures were not applied, the evidence was not obtained, and the conclusions reached were not suitably supported. The Proposed Standard further indicates that this presumption is rebuttable by persuasive evidence to the contrary.

The release announcing the Proposed Standard indicates that, “[t]he Board contemplates that oral explanation alone would not constitute persuasive other evidence and invites comment on the addition of such a requirement to the proposed standard.” We believe that the determination of whether persuasive other evidence exists is a matter of judgment dictated by individual facts and circumstances. We do not believe it is appropriate to limit the consideration of oral evidence when evaluating the sufficiency of audit procedures performed, evidence obtained and conclusions reached.

Changes to Audit Documentation

The Proposed Standard contains a number of references to dates or periods of time that initiate or require certain actions. Specific references to dates or periods of time in the Proposed Standard follow:

- Paragraph 14 states that, “[a] complete and final set of audit documentation must be assembled for retention within a reasonable period of time following the first time that the auditor grants permission to use the auditor’s report in connection with the issuance of the company’s financial statements. Such reasonable period of time ordinarily should not be more than 45 days.”
- Paragraph 13 states that, “[a]udit documentation must be retained for seven years from the date of completion of the engagement, as indicated by the date of the auditor’s report...”
- Paragraph 15 states that, “[i]f evidence is obtained after completion of the engagement, or if work performed before engagement completion is documented after completion, the documentation added must indicate...”

To clarify the dating and timing requirements and to enhance consistency in practice, we recommend that the date triggering the time period during which work paper assembly ordinarily should be completed be more objectively determinable than the date on which the auditor “grants permission...” We recommend that the Board consider using the issuer’s filing date with the SEC, which usually would approximate the date on which we believe auditors generally would conclude that they “grant permission” to use their report. This clarification would provide reviewers and inspectors with the ability to objectively determine compliance with dating requirements and would enhance consistency in practice.

In addition, we recommend that the final standard adopted by the Board refer to the same trigger date for initiating both the time period during which work paper assembly ordinarily should be completed and the seven-year retention period. We note that the SEC’s Final Rule, *Retention of Records Relevant to Audits and Reviews*, requires retention of certain audit and review records, which include work papers, for “seven

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years after an accountant concludes an audit or review.” If the Board decides not to adopt a filing date trigger for the seven-year retention period, we recommend that the Board’s final standard conform to language in the SEC’s rule.

We recommend that the final standard include clarification of the concept of assembling documentation for retention in paragraph 14 and the concept of subsequent additions to audit documentation in paragraph 15 of the Proposed Standard. In this context, we have interpreted the Proposed Standard such that the provisions of paragraph 15 do not apply until the expiration of the 45-day period referred to in paragraph 14. We concur with an approach that provides the auditor a reasonable time period (not to exceed 45 days) to assemble and complete the final set of audit documentation. We believe this provision is even more important in the environment of issuer accelerated filing requirements that continue to be phased-in during 2004 and 2005, ultimately resulting in a 60-day deadline for filing annual reports on Form 10-K. As noted above, we recommend that the completion of the engagement be defined as the filing date with the SEC, for purposes of implementing both the assembly provisions of paragraph 14 (i.e., when the 45-day period commences), and the provisions of paragraph 15 (i.e., additions to audit documentation subsequent to the expiration of the 45-day period). If our interpretation is not consistent with the Board’s intent, we suggest that the Board clarify the provisions of paragraphs 14 and 15 to assure consistency in practice and objectively determinable documentation requirements.

In addition to the issues presented above, we encourage the Board to consider undertaking a project to reconsider report-dating protocols in general. AU Section 530.01 indicates that, “[g]enerally, the date of completion of field work should be used as the date of the independent auditor’s report.” Determining the “date of completion of fieldwork” is subject to varying interpretation and, accordingly, we suggest the Board consider introduction of a more objective measure for establishing the date of the auditors’ report.

Other Matters

We note that the Proposed Standard does not address several fundamental tenets of audit documentation currently included in AU Section 339. These matters are discussed further in the following paragraphs.

Auditor judgment. AU Section 339.01 states that, “[t]he quantity, type, and content of audit documentation are matters of the auditor’s professional judgment.” AU Section 339.09 indicates that “...the auditor should document audit findings or issues that *in his or her judgment* are significant” [emphasis added]. In addition, according to the release announcing the Proposed Standard, the Board is adopting the substance of the General Accounting Office’s documentation standard. That standard includes a reference to auditor judgment consistent with the aforementioned language in AU Section 339.01. Auditor judgment clearly influences the determination of the quantity, type, and content

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of audit documentation. Accordingly, we recommend that the Board's final standard appropriately acknowledge the importance of auditor judgment in determining the sufficiency of audit documentation.

Ownership and client confidentiality. AU Sections 339.10 through 339.13 refer to the auditor's ownership of audit documentation and the auditor's obligation, ethical and sometimes legal, to maintain the confidentiality of client information. Further, AU Section 339 indicates that the auditor "should adopt reasonable procedures to prevent unauthorized access to the audit documentation." We recommend that the Board's final standard include provisions regarding ownership and client confidentiality to remind auditors of their ethical, and sometimes legal, obligations regarding confidentiality and to facilitate compliance with such obligations.

Paragraph 12 of the Proposed Standard states that, "[i]n addition to the documentation necessary to support the auditor's final conclusions, *information* the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions must also be included in the audit documentation" [emphasis added]. We believe this provision confuses, and may be inconsistent with, the related concept in the SEC's Final Rule: *Retention of Records Relevant to Audits and Reviews* and AU Section 311.14 of the Board's interim standards.

AU Section 311.14 provides guidance to the auditor in those instances where differences of opinion concerning accounting and auditing issues exist among audit engagement team personnel. AU Section 311.14 provides that an audit engagement team member should document a disagreement with final conclusions reached if, after appropriate consultation, he or she believes it is necessary to be disassociated from the resolution of the matter. We suggest that the Board's final standard clarify that the "information" referred to in paragraph 12 of the Proposed Standard is consistent with that contemplated in AU Section 311.14. However, if the intent of paragraph 12 of the Proposed Standard is to expand documentation requirements in the work papers beyond the resolution of differences in professional judgment, we recommend that the Board provide additional guidance on what constitutes information identified by the auditor that is inconsistent with or contradicts the auditor's final conclusions. We recommend that this guidance include several examples identifying such information and the Board's proposed approach to the documentation of such matters in its final standard on audit documentation. Finally, we encourage the Board to coordinate its deliberations in this area with the SEC staff and consider clarifying guidance on the scope of both the Board's final standard and the SEC's Final Rule on retention of records.

Effective Date

The Proposed Standard provides that the final standard adopted by the Board would apply to engagements completed on or after June 15, 2004. Registered public accounting firms require time to develop and implement processes and provide training with respect

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to several aspects of the Proposed Standard. Also, it is important to understand that audit documentation is, in many instances, prepared throughout the year under audit. Accordingly, we believe it is imperative that any final audit documentation standard be effective for years beginning after a specified date. We recommend that the Board consider an effective date for the final standard as follows:

This standard applies to engagements to audit financial statements for years beginning on or after September 15, 2004 (for calendar year issuers, the year ending December 31, 2005) and for reviews of interim financial information for the first interim period of the first annual fiscal year the standard is applied (for calendar year issuers, the interim period ending March 31, 2005).

* * * * *

KPMG International is a Swiss cooperative which functions as an umbrella organization to approximately 100 KPMG member firms in countries around the world, to which it licenses the KPMG name. Each KPMG member firm is autonomous with its own separate ownership and governance structure. The KPMG member firms do not share profits amongst themselves, and they are not subject to control by any other member firm nor by KPMG International.

If you have questions regarding the information included in this letter, please contact Sam Ranzilla, (212) 909-5837, sranzilla@kpmg.com, Craig Crawford, (212) 909-5536, ccrawford@kpmg.com, or, with respect to non-U.S. matters, Neil Lerner, +(44) 207-311-8620, neil.lerner@kpmg.co.uk.

Very truly yours,

KPMG

cc: William J. McDonough, Chairman
Kayla J. Gillian
Daniel L. Goelzer
Willis D. Gradison, Jr.
Charles D. Niemeier

The following other comments and suggestions are presented for your consideration:

1. Paragraph 1 of the Proposed Standard indicates that the standard “does not supplant specific documentation requirements of other auditing and related professional practice standards.” It is not clear which other standards are being referenced in this statement and, accordingly, we recommend that this statement be deleted or clarified. To the extent that the Proposed Standard is referring to other auditing standards adopted by the Board, we recommend specifically referring to, or incorporating the guidance from, those standards. We believe a statement that this standard does not “supplant” documentation standards outside the auditing standards (presumably for example, state law) will lead to unnecessary confusion.
2. Paragraph 3 (d) and (f) – Generally, parties other than those identified in paragraphs 3(a), (b), (c), and (e) review work papers at the discretion of the independent auditor. In order to avoid confusion with respect to the auditor’s obligation to provide work papers to other parties, we recommend that paragraph 3 (d) and (f) be deleted and be replaced with the following language, that would follow paragraph 3(e), as currently numbered: “At the discretion of the auditor, other parties such as a successor auditor.”
3. Paragraph 6 refers to “auditors, including any specialists.” It is unclear to us what “specialists” are referred to in this phrase. The Board’s Statement of Authority defines the auditor as “a registered public accounting firm or an associated person of such a firm.”; therefore, we believe that specialists employed by the auditor or third parties with which the auditor contracts to function as a specialist are encompassed by the reference to auditors. Specialists not employed or contracted by the auditor (for example, an actuary engaged by the issuer to prepare actuarial calculations), are outside the scope of an auditing standard on documentation. Accordingly, we recommend that the reference to specialists in Paragraph 6 be deleted.
4. We recommend that paragraph 7(b) of the Proposed Standard be revised to read, in part, that “support the basis for the auditor’s conclusions concerning ~~each~~every ~~material~~ financial statement assertion that, in the auditor’s judgment, is material.”
5. Paragraph 8 of the Proposed Standard indicates that, “[c]ertain matters, such as auditor independence and staff training and proficiency, may be documented in a central repository....” This paragraph also indicates that the audit documentation for a particular engagement should contain a reference to the central repository and that “[d]ocumentation of matters unique to a particular engagement should be included in the audit documentation of the pertinent engagement.” We do not believe it is necessary for audit documentation to include a “boiler plate” reference that certain documentation is maintained in a central repository. Accordingly, we recommend

that the first two sentences of paragraph 8 be deleted, such that the paragraph refers only to documentation of these matters unique to a particular engagement.

If the Board elects to retain the requirement to refer to a central repository, we recommend that specificity be added to the phrase, “certain matters, such as auditor independence and staff training and proficiency.” Without such specificity, widely varying interpretations and practices will develop among auditors with respect to matters that are referenced and the nature of such references.

6. Paragraph 9(c) of the Proposed Standard defines an audit adjustment as “a proposed correction of a misstatement of the financial statements that could, in the auditor’s judgment, either individually or in the aggregate, have a material effect on the company’s *financial reporting process*”. The Board’s interim standards, AU Section 380.09, define an audit adjustment as, “...a proposed correction of the financial statements that, in the auditor’s judgment, may not have been detected except through the auditing procedures performed.” We recommend that the final standard adopt the definition of an audit adjustment consistent with that in AU Section 380.09.

Paragraph 9(c) of the Proposed Standard also states that “[a]udit adjustments include corrections of misstatements, of which the auditor is aware, that were or should have been proposed based on the *known* audit evidence”. We recommend that the word *known* be deleted or that this phrase be clarified.

7. We recommend the following editorial revision to paragraph 9(d) of the Proposed Standard: “Disagreements among members of the engagement team or with others consulted on the engagement about final conclusions reached on significant accounting or auditing matters.”
8. We recommend the following editorial revision to paragraph 9(e) of the Proposed Standard: “Significant findings or issues identified during the review of ~~quarterly~~ interim financial information.”
9. Paragraph 10 of the Proposed Standard states that, “[t]he auditor must identify all significant findings or issues in an engagement completion memorandum” and further discusses the nature and content of this memorandum. We recommend that the word *memorandum* be replaced with *document*. We believe that various forms of communication may meet the objectives of the “completion memorandum” referenced in the Proposed Standard and the form of documentation should not be mandated in an auditing standard.
10. Paragraph 11 of the Proposed Standard requires documentation of auditing procedures that involve inspection or confirmation to include identification of the items tested. Footnote 2 to paragraph 11 provides that this requirement may be satisfied by indicating the source from which the items were selected and the

specific selection criteria. We recommend that the Board's final standard specifically indicate that the auditor is not required to retain as audit documentation copies of the client's records from which the tested items were selected.

11. Paragraph 15 of the Proposed Standard, states that, "Audit documentation must not be deleted or discarded; however, information may be added, including *an explanation of its relevance*, as long as the information identifies the date the information was added; by whom it was added; and *the reason for adding it*". We view the two italicized phrases to be duplicative and recommend that the first italicized phrase be deleted.
12. Paragraph 17 of the Proposed Standard and related footnote 4 refer to document retention requirement relative to the SEC's Final Rule. The specific section of the SEC's Final Rule referred to relates to documents other than work papers required by the Board's auditing and related professional practice standards. We recommend that paragraph 17 be removed, or clarified to note the referred documents do not constitute work papers or audit documentation pursuant to the Board's auditing and related professional practice standards.

* * * * *

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20 January 2004

Ladies and Gentlemen

Docket Matter No. 012
Proposed Auditing Standard on Audit Documentation
and Proposed Amendment to Interim Auditing Standards
Release No. 2003-023

We are submitting this letter in response to a request of the Public Company Accounting Oversight Board (the "**Board**") for comments in respect of its proposed audit documentation standard (to supersede AU. Sec. 339) and an amendment to the interim auditing standards (AU. Sec. 543) as directed by Section 103(a)(3)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "**Act**").

We want, initially, to thank the Board for continuing to consider the position of foreign public accounting firms and the special concerns posed by application of certain aspects of the provisions of the Act and the Board's rules and regulations to such firms. We believe that the dialogue in which the Board has been engaging with many of its foreign counterparts has been constructive and we encourage the continued consideration of the position of foreign public accounting firms, particularly as regards their obligation to comply with the regulatory regimes in both their home jurisdictions as well as that of the United States.

We represent BDO Global Coordination B.V., Deloitte Touche Tohmatsu, Ernst & Young Global Limited, Grant Thornton LLP, KPMG International and PricewaterhouseCoopers International Limited, which are the co-ordinating entities of the international networks of the "Big Four plus two" accounting firms. We have been assisting our clients in relation to the non-US legal issues that arise out of the implementation of the Act, including issues connected with the proposed audit documentation standard (the "**Proposed Audit Standard**"), which remain of particular concern to our clients. Our clients have requested that we provide the Board with our analysis of one specific issue: the non-US legal data privacy issue that arises in consequence of the fact that audit documentation assembled and delivered to the auditor that issues the audit report in respect of an SEC-reporting issuer (the "**principal auditor**") pursuant to the Proposed Audit Standard may be disclosed to the Board or the US Securities and Exchange Commission ("**SEC**").¹ This issue is serious since there is a material conflict between the Proposed Audit Standard and the data privacy laws of many jurisdictions.

¹ This is not the only significant non-US legal issue associated with the Proposed Audit Standard. However, this letter does not consider any other issues.

A list of the names of the partners and their professional qualifications is open to inspection at the above office. The partners are solicitors, registered foreign lawyers or registered European lawyers. The firm is regulated by the Law Society.

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The Proposed Audit Standard establishes general requirements for documentation auditors should prepare and retain in connection with any engagement conducted in accordance with auditing and related professional practice standards. In particular, the Proposed Audit Standard would generally require that audit documentation be retained at the offices of the principal auditor for a period of seven years from the date of completion of an engagement. Consistent with comments made by the Board and the Board's authority to obtain information under the Act, both we and our clients believe that one of the principal purposes of the proposal is to assist its efforts and those of the SEC to oversee and have the ability to inspect the work undertaken by non-US audit firms that audit the accounts of subsidiaries of US domestic companies whose securities trade in the US public markets. We also believe that a non-US court would be likely to consider this to be one of the principal purposes of the Proposed Audit Standard.

In a memorandum that our Firm submitted to the Board on 31 March 2003 entitled, *Legal Implications for Foreign Accountancy Firms in consequence of Registration with the PCAOB under the Sarbanes-Oxley Act of 2002* (the "**Memorandum**"),² we highlighted areas where there exist significant potential conflicts between the requirements of the proposed rules giving effect to the Act and the laws and regulations of a representative selection of jurisdictions³ outside the United States. The Memorandum was primarily intended to identify and encourage consideration of the potential conflicts that would arise from completion of the Board's registration form by foreign public accounting firms that audit or play a substantial role in the audit of issuers (within the meaning of Section 2(a)(7) of the Act). The Memorandum focused in particular on conflicts arising in relation to confidentiality, data protection, legal enforcement, employment liability, banking secrecy and official secrets. Because we believe that the vast majority of the issues discussed in the Memorandum have equal application in the context of the Proposed Audit Standard, we do not propose to discuss in detail those issues again in this letter. However, we would commend the Board to review our Memorandum in order to more fully understand many of the non-US legal issues of concern to the Firms, as well as the data privacy and disclosure issues that are the focus of this letter.

As was the case with our Memorandum, we have not thought it necessary in connection with our consideration of the Proposed Audit Standard to conduct a comprehensive survey of all of the countries throughout the world that may be affected by this proposal. Instead, we have focused primarily on five countries, the United Kingdom, Germany, Spain, Brazil and Japan (the "**Surveyed Countries**") as well as the general European Union laws of data privacy. The Surveyed Countries were chosen not because they are known to be particularly difficult. Indeed, we have deliberately not chosen countries at the extremes in terms of ease (i.e. countries with no data privacy or other relevant laws) or difficulty (e.g. France and Belgium) on the grounds that these countries are not typical. Rather, we selected the Surveyed Countries on the basis that they are reasonably representative of the countries that are likely to be affected by the Proposed Audit Standard.

1 **Basic legal impediments**

The focus of this letter is data privacy laws since these are likely to impact most audits and a wider range of jurisdictions. It is important to note, however, that the issues arising under such laws are not the only issues associated with the Proposed Audit Standard.⁴ The other issues can be broadly sub-divided as follows:-

² Please see http://www.pcaobus.org/rules/Comments_21-30_2003-001.zip for a copy of our Memorandum. A further copy is submitted with this letter as Appendix 1.

³ These comprised the United Kingdom, Germany, Japan, Israel, Switzerland, Mexico and, in respect of certain issues, France and Brazil.

⁴ For a more detailed discussion of these issues, please see our Memorandum.

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- (i) legal issues relating to professional duties and, in particular, duties of confidentiality; and
- (ii) issues relating to various specific legal constraints (e.g. those arising under banking secrecy laws and national security laws).

In most jurisdictions (and specifically in each of the Surveyed Countries), duties of confidentiality are owed by an auditor to its audit client. In most jurisdictions, such duties can be waived under applicable law by that client but in some places (e.g. France and Belgium), waivers or consents cannot alter the legal duty.⁵

Under applicable non-US banking secrecy and national security laws, there may be circumstances in which an individual working for the auditor of the subject company could be entitled to have access to material protected by such laws in circumstances in which the Board or SEC would not be entitled to have such access because members of the Board or SEC do not have the requisite Governmental clearance to review such information.⁶ In these circumstances, a disclosure of information with a view to its potential onward transmission to the Board or the SEC could be illegal.

These are clearly serious issues but they are not the subject of this letter.

2 Data privacy considerations

2.1 Duty of confidentiality

In many jurisdictions, personal data in the possession of a person (e.g. an audit client or an auditor) may only be used for a purpose that is deemed to be lawful. In particular, personal data may only be disclosed to a third party in circumstances falling within an exception to the general duty to preserve the confidentiality of such data.

The scope of this duty and the exceptions to it vary from jurisdiction to jurisdiction. At one extreme, there are countries (such as Brazil) that currently have no data privacy laws. At the other extreme, there are countries (such as Italy) that have extensive laws protecting all data whether relating to individuals or bodies corporate. The laws of most jurisdictions in those parts of the world where most relevant audit work is conducted, however, fall in between these extremes: they impose duties with regard to data relating to individuals. The jurisdictions that have data privacy laws now include many outside the European Union (e.g. Japan) but, since the relevant laws are generally no more extensive than those of Member States of the European Union, our focus will be on the laws of such Member States.

2.2 The basic issue

The foundation of the data privacy laws of all Member States is the European Union directive on data privacy (the "**Data Protection Directive**").⁷ This permits "personal data" to be "processed" only if one of certain specified situations exist. Put broadly, the issue that concerns our clients is that audit documentation as defined by the Proposed Audit Standard⁸ is likely to contain "personal data" within the meaning of the Data Protection Directive; the disclosure of such data to the Board or the SEC would constitute "processing"; but not all such disclosure would fall within one of the

⁵ See paragraph 4 of our Memorandum for examples and further details.

⁶ See paragraph 6 of our Memorandum for examples and further details.

⁷ Directive 95/46/EC of 24 October 1995.

⁸ See paragraphs 2 and 4 through 12 of the Proposed Audit Standard. Of course, a narrower definition of "audit documentation" might well result in it containing little or no personal data. This point is considered further in paragraph 4.1 below.

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specified permissible situations. Hence disclosure to the Board or the SEC of all audit documentation is likely to be unlawful. Furthermore, because of this, it would be likely to be unlawful for an audit client or non-US auditor to assemble and deliver documentation to another third party (e.g. the principal auditor) in circumstances in which the onward disclosure to the Board or SEC was in contemplation.⁹

We will analyse the various elements of this problem in turn.

2.3 Personal data

The Data Protection Directive defines "personal data" to mean "any information relating to an identified or identifiable natural person".¹⁰ The precise scope of this definition is unclear and there is currently no clear European Court guidance on its meaning. Furthermore, like all of the provisions of the European Union directives, the provisions of the Data Protection Directive do not have direct legal effect within the European Union. Each Member State has had to enact its own implementing legislation, and the result is inconsistency and still greater obscurity. What is clear is that European Union regulators and courts, in practice, have wide discretion to interpret the law, and their approach is likely to vary from country to country.¹¹

The generally accepted legal view, however, is that the definition set out above should be construed broadly so as to encompass almost all information referencing an individual. In the context of workpapers maintained by auditors, this is likely to include information relating to a wide range of people: partners and employees of the local auditor; directors and employees of the audit client; individual customers and suppliers, and directors and employees of corporate customers and suppliers, of the audit client; and potentially others. Any audit document that mentions the name of any such individual potentially contains personal data.

2.4 "Processing"

The term "processing" includes "disclosure by transmission, dissemination or otherwise making available".¹² Clearly, therefore, disclosure to the Board or the SEC would comprise "processing". Hence, unless an exception were available, such disclosure would be illegal under the laws of European Union Member States.¹³

2.5 Exceptions

The most obvious exception to the prohibition on disclosure of personal data is the situation in which the individual to which the data relates has "unambiguously given his consent" to the disclosure.¹⁴ This possibility is considered below.¹⁵

⁹ This is not the only concern that arises under the Data Protection Directive in relation to disclosure or potential disclosure of personal data to the Board or the SEC but it comprises the most fundamental concern and hence is the focus of this letter.

¹⁰ Article 2(a) of the Data Protection Directive.

¹¹ Spain, for example, has adopted a very narrow interpretation of the Data Protection Directive in its translation of the Directive into local law. As a result, it may well be that currently little data within Spanish audit documentation will cause concern. Furthermore, a very recent decision of the English Court of Appeal (*Durant v Financial Services Authority*, 8 December 2003) has given a restricted meaning to the term "personal data" under UK law. This decision shows commendable common sense, but it is out of line with the interpretation given to the relevant local law by most of the European regulators (including the normally liberal UK Information Commissioner, who is having to reconsider his position and published guidance in the light of the decision).

¹² Article 1(b) of the Data Protection Directive.

¹³ Assuming each Member State has properly implemented the Directive, which most have in this respect.

¹⁴ Article 7(a) of the Data Protection Directive.

¹⁵ See paragraph 3.3 of this letter.

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The only other situations in which disclosure is permitted and which might at first sight be of assistance in the present case are situations in which either:

- (i) "processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in the controller or in a third party to whom the data are disclosed";¹⁶ or
- (ii) "processing is necessary for the purposes of the legitimate interests pursued by the controller or by the third party or parties to whom the data are disclosed, except where such interests are overridden by the interests for (*sic*) fundamental rights and freedoms of the data subject which require protection under [the Data Protection Directive]".¹⁷

Once again, it is impossible to define precisely the scope of these exceptions and of the relevant implementing laws of Member States and there are no decisions of relevant appellate courts that materially assist in their interpretation. However, the generally accepted view is that general disclosure of all personal data in audit documentation to non-European Union regulators (such as the Board and the SEC) is not permitted by these exceptions. We share this view and, more importantly, so do the key European Union regulators.¹⁸

2.6 Indirect securing of illegal objective

In the absence of consent from the relevant data subjects, the disclosure of all audit documentation to the Board or the SEC would be likely to be illegal under the laws of Member States of the European Union. The Proposed Audit Standard, however, does not by its terms require disclosure to the Board or the SEC: it requires disclosure to the principal auditor. It is, therefore, necessary to consider whether this alters the above analysis.

In our opinion, it does not. Yet again, it is possible that the laws of different Member States may differ and there is no clear judicial guidance. However, under the laws of those jurisdictions that we have specifically considered for this purpose (i.e. Germany and the UK), we believe that a disclosure of data to a principal auditor pursuant to the Proposed Audit Standard would be regarded as having as one of its purposes the assistance of the Board and the SEC in their investigations and the enforcement of the Act and other applicable laws and that, in consequence, such disclosure would be regarded as a matter of law in substantially the same manner as a disclosure to the Board or the SEC itself.¹⁹ This is consistent with the normal requirement that European Union directives and laws implementing them be interpreted purposively²⁰ and also with the essentially purposive language of the relevant parts of the Data Protection Directive and the relevant implementing legislation.

¹⁶ Article 7(e) of the Data Protection Directive.

¹⁷ Article 7(f) of the Data Protection Directive.

¹⁸ In any event, the exceptions do not extend to sensitive personal data (e.g. the disclosure of medical data or information relating to criminal convictions). Furthermore, several Member States of the European Union have not enacted the relevant exceptions in full or even at all. Spain is one such Member State. See further paragraphs 3.3.2 and 3.3.5 of our Memorandum.

¹⁹ Japanese law may differ slightly in this respect in that we have been advised that the privacy problem might arise not at the time of the disclosure to the principal auditor but in the event of a subsequent disclosure to the Board or the SEC.

²⁰ Case C – 84/95 *Bosphorus v. Minister for Transport, Energy and Communications, Ireland and the Attorney General* [1996] ECR I-3953 and Case C - 6/72, *Europemballage Corporation and Continental Can Company Inc. v. Commission of the European Communities*. [1972] ECR I-157.

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3 The disclosure problem in practice**3.1 US firm conduct of audit work**

One option that we understand has been suggested with a view to overcoming the problem identified above is for the US firms (or other principal auditors) to send audit teams to the relevant non-US jurisdictions to undertake the necessary audit work and then assemble and retain all relevant audit documentation. However, this would not solve the problem described above. The precise legal analysis would differ by country, but the end result would be that data would have to be disclosed to the relevant US firm knowing that it would be assembled and retained with a view to its potential disclosure to the Board and the SEC. This would be likely to be unlawful in most European Union jurisdictions.²¹

3.2 Redaction of personal data

The data privacy problem is caused by the presence of personal data in audit documentation. Consequently, although highly theoretical, under applicable data privacy law the problem could be solved by the redaction of that documentation so as to remove all personal data. However, we suspect that the costs and time that would need to be devoted to a redaction exercise of this kind would be so huge as to render the process impracticable.

As this letter suggests, data privacy law is extremely complicated, and analysing all audit documentation with a view to ensuring that data that is protected by local law (but only such data) is eliminated from the audit documentation would be a very time consuming and subjective process. As we have previously indicated, audit workpapers are likely to contain a considerable range of personal data. Redaction would literally involve the analysis of each and every workpaper and, in many cases, the production of versions of documents with names and other details omitted. This might be a practical solution in connection with a one-off request for specific audit workpapers. The burden of compliance in such a case would be limited and could doubtless be further limited after discussion with the Board or SEC on a case-by-case basis. In relation to the Proposed Audit Standard, however, the compliance burden would exist in relation to each and every audit document relating to any audit of an SEC-registrant, and there would be no meaningful opportunity to discuss how to address any specific problems.²²

The consequence of this is that, although it is essential that the Proposed Audit Standard state that the obligations imposed by it are subject to applicable foreign law if a conflict with non-US laws is to be avoided, it is by no means sufficient in and of itself to deal with the practical problems that are likely to be encountered.

3.3 Securing consents from affected data subjects

Certain data privacy and other problems can, of course, be overcome by obtaining the consent of the third party to whom a duty of privacy is owed.²³ It is, therefore, necessary to consider whether consents might be obtained so as to solve the problem considered in this letter. Unfortunately, this would not be possible for several reasons.

²¹ We have not been asked to consider in this letter other potential local law issues with this suggestion (e.g. the lawfulness of the conduct of local audit work by the US firms under local audit licensing laws).

²² The existence of a specific request made in relation to a specific investigation or enforcement action might also enable reliance to be placed on exceptions to the duty of confidentiality that would not be available in relation to the kind of general disclosure contemplated by the Proposed Audit Standard. Hence, the amount of data required to be redacted in relation to a disclosure under that Standard might be greater than the amount required in relation to a specific request.

²³ See, for example, Article 7(a) of the Data Protection Directive.

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First, and most obviously, the number of data subjects is likely to be so large that obtaining consents from all of them would be logistically almost impossible.²⁴ Many would have no incentive even to reply to a request for consent and others might well refuse consent on principle.

Equally seriously, many consents would be effectively void. This is because the relevant consents must normally satisfy some basic requirements. Under European Union law, for example, they must be "freely given, specific and informed".²⁵ Hence, it is not always possible to obtain effective consents, particularly from employees, nor is it always practicable to do so.²⁶ In any event, in many jurisdictions, consents are revocable at any time.

The problem with the Proposed Audit Standard is that any consents would have to deal with future data of a non-specific nature. Consequently, subject to what is said below, in many places, including most jurisdictions within the European Union, no meaningful or reliable consents could be obtained in advance as they would not be "specific and informed".

In some jurisdictions, it would be possible to obtain effective consents from members of the non-US firm's audit team (i.e., the partners and staff engaged on the relevant audit), provided that these consents were sought around the time when the audit work commenced and, probably, that the giving of the consent was a condition of being permitted to be a member of the team. This process would obviously be cumbersome, but it would at least resolve one of the data privacy issues.

Another meaningful consent that could be obtained in advance in relation to audit documentation is the consent of the relevant client. We note in this context that another possible way of progressing this might be through an SEC rule requiring SEC-registrants to consent or procure that their subsidiaries consent to the production of relevant documentation.

As indicated above, however, these consents would only scratch the surface of the problem. The data privacy issue would remain in relation to all other personal data in the audit documentation.

4 Overcoming the problems

It is not easy to find a legally acceptable and practical solution that would be applicable in most jurisdictions to the problems described above and the problem is compounded by the concern that regulators outside of the United States may look at the substance of what is occurring (i.e. the delivery of data to a non-European Union regulator) rather than at its form. Nonetheless, there are various possibilities that may be worth exploring further.

4.1 Limiting the content of

The problem discussed in this letter is caused by the existence of "personal data" within audit documentation. As indicated above, this typically comprises information relating to "an identified or identifiable natural person".²⁷ If the Proposed Audit Standard were to restrict the scope of the materials that the Board requires be assembled and delivered to the principal auditor to something likely to contain significantly less information about individuals, then the data privacy problem

²⁴ See paragraph 2.3, which considers the range of individuals from whom consent might be required.

²⁵ Article 1(h) of the Data Protection Directive.

²⁶ Under the laws of most European jurisdictions, it is almost impossible to assert that a general consent given by an employee is "freely given".

²⁷ Article 2(a) of the Data Protection Directive. As indicated above, some states, such as Italy, have extended their data privacy laws to encompass data relating to corporations.

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would at the very least be greatly reduced in scope. Clearly, the more limited the scope of such materials, the less difficult the problem would become.

4.2 Use of other regulators

In general, the laws of most EU Member States permit the disclosure of personal data to local regulators for specific investigatory and monitoring purposes pursuant to the "public interest/official authority" provisions of the Data Privacy Directive.²⁸ Furthermore, the same provisions would normally enable the non-US securities regulator to cooperate with the SEC via the IOSCO Memoranda of Understanding in relation to investigations and enforcement matters. This fact may be crucial in assessing the impact of some of the possible changes to the Proposed Audit Standard and considering their acceptability from a policy perspective. For example, the impact of the maintenance of audit documentation by the local auditor within the relevant non-US jurisdiction rather than by the principal auditor in the United States of America should be viewed in the light of the ability of the non-US securities and/or accounting regulator to access that documentation. In addition, the position of the Board could be further enhanced if it were to enter into cooperation agreements with the relevant non-US accounting regulators in relation to enforcement and investigations. These ideas reflect some of those outlined by the Board in its *Proposed Rules Relating to the Oversight of Non-U.S. Public Accounting Firms*, dated 10 December 2003,²⁹ and we would commend the Board to consider the issues raised above in light of that proposal and its implementation.

We recognise that the legal and administrative difficulties to be addressed before any solution can be reached will be considerable, and that there will be many second-order issues that will need to be overcome (e.g. in relation to employee and customer notifications and sensitive data). In practice, in many countries, the attitude of the non-US regulator will be crucial, and non-US regulatory objectives and policy as much as law will then determine the outcome of any discussions. We believe that the dialogue that is underway between the Board, the Firms and non-US regulators, particularly within Continental Europe, will be key to resolving these issues in a manner that best achieves the goals of the Board, while recognising and taking into account the foreign law issues resulting from the proposed rules.

* * * *

We would be pleased to respond to any inquiries regarding this letter or our views on the Proposed Audit Standard generally. Please feel free to contact either Richard Godden or Jason Manketo in London on +44 207 456 2000.

Very truly yours



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²⁸ Article 7(e) and Article 13(f) of the Data Protection Directive. Sensitive personal data, as always, would remain a problem, but in many cases a way around the problem could be found, particularly if the derogation powers in Articles 8(4) and 8(5) of the Data Protection Directive are utilised. However, this would require action by EU legislators or regulators, as non-EU regulators cannot take advantage of these provisions.

²⁹ Docket Matter No. 013, Release No. 2003-024.

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Appendix 1

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Memorandum

31 March 2003

To Office of the Secretary of the PCAOB

From Linklaters

Direct Line 020 7456 2750

Legal Implications for Foreign Accountancy Firms in consequence of Registration with the PCAOB under the Sarbanes-Oxley Act 2002

1 Introduction

We have been instructed by the Big Four accountancy firms (the "**Firms**") to draft a report highlighting areas where there are significant potential conflicts between the requirements of the proposed rules giving effect to the Sarbanes-Oxley Act 2002 (the "**Act**") and the laws and regulations of jurisdictions outside the United States (the "**Report**"). These potential conflicts arise from the requirement for Firms which carry out audit or audit related work on behalf of companies which have reporting obligations to the Securities and Exchange Commission (the "**SEC**") to register with the Public Company Accounting Oversight Board (the "**PCAOB**") and to comply with the rules and regulations imposed by the PCAOB, pursuant to the provisions of the Act.

This memorandum is intended to address the PCAOB's request in its Release No. 2003-1 dated 7 March 2003, for potential conflicts to be identified.

In the time available, it has not been possible to conduct a comprehensive review of a large number of territories affected by the Act. A more limited survey has therefore been undertaken, focusing on a representative cross-section of territories in order to provide the PCAOB with an indication of some of the significant issues with which the Firms are faced. The jurisdictions that participated in our review are the United Kingdom, Germany, Japan, Israel, Switzerland, Mexico and, in respect of certain issues, France and Brazil.

We have considered each area of potential conflict, highlighting legal restrictions which create obstacles to the compliance of Firms outside the United States with the obligations of the Act and examples of sanctions that will be applicable where such restrictions are breached. Potential exceptions which may legitimise compliance with the Act's requirements have also been identified. Clearly, we would expect that further work and dialogue between relevant authorities will be required to resolve potential conflicts.

2 Executive Summary

- 2.1 There is significant potential conflict between the Act and the laws and professional regulations within those jurisdictions surveyed, including in relation to data protection, confidentiality,

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employment, bank secrecy and the extent to which a foreign legal obligation can be enforced. The effect of this would be to prevent full compliance with the requirements which the Act places on Firms to disclose information upon registration with the PCAOB or pursuant to requests for testimony or the production of documents made by the PCAOB¹.

2.2 The conflicts identified can be summarised as follows:

- 2.2.1 **Confidentiality** – all of the jurisdictions raised issues of confidentiality. The duty of confidentiality between a Firm and its client is very strict and places significant restrictions on a Firm disclosing any client or third party information which has become known to it during the course of business. Furthermore, a duty of confidentiality also arises in the context of disclosure of employee data.
- 2.2.2 **Data Protection** – data protection legislation in some of the jurisdictions surveyed prohibits the disclosure of personal data to the PCAOB and the transfer of such data into a jurisdiction which is not considered to have an equivalent level of data protection, unless relevant exceptions apply.
- 2.2.3 **Legal Enforcement** – all of the jurisdictions raised issues in relation to the PCAOB conducting inspections of a Firm's operations and practice. These issues relate to national sovereignty and consequential restrictions on extraterritorial enforcement of foreign legal obligations.
- 2.2.4 **Employment Liability** – some of the jurisdictions raised employment liability issues in relation to the requirement under the Act for Firms to agree to secure consent from all associated persons regarding compliance with requests for testimony. In particular, these issues will arise where a Firm makes it a term of an employee's employment to provide such consent, it being a ground for dismissal where they refuse.
- 2.2.5 **Banking Secrecy** – some of the jurisdictions have banking secrecy legislation which requires banks, their officers and employees to keep secret the identity of their clients and details of their relationship with them. This raises particular concerns where a Firm has banking clients.
- 2.2.6 **Official Secrets** – some of the jurisdictions have rules that exist to protect national security which prevent unauthorised disclosure of certain information to protect the state from espionage. In such cases, conflicts with the Act will arise where a Firm has in its possession documentation of relevance to national or economic security.

¹ Section 102 (b) (3) of the Act

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- 2.3** Most of the relevant jurisdictional laws and regulations are expressed in general language, in particular the various exceptions to provisions which conflict with the Act's requirements. The existence or extent of a conflict will to a large extent depend on how such language is interpreted. A sympathetic court or regulator may use the flexibility provided by such general language to reconcile any potential conflict between the local and United States requirements. Conversely, a court or regulator that was not so predisposed may find a real conflict. Simply relying on these potential interpretations raises risks which are not insignificant. These risks include exposure to criminal and civil liability.
- 2.4** Obtaining express consent from relevant individuals may provide a way around the potential conflict between the United States and local requirements to the extent that such requirements arise in relation to Firms' clients, who would presumably give their consent. However, consent only deals with some of the issues and does not provide a means of overcoming all conflicts:
- 2.4.1** in France, for example, prior consent of the client would not release a Firm from criminal and civil disciplinary sanctions where they breach obligations of client confidentiality;
 - 2.4.2** in Switzerland, prior consent of a client would not release a Firm from criminal liability where they are in breach of the anti-espionage legislation, which is broadly applied, making it an offence to make available business information to a foreign authority where it is deemed not to be in the interests of the Swiss Confederation;
 - 2.4.3** in some jurisdictions, such as the United Kingdom, Germany and Japan, consent given by certain individuals, especially employees, may not be valid and in the United Kingdom and Germany would not in any event override the privilege against self-incrimination;
 - 2.4.4** the PCAOB, as a result of its broad powers under the Act, may request the disclosure of or, in the course of an inspection, become aware of information which contains personal details relating to individuals not connected to clients who are SEC registrants or issuers and who would not therefore be similarly motivated to consent to the disclosure;
 - 2.4.5** in some territories (for example, Switzerland) restrictions on extraterritorial enforcement of legal obligations cannot be overcome by consent of the Firm.
- Similarly, drawbacks exist in relation to other potential exceptions including disclosures made in the public interest or required by a legal obligation.
- 2.5** In light of these conclusions, it seems desirable that the Firms discuss these matters further with relevant government and regulatory bodies in the United States and in their respective jurisdictions in order to identify an acceptable way forward.

3 Data Protection

3.1 Restrictions

Many of the jurisdictions we surveyed have data protection or privacy legislation in place which will pose significant restrictions on a Firm's ability to disclose information to the PCAOB.

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Essentially, data protection legislation seeks to regulate the use of “personal data”,² which means data (this may include electronic and manual data) relating to an identifiable individual (a “data subject”). The various laws impose certain obligations on an entity which collects and controls the use of the personal data (“data controller”) and, more importantly in the context of the Act, there are significant restrictions on who that personal data can be disclosed to.

Data Protection legislation in the European Union is based on the Directive on the protection of individuals with regard to the processing of personal data and on the free movement of such data (95/46/EC) (the “EU Data Protection Directive”). The EU Data Protection Directive has been implemented in the various EU member states in broadly the same fashion, although it is worth noting that significant variations exist between member states that are free to implement stricter requirements if they wish.

Data protection legislation is not limited to the EU and there are many other jurisdictions that have legislation setting out similar requirements to the EU Data Protection Directive, such as Switzerland³, Israel⁴, Japan⁵ and Hong Kong⁶.

The most significant restrictions imposed by data protection legislation can be summarised as follows:

3.1.1 Restrictions on Disclosure

Disclosure of personal data to the PCAOB is prohibited unless a relevant exception applies (see further paragraph 3.3 below). This raises potential conflicts with the requirements under the Act including those which:

- (i) compel registrants to provide a list of all accountants associated with the Firm who participate in or contribute to the preparation of audit reports including the person’s name, social security number (or comparable non-United States identifier), and all license or certification numbers authorising the person to engage in the business of auditing or accounting⁷;
- (ii) compel registrants to reveal information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against any associated person of the Firm in connection with any audit report⁸;
- (iii) allow the PCAOB to demand from the registrants any other kind of information that the PCAOB has specified as necessary or appropriate in the public interest or for the protection of investors⁹; and

² In many jurisdictions personal data covers only data relating to identifiable living individuals, however, it is worth noting, that there are some jurisdictions, outside the scope of this submission that also regulate the processing of data relating to legal entities, for example, Italy.

³ Federal Act on Data Protection 1992.

⁴ The Privacy Protection Law 1981.

⁵ Japan is currently implementing data protection legislation. Our analysis is therefore based on the provisions of the draft legislation.

⁶ The Personal Data (Privacy) Ordinance.

⁷ Section 102 (b) (2) (E) of the Act.

⁸ Section 102 (b) (2) (F) of the Act.

⁹ Section 102 (b) (2) (H) of the Act.

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- (iv) entitle the PCAOB to require Firms to report more frequently than in its annual report in order to update its application and other information concerning the Firm and all accountants associated with the Firm¹⁰.

The disclosure requirements of the Act relate to employees, clients and third parties. Although certain information relating to the Firms' clients is not required per se as part of the process of registration with the PCAOB, the Firms are compelled to give their consent to co-operate in and comply with all requests for testimony or the production of documents made by the PCAOB¹¹. Such documents or information may relate to the Firms' clients or third parties, for example, copies of audit work papers. To be able to give such consent the Firms need to be in a position vis-à-vis their clients and any other third parties to justify such co-operation and disclosure.

It is clear from our survey that the disclosure of the information required by registration or in connection with the ongoing oversight of the PCAOB will be significantly restricted by data protection requirements in certain jurisdictions.

In the United Kingdom the first principle of the Data Protection Act 1998 ("DPA") requires that personal data be processed fairly and lawfully. To this end the disclosure of information to the PCAOB will only be permissible if one of the exceptions identified in paragraph 3.3 below apply. This is also the case under the German Data Protection Act 1990 (as amended in 2001).

Data which is classified as "sensitive personal data", pursuant to the EU Data Protection Directive, attracts a higher degree of protection from disclosure and the relevant exceptions are generally more difficult to satisfy (see further paragraph 3.3 below). The requirement under Section 102(b)(2)(F) of the Act to disclose information relating to offences or alleged offences or disciplinary proceedings will be categorised as sensitive personal data whether or not they are in the public domain.

3.1.2 Restrictions on Transborder Data Flow

Transfer of personal data to a jurisdiction which is not considered to provide an equivalent level of data protection is prohibited unless a relevant exception applies (see further paragraph 3.4 below). Of the territories surveyed, the United Kingdom, Germany, Switzerland and Israel¹² place such restrictions of the transfer of data outside their jurisdiction to the United States, which is not considered to have an equivalent level of data protection for these purposes. Similar restriction apply in respect of all EU Member States, Poland, Hong Kong and Canada.

3.2 Sanctions

Breaches of data protection legislation attract both criminal and civil sanctions, including exposure to regulatory fines and individual claims for damage and distress. In the United Kingdom, for example, a person would be criminally liable where they breached the Data Protection Act 1998 and failed to comply, or falsely purported to comply, with an enforcement notice issued by the

¹⁰ Section 102 (d) of the Act.

¹¹ Section 102 (b) (3) of the Act.

¹² The Privacy Protection (Transfer of Data Outside of Israel) Regulations 2001 set out this requirement for the transfer of *databases* outside Israel. Although information held by Israeli accountancy firms and requested by the PCAOB is unlikely to be classified as a "database" for these purposes, it is reasonable to assume that similar criteria will be applied by Israeli courts regarding the transfer of sensitive data outside Israel.

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Information Commissioner to remedy the breach. In Switzerland, a person who wilfully and without authority discloses sensitive personal data can be punished by fine or imprisonment¹³. The legislation in Germany and Spain also provides for criminal sanctions.

In addition, regulatory fines can be substantial. Although Spain is not one of the jurisdictions we surveyed, we are aware that the Spanish Data Protection Agency imposed a fine on Telefonica Espana of €840,000¹⁴.

3.3 Exceptions to Restrictions on Disclosure

The most relevant exceptions to the restrictions outlined above are:

3.3.1 Consent

Consent of the "data subject" in all the jurisdictions surveyed would permit Firms to disclose the requested data to the PCAOB without breaching the relevant data protection legislation.

In relation to the disclosure of "sensitive personal data", obtaining the explicit consent of the relevant individual is the only relevant exception.

The consent is not required from the corporate client¹⁵ but from each and every individual whose data is contained in the information to be revealed to the PCAOB.

Whilst it may be expected that clients who are SEC registrants or issuers would readily consent to the disclosure of their data to the PCAOB, it should be noted that:

- (i) the PCAOB, as a result of its broad powers under the Act, may request the disclosure of or - in the course of an inspection - become aware of information which contains personal details relating to individuals not connected to the SEC registrant or issuer clients and who would not therefore be similarly motivated to consent to the disclosure. This information may, for example, be contained in audit work papers. Obtaining the consent of all clients/third parties, including non-SEC listed clients/third parties would be a logistical challenge, if not practically impossible in some circumstances;
- (ii) gaining the consent of an issuer with whom a Firm has played a substantial role, rather than the main role, in respect of preparing or furnishing them with an audit report is also likely to be logistically challenging;
- (iii) even if given, consent can be withdrawn at any time;
- (iv) Firms are unlikely to have obtained the consent of certain data subjects, such as its employees, particularly given that most data collected about them will have occurred prior to the implementation of the Act. It is clear that obtaining such consents will involve substantial effort. For example, the information required by the PCAOB on criminal convictions in connection with audit reports relating to the

¹³ For these purposes sensitive personal data will be data relating to religion, political beliefs, trade union activities, health, race, social assistance or criminal records.

¹⁴ A subscriber had opted out of the use of his data for anything other than the provision of the telephony service for which he was subscribing. Despite this, Telefonica Espana proceeded to share that individual's data with one of its subsidiaries, Telefonica Data and the individual in question then reported Telefonica Espana to the Spanish Data Protection Agency.

¹⁵ Except where personal data is defined to include corporate data, such as under Italian data protection laws.

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Firm or "any person associated with" the Firm and dating back 10 years¹⁶, may pertain to a large number of individuals;

- (v) there is a real risk that in certain circumstances consent may not be regarded as legal, especially where such consent is required of employees. For consent to be valid, it must be freely given. For example, in accordance with the EU Data Protection Directive, the relevant United Kingdom and German implementing legislation requires that the consent must be "freely given, specific and informed".

Obtaining consent in the employment context – for example, from a Firm's employees – may be difficult to establish. In the United Kingdom and Germany, in accordance with the Article 29 EU Data Protection Working Party¹⁷, it has been questioned whether consent given in an employment context constitutes "freely given consent" as employees do not have the option to refuse their consent without possible adverse consequences.

It also remains questionable how a client's consent can be freely given if, without such consent, a client would not be able to retain a registered Firm.

It remains unclear how this requirement of "freely given consent" will be interpreted in respect to the disclosure obligations by accountants under the Act and whether the United Kingdom and German regulators will choose to take a pragmatic view of consents given by such highly-remunerated, well-informed employees and consider them to be legitimate. There has been no official view disclosed by regulators in either jurisdiction in this respect; and

- (vi) in relation to "sensitive personal data", it may be even more difficult to obtain valid consent in circumstances where potentially incriminating activities are being investigated: individuals are less likely to willingly consent to the disclosure of information relating to criminal actions pending against them.

3.3.2 Public Interest

The United Kingdom and Israel will allow disclosure of personal data to the PCAOB where the processing of such data is in the public interest. However, the interpretation of what is in the public interest is a question for the regulators and courts in each jurisdiction to decide.

It may be felt that this exception can be relied upon to legitimise the disclosure and inspections required by the Act in view of, amongst other things, the "public interest" nature of the Act and the harm it is intended to counter. However, to date "public interest" has been narrowly construed and it is unclear whether the obligations under the Act will be interpreted as being in the public interest of the local territory as well as the United States.

In the United Kingdom, for example, disclosure may be permitted where it is necessary "*for the exercise of any functions of a public nature exercised in the public interest by any person*" where a Firm can show that it is exercising a function of a public nature in the public interest. The definition of public interest has to date been narrowly interpreted by

¹⁶ Part V, item 5.1 of the PCAOB's proposed rules.

¹⁷ The working party set up pursuant to Article 29 of the EU Data Protection Directive. It is an independent advisory body whose opinions are not legally binding.

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the United Kingdom regulators and courts¹⁸ and there is no precedent for this exception being successfully relied upon in circumstances such as these.

Use of this exception in Israel is also questionable given that the public interest arguably relates to that of another jurisdiction.

As such, it remains unclear whether this exception can be relied on.

3.3.3 Compliance with a legal obligation

The data protection legislation in the United Kingdom, Germany, Israel and the draft data protection bill in Japan provide for disclosure of personal data where it is necessary for compliance with any legal obligation to which a Firm is subject.

However, this exception will not apply to foreign (in this case, United States) legal requirements. The Israeli Interpretation Law 1981 provides that this exception can only be defined as applying to an Israeli legal obligation and, similarly, under the Draft Data Protection Legislation in Japan, a legal obligation will not include that of a foreign jurisdiction. Likewise, United Kingdom and German Data Protection Legislation makes it clear that this exception will only apply to local legal obligations.

3.3.4 Whilst it may be felt that a court or regulator in the relevant jurisdiction would strive to reconcile a potential conflict between United States and local laws and recognise United States legal requirements, it must be recognised that a court or regulator may find it difficult to do so without opening the floodgates to laws of other jurisdictions

3.3.5 Legitimate Interests

In the United Kingdom and Germany, in accordance with the EU Data Protection Directive, disclosure is permitted if it is necessary for the legitimate interests pursued by a Firm or by the third party or parties to whom the data is disclosed, except where the processing is unwarranted in any particular case by reason of being overridden by the rights and freedoms or legitimate interests of the individual.

It may be deemed surprising, in the current circumstances, that certain disclosures will be overridden by the rights and freedoms or legitimate interests of the data subjects. However, the United Kingdom or German regulator or court may take a different view. For example, blanket disclosures of information relating to disciplinary actions (however small) pending against a Firm or associated person would undeniably be prejudicial to an individual who had committed a disciplinary or other offence.

Each individual case would need to be considered on its own facts to determine whether an overriding interest of the data subject exists, prohibiting that particular disclosure of personal data. With this in mind it is clear that this exception may well enable disclosure in certain circumstances but could not be used as blanket permission without risking a breach of the applicable data protection legislation in either jurisdiction.

3.3.6 Other

Under the Israeli Privacy Law, disclosure to the PCAOB would be allowed where it took place in the ordinary course of business of the Firm and there was going to be no

¹⁸ The United Kingdom Information Commissioner, who enforces the Data Protection Act 1998, may in future take a wider view of "public interest" in light of the definition that will be adopted under the Freedom of Information Act 2002 – however, this is only an informed view.

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publication of the data. However, it remains unclear to what extent the delivery by Firms of certain personal data to the PCAOB is in the ordinary course of their business. Furthermore, this exception would not apply where the PCAOB may make available information published which has not been granted confidential treatment.

3.4 Exceptions to the Restrictions on Transborder Data Flow

The following are the relevant exceptions which may apply to legitimise transfer of personal data to the PCAOB in the United States:

3.4.1 Consent

The data subjects give their consent. The EU Data Protection Directive provides that this consent must be unambiguous, which will normally need to be express and in writing. Note that this exception is distinct from the possibility of legitimising disclosure more generally by the use of consent, although the same caveats relating to consent as identified in paragraph 3.3.1 above apply.

3.4.2 Transfer necessary for reasons of public interest

This exception is set out in the EU Data Protection Directive and is therefore relevant for Member States of the EU, although the same caveats apply relating to what will be deemed by each jurisdiction as being in the public interest as identified in paragraph 3.3.2. Furthermore, it is worth noting that this exception is even more restrictive than the exception identified in paragraph 3.3.2 above.

3.4.3 EU Model Clauses

These clauses enable a Firm based in an EU Member State and registered with the PCAOB to agree to transfer the data on the basis of the EU model contractual clauses as approved by the European Commission which, if adhered to by the relevant foreign authority (i.e. the PCAOB), would justify the transfer of personal data to the PCAOB. These would be put in place between Firms and the PCAOB.

3.4.4 Bespoke Contract

The EU Data Protection Directive enables a Firm based in an EU Member State and registered with the PCAOB to agree to transfer the data on the basis of individually drafted contractual clauses which would need to be approved by data protection authorities. The aim of such contracts would be to ensure that the PCAOB has in place adequate data protection procedures to ensure the security of the data transferred. . In addition, if onward public disclosure of the personal data in the United States, which has not been granted confidential treatment, is not contractually restricted, the data protection authorities may not approve the contract.

Alternatively, this exception may be fulfilled by the Firms/the European Commission and the PCAOB entering into bilateral/multilateral arrangements. Indeed, the opinion of the Article 29 EU Data Protection Working Committee is for relevant regulators to enter into a dialogue to reach an acceptable compromise. However, a recent resolution of the European Parliament has created doubt as to the validity of this approach¹⁹.

¹⁹ In March 2003, the European Parliament rejected an agreement between the European Commission and United States immigration services in relation to the transfer of passenger records pursuant to the requirements of the United States Aviation and Transportation Security Act 2001. The European Parliament considered this agreement lacked legal basis.

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Swiss data protection legislation also provides that a transfer of personal data to the PCAOB may take place if the transferor (the Firm) and the recipient (the PCAOB) of the personal data enter into a contractual agreement whereby the recipient undertakes to follow the requirements of Swiss Data Protection Legislation. For example, such an agreement would have to provide for the duty to keep the personal data confidential. In addition, the Swiss Data Protection Legislation specifically provides that the data may not be disclosed to any other authorities. Furthermore, the data subjects must have knowledge of the data transfer; otherwise the transfer has to be notified to the "Eidgenössischer Datenschutzbeauftragter" ("Federal Data Protection Mandatee").

3.4.5 European Commission finding of "adequacy"

Article 25 of the EU Data Protection Directive mandates the European Commission to determine if data to be transferred to third parties will be protected in an "adequate" fashion. This has not yet been done in respect of data transfers to the PCAOB and, if it were to be considered in the future, the European Parliament would have to decide whether the data protection arrangements in place are adequate. Again, the extent to which the information which has not been granted confidential treatment, can be ring fenced from onward public disclosure in the United States, is likely to be relevant to any assessment of adequacy. Further, this exception applies only to EU Member States and would not assist in the other jurisdictions.

4 Confidentiality

4.1 Client Confidentiality

In all the jurisdictions that we surveyed, the duty of confidentiality between a Firm and its client is very strict. As well as being set out in various laws and regulations in each jurisdiction the requirement of confidentiality may also be implied or expressly set out in the contract or engagement letter each Firm has with its client. These requirements lead to potential conflict with the requirements of the Act relating to the disclosure of client information, in particular pursuant to the PCAOB's ongoing oversight role (see further paragraph 3.1.1 above).

These requirements lead to a potential conflict with those Sections of the Act which: compel registrants to provide the names of certain issuers for which the Firm has prepared or issued audit reports and the annual fees received from such issuers by the Firm²⁰; compel registrants to give their consent to co-operate in and comply with all requests for testimony or the production of documents made by the PCAOB²¹; allow the PCAOB (i) to conduct inspections at the registrants in relation to selected audit and review arrangements and (ii) to evaluate the audit, supervisory and quality control procedures of the registrant²²; and allow the PCAOB to conduct an investigation of any act, practice, or omission to act by a registered Firm²³.

In France, Article L225-240 of the French Commercial Code provides that auditors and their assistants and expert advisers shall be bound by professional secrecy as regards all acts, events and information of which they may have become aware in the course of their duties.

²⁰ Section 102 (b) (2) (A), (B) of the Act

²¹ Section 102 (b) (3) of the Act

²² Section 104 (d) of the Act

²³ Section 105 (c) (1) of the Act

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Article 321 of the Swiss Penal Code provides a general secrecy duty on certain professionals including accountants. This will protect all information which the Firms' clients want to keep confidential where it has become known to the Firms in their professional capacity. This provision will be breached regardless of whether the information is revealed orally, for example by giving testimony, in writing or by furnishing the PCAOB with copies of the documents containing the information. Furthermore, the Swiss anti-espionage legislation, which is broadly applied, makes it an offence to make available business information to a foreign authority where it is deemed not to be in the interests of the Swiss Confederation (please see paragraph 8 below for further details).

Likewise, Article 27 of the Japanese Law concerning Certified Public Accountants 1948 prohibits any accountants from disclosing their clients' secrets, which they gained during the course of business, to a third party or making use of them for the accountants or a third party's benefit without due reason. The Code of Ethics established by the Japanese Institute of Certified Accountants provides that accountants will have "due reason" where they have obtained the client's consent or are complying with a legal obligation in Japan.

In Germany, a similar requirement is set out in Section 9 of the Accountants' Professional Articles of Association. Also, Section 323 of the German Commercial Code and Section 43 of the Accountants Ordinance trigger the accountant's duty to keep information confidential. The accountant's duty of confidentiality is far reaching and includes all circumstances the accountant (i) was made aware of by the client and (ii) became aware of during the provision of professional services to a client. To this end, the name of and the amount of fees paid by a client are confidential information. In Germany, in addition to a duty to keep information confidential, an accountant has the right to refuse to testify in civil, criminal and administrative proceedings.

In Mexico, the Law of Professions 1945 provides a general obligation on any person holding a professional qualification, including accountants, to keep "in strict secrecy the matters conferred upon them by clients". In addition, a Code of Ethics of the Mexican Institute of Public Accountants ("MIPA") reinforces this requirement via Principle VI which sets out an obligation on accountants to keep confidential all data relating to their client practice.

In the United Kingdom the duty of confidence is reflected in the Institute of Chartered Accountants in England and Wales ("ICAEW") Members Handbook. There is a general duty to keep all information confidential, not merely to take all reasonable steps to do so, subject to certain exceptions identified in paragraph 4.4 below. Moreover, it is not just a duty not to communicate the information to a third party, it is a duty not to misuse the information, not to make any use of it or to cause any use of it to be made by others otherwise than for the client's benefit without the consent of the client. This includes a duty not even to disclose the client's name and a duty not to provide an account of facts that could identify any particular client. Confidentiality also extends to third parties from or about whom information has been received in confidence.

4.2 Employee Confidentiality

It is apparent that in some jurisdictions confidentiality obligations will not only arise in relation to the relationship a Firm has with a client but also in an employee context. These requirements lead to a potential conflict with the Sections of the Act which: compel registrants to reveal information relating to criminal, civil, or administrative actions or disciplinary proceedings pending against any associated person of the Firm in connection with any audit report²⁴; and compel registrants to give

²⁴ Section 102 (b) (2) (F) of the Act.

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their consent to co-operate in and comply with all requests for testimony or the production of documents made by the PCAOB²⁵.

In the United Kingdom, the employment relationship gives rise to an implied duty of confidence between the employer and the employee. Information held by an employer, such as details of disciplinary proceedings, may be regarded as confidential to the employee. The disclosure of such confidential information would constitute a breach of confidence and a breach of the implied term of trust and confidence.

Likewise, in Germany as a result of the employer's duty of care, an employer is, as a matter of principle, obligated to keep personal data confidential in order to safeguard the personal rights of an employee. Therefore, the disclosure of personal data, such as the employee's salary or other relevant employee data required by the PCAOB, could violate the personal rights of an employee.

4.3 Sanctions

There are various sanctions that may be imposed where this duty of confidentiality is breached. It is clear that in many jurisdictions a natural person acting on behalf of a Firm is punishable personally. In Japan, for example, an individual accountant who is in breach of this obligation may be imprisoned or fined JPY 1 million. In Switzerland, breach of the requirements under Article 321 of the Penal Code is punishable by up to three years imprisonment or a fine and, in addition, the Firm may be liable for damages in certain circumstances. In Germany, any illegitimate disclosure by an accountant of a client's confidential information is a criminal offence pursuant to Section 203 of the German Penal Code (Strafgesetzbuch) and Section 333 of the German Commercial Code and is subject to fines and imprisonment of two years maximum. In addition, a breach of Principle VI of the Code of Ethics in Mexico could technically lead to the expulsion of that Firm from MIPA.

The breach of professional secrecy by a French auditor is a criminal offence sanctioned by imprisonment of up to one year and a fine of up to € 15,000²⁶. In addition to criminal sanctions, the breach of professional secrecy by a French auditor would lead to disciplinary sanctions and possible civil liabilities. Most importantly, the prior consent of a client for the disclosure of information may prevent the auditor from potential civil liabilities vis-à-vis such client, but would not release the auditor from criminal and disciplinary sanctions, as professional secrecy is deemed a core and essential obligation of the profession and is required by law. In Germany, Section 203 of the Penal Code provides that a certified public accountant who discloses a client secret without authorisation may be imprisoned for up to one year or fined up to €1,800,000. Furthermore, in accordance with the German Accountants Ordinance they may be excluded from the profession.

Where there has been a breach of the obligations of confidentiality to an employee in the United Kingdom or Germany an employee could seek an injunction from the courts to prevent the disclosure of such confidential information. In the United Kingdom, the disclosure of information to the PCAOB in breach of an injunction would constitute contempt of court, the penalty for which is a fine and/or imprisonment.

4.4 Exceptions

4.4.1 Consent

²⁵ Section 102 (b) (3) (A) of the Act.

²⁶ Article L226-13 of the French Penal Code)

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In most of the jurisdictions surveyed, obtaining client consent to disclosure of confidential information would permit the disclosure of information to the PCAOB. However, the same caveats apply as set out above in paragraph 3.3 and the limitations on consent in France should be noted (see paragraph 4.3 above).

In Mexico, for example, there would be no breach of Mexican law where an authorised officer of the client provided the Firm with an acknowledgement that (i) it is an issuer reporting to the SEC; (ii) that it is subject to reporting obligations to the PCAOB pursuant to the Act; and (iii) that it will require its external auditors to register with, comply with the requirements of and report to the PCAOB in accordance with the Act.

It is worth noting that, in the United Kingdom at least, obtaining the consent of an employee to overcome the issues of confidentiality will not override the privilege against self-incrimination (see paragraph 5 below).

In Switzerland, prior consent of a client would not release a Firm from criminal liability where they are in breach of the anti-espionage legislation, which is broadly applied, making it an offence to make available business information to a foreign authority where it is deemed not to be in the interests of the Swiss Confederation (please see paragraph 8 below).

Finally, where banking secrecy obligations apply (please refer to paragraph 6 below) the consent of both the bank and third parties (i.e. the clients of the bank) whose information is also disclosed would be required. Obtaining such consents will be a huge logistical challenge and may, in some circumstances, be impossible.

4.4.2 Public Interest

In the United Kingdom, paragraph 13 of Statement 1.306 of the ICAEW Members Handbook states that a member is free to disclose information that would otherwise be confidential, where such disclosure is justified in the public interest, although the same caveats apply relating to what will be deemed as being in the public interest as identified in paragraph 3.3.2. The Members Handbook states that, whilst the concept of public interest is recognised by the courts, no definition has ever been given. However, the ICAEW expressly recognises that the public interest exception is narrow and the courts have tended to view the public interest defence very strictly, in that it applies where there is a real need for disclosure, such that the duty of confidentiality would be contrary to public policy.

A distinction may therefore need to be made between disclosures given in respect of *specific* requests by the PCAOB (e.g., in relation to suspected criminal activity) and disclosures given in respect of *general* ongoing requests by the PCAOB (e.g., in relation to annual notification of the names of all the issuers for which the Firm has prepared audit reports). In relation to the former, it is arguable that disclosure is in the public interest. In relation to the latter, we do not believe that disclosure will be in the public interest as only certain categories of data are likely to be relevant to any particular public interest.

4.4.3 Legal Obligation

In some jurisdictions, for example the United Kingdom and Japan, the obligation of confidentiality will not be breached where disclosure is carried out in compliance with a legal obligation.

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In the United Kingdom, for example, paragraph 20-21 of Statement 1.306 of the ICAEW Members Handbook permits disclosure if authorised by statute. However, in respect of non-governmental bodies (which the PCAOB would likely be defined as), paragraph 22 states that members should not comply with bodies' requests without client consent.

In addition, in respect of suspected breaches of foreign law, paragraph 78 of Statement 1.302 of the ICAEW Members Handbook states that if a member becomes aware of contraventions by his client of foreign law he is under no duty in English law to disclose the matter to the relevant foreign authority regardless of whether he may be under such a duty in foreign law. In the current context, we would agree.

A disclosure required by statute is therefore likely to be restricted to a local statute and, in the absence of an obligation to disclose information to a United States regulator, would not permit disclosure in this case.

5 Employment Law Liability

5.1 Compliance with requests for testimony

In certain jurisdictions, including the United Kingdom, Germany and Japan, the requirement under the Act for Firms to agree to secure consent from all associated persons regarding compliance with requests for testimony and the production of documents could give rise to employment law liabilities and in particular, liability for unfair dismissal.

In order to obtain such consent, Firms would in practice need to make offers of employment conditional upon this consent being obtained. In the event that a Firm makes it a ground for dismissal to refuse such consent, and an employee is dismissed or leaves his or her employment as a result, it is likely to face employment liability in the United Kingdom²⁷ and Germany.

However, in the United Kingdom, even if consent is obtained, employees may have the right to refuse to testify or disclose documents on the grounds of the privilege against self-incrimination. Under English law the principle of privilege against self-incrimination provides that a person shall not be coerced by the exercise of state power to convict himself/herself of a crime or expose himself/herself to any criminal penalty. If the PCAOB is an "emanation of the state", any associated person required to disclose information could refuse to disclose such information on the grounds of privilege against self-incrimination if the disclosure would incriminate the individual under English law.

Similarly, in Germany, even if the employees' consent can be obtained, the employer cannot fully rely on such consent. According to mandatory provisions of German law, an employee cannot be required to disclose criminal convictions to the employer, unless the conviction is registered in the Federal Central Register of previous convictions (which only applies for severe crimes) *and* the conviction is relevant for the specific occupation of the employee. Furthermore, in accordance with Section 383 of the German Civil Procedure Act and Section 53 of the Criminal Procedure Act accountants have the right to refuse to testify in administrative proceedings in civil, criminal, tax and administrative proceedings.

²⁷ In the United Kingdom, for example, the Firm is likely to face employee claims of unfair dismissal.

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5.2 Suspension of Employees

In certain territories, the PCAOB's powers under the Act to suspend or bar an individual from being associated with a Firm gives rise to certain employment law issues.

In Germany any notice of termination of employment given by a Firm is void unless such notice is justified under the Protection from Dismissal Act.

Under English law any sanction imposed on an employee must be proportionate to the employee's act or omission. Therefore, if an accounting Firm dismissed an employee following an order from the PCAOB, an employment tribunal could rule that the dismissal was a disproportionate sanction and unfair. In addition, in the United Kingdom, if an employee is dismissed for refusing to disclose documents and is protected by the privilege against self-incrimination, the dismissal will be unreasonable and therefore unfair. The failure to carry out a fair disciplinary procedure can also give rise to a breach of the implied duty of trust and confidence under English law owed by an employer to an employee, leading to damages for breach of contract.

6 Banking Secrecy

6.1 Restrictions

Some of the jurisdictions we surveyed have banking secrecy legislation which requires banks and their officers and employees to keep secret the identity of their clients and the details of their relationship with them. This will be particularly relevant where a Firm has banking clients.

In Switzerland, for example, Article 47 of the Banking Act protects information about the clients of Swiss banks, including their names and the mere fact that a certain person is a client of a bank. This obligation is also set out in the Federal Act on Stock Exchanges and Securities Trading in relation to clients of securities dealers and participants of the stock exchange. Both pieces of legislation will specifically apply to a bank's auditors. Disclosure of information required by the Act would result in a breach of the banking secrecy legislation. There are also obligations in Mexico for auditors of a financial institution. In addition, although not part of the jurisdictions that we surveyed, we are aware that similar legislation exists in Luxembourg and Brazil. The Brazilian constitution establishes in Article No. 5, item XII the concept of banking secrecy, which is further regulated by Law no. 105²⁸ which applies to the secrecy of transactions carried out by financial institutions.

6.2 Sanctions

A breach of Swiss banking secrecy legislation is a criminal offence punishable by up to six months imprisonment or a fine. Infringement of banking secrecy legislation in Luxembourg is also subject to criminal sanctions and may lead to civil liability and regulatory sanctions. Furthermore, breach of banking secrecy obligations in Brazil may result in criminal liability of up to four years imprisonment.

6.3 Exceptions

In Switzerland and Brazil the consent of the banks and their clients will be required and in Mexico it will be necessary to obtain the consent of the National Banking and Securities Commission. Again, however, similar caveats exist with regard to such consent as set out in paragraph 3.3.1

²⁸ Enacted on 10 January 2001

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above. The process of obtaining the consent of the bank's clients in both Switzerland and Brazil will be a huge logistical challenge and may, in some instances, be impossible.

7 Legal Enforcement Issues

All the jurisdictions surveyed raised issues in relation to the PCAOB conducting inspections of a Firm's operations and practice. These issues relate to restrictions on extraterritorial enforcement of legal obligations and, in some territories (for example, Switzerland), the issues cannot be overcome by consent of the Firm.

In Germany, for example, even if the PCAOB carries out an inspection on German territory with the agreement of the concerned Firm, issues of German sovereignty arise. In principle, foreign governmental authorities have no right to carry out acts of state, such as an inspection of the business of a Firm, on German territory without the permission of the government.

In the United Kingdom, Israel and Japan, if the PCAOB wanted to conduct an inspection of a Firm, it would in practice only be able to do so where the Firm is prepared to cooperate. One would expect such cooperation to be given. However, where the Firm is not prepared to cooperate, an order from a competent United States court to inspect a Firm will not in principle be endorsed by a competent United Kingdom, Japanese or Israeli court. The situation would be different where there existed parallel powers between regulators, but this is not the case here.

In Switzerland, Article 271 of the Penal Code forbids without the approval of the competent authorities, on the Swiss territory, the performance of all acts in favour of a foreign state (or a foreign organisation) that are normally performed by state authorities. In such circumstances, it is highly probable that the PCAOB qualifies as a foreign organisation and that, generally speaking, requests and subpoenas by the PCAOB to produce personnel for questioning or to give testimony, to produce and furnish copies of working papers and to submit other information, as well as inspections of a Firm's operations would constitute acts that are normally performed by state authorities. Indeed, the PCAOB could be viewed as part of the authorities protecting United States investors, a function which, from the Swiss perspective, is in principle a governmental one. Thus, such acts are forbidden under Article 271 of the Penal Code.

Since Article 271 protects Swiss sovereignty, the consent of a private person, including the audit client, cannot exempt those performing obligations on behalf of a foreign state from punishment. This approach is mandatory and cannot be bypassed to allow for direct requests or subpoenas from the PCAOB and the officers of the PCAOB and, possibly the employees of the Firm who respond to such requests, could be subject to imprisonment of between three days and twenty years. However, where a request has been made pursuant to the rules of international judicial assistance or with the authorisation of the competent Swiss authority, the respective Firm may, voluntarily, make the required disclosures to the PCAOB.

In Mexico, similar issues of sovereignty arise and, under the bill of rights section of the Constitution²⁹ a person cannot be mandated to follow a conduct other than by a "competent authority". For these purposes, a Mexican Court is unlikely to consider the PCAOB to be a competent authority.

²⁹ Articles 14, 16 and 17

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8 Official Secrets

8.1 Restrictions

In the United Kingdom³⁰ and Germany rules exist to protect national security which prevent unauthorised disclosure of certain information to protect the state from espionage etc. Occasionally, a Firm will have sensitive documentation of relevance to national security in its possession and these restrictions will apply.

Similar restrictions apply in Israel where, under the General Security Service Law 2002, a government agency known as the General Security Service has been established for the purpose of protecting national security and is responsible for the protection of certain sensitive information, as determined by the Israeli Government. The holder of such information is required to handle it in accordance with regulations enacted by the Prime Minister. Again there will be circumstances where a Firm holds information that is subject to these restrictions, for example, where a Firm acts as auditor for defence contractors (and we note that a number of such companies are publicly traded in the United States securities markets), it may well be subject to these restrictions.

The anti-espionage legislation³¹ in Switzerland is broadly applied making it an offence to make available business information to a foreign authority where it is deemed not to be in the interests of the Swiss Confederation. Given that these provisions are aimed at protecting the confidentiality of the Swiss Confederation rather than private individuals, prior consent of a client would not release a Firm from criminal liability where they are in breach.

8.2 Sanctions

In the United Kingdom, where a Firm is subject to the Official Secrets Act 1989, a person will be subject to criminal sanctions where he discloses any information, document or other article relating to security or intelligence which is or has been in his possession during the course of his work.

Breach of the Swiss anti-espionage legislation is a criminal offence punishable by three days to twenty years in prison.

³⁰ The Official Secrets Act 1989

³¹ Article 273 of the Penal Code

From: Michael Howard [MHoward@auditor.state.oh.us]
Sent: Monday, December 01, 2003 4:11 PM
To: Comments
Subject: Docket 012

Having worked with GAAS for 30 years and GAGAS for 24, I believe the GAGAS standard of documentation is appropriate.

Specific comments:

--I suggest the PCAOB define the firms' budget and time summaries and their internal payroll records as being subject to this rule. If work was performed and paid for by the clients, then there should be documentation in the working papers supporting that work done and conclusions reached. Without access to those BATS and payroll records, the reviewers may not know that such work was performed. Firms are reluctant to share that data with reviewers, however, I would consider it essential to the PCAOB's work.

--Footnote 3 - under what circumstances does the Board contemplate there being no report? Auditor withdrawal from the engagement? I think you could better define the date of "substantial completion" by reference to some known date, such as the firm's indicated date of withdrawal.

--Paragraph 16: these files could be huge. Is the Board speaking of other independent auditors, which is the subject of your other proposed rule? Specialists may not share all their work with the firm - did you contemplate having those somehow kept by the firms too? If so, how?

--This proposed rule and the other one both refer to AICPA AU sections. This could make it cumbersome to change your rules if the AICPA edits those sections. I suggest you consider either quoting those sections, if legally possible, or put a date on them, such as "AU sec 543 [12/01/03]".

These are my comments, and do not necessarily reflect the views of the Auditor of State of Ohio.

L. Michael Howard
12/1/03

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Chief Auditor
Accounting & Auditing Support
BETTY MONTGOMERY
Auditor of State
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January 20, 2004

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

RE: PCAOB Rulemaking Docket Matter No. 012
Proposed Auditing Standard, *Audit Documentation*
Proposed Amendment to Interim Auditing Standards, *Part of Audit Performed by Other Independent Auditors*

Dear Mr. Secretary:

McGladrey & Pullen, LLP is pleased to submit written comments on the proposed auditing standard, *Audit Documentation* and the proposed amendment of interim auditing standards, *Part of Audit Performed by Other Independent Auditors*. McGladrey & Pullen, LLP is a registered public accounting firm serving middle-market issuers. We support the PCAOB's efforts to improve the quality of audits and generally support its proposals to strengthen existing audit documentation standards. However, we do have the following comments and suggestions for your consideration:

PROPOSED AUDITING STANDARD, *Audit Documentation*

Paragraph 5.b.

In recognition of the fact that reviews - like audit procedures - may be performed over a period of time, we suggest replacing "the date of such review" with "the date such review was completed".

Paragraph 8

The second sentence of this paragraph would cause a reference to central repositories to be included in the audit documentation on each and every audit engagement. We believe that requirement creates a costly and unnecessary administrative burden, with no corresponding improvement in the overall quality of audit documentation. We suggest this sentence be deleted.

Paragraph 15

This paragraph would require that evidence obtained or documentation added after engagement completion indicate the date the information was added, by whom it was added and the reason for adding it. Paragraph 13 defines the date of completion of the engagement to be the date of the auditor's report, or

if no report is issued, the date that fieldwork was substantially completed. Paragraph 14 requires that a complete and final set of audit documentation be assembled for retention within 45 days after the auditor first grants permission to use his or her report in connection with the issuance of the financial statements.

Hypothetically, an auditor might complete fieldwork on February 20 and first grant permission to use his or her report on March 16. Under that scenario, the auditor would have until April 30 to assemble a complete and final set of audit documentation. However, any evidence obtained or documentation added after February 20 would need to indicate the date the information was added, by whom it was added and the reason for adding it. Often, significant activities (including engagement review activities) occur subsequent to the substantial completion of audit fieldwork and the date of the auditor's report. We believe that it is only necessary to indicate the date the information was added, by whom it was added and the reason for adding it for evidence obtained or documentation added after the auditor first grants permission to use his or her report.

In addition, paragraph 15 states that audit documentation must not be deleted or discarded. During the course of fieldwork, an auditor frequently accumulates audit documentation that is ultimately determined to be unnecessary and would not otherwise be required to be retained under the requirements of the proposed standard. We believe that, prior to the date the auditor first grants permission to use his or her report, he or she should be permitted to delete or discard information that he or she determines to be irrelevant or superfluous.

Paragraph 16

We see no reason that a multi-office firm using more than one office of the firm to perform an audit should be required to retain all audit documentation in the office that issued the report. As long as the offices are in the same firm, they would be subject to identical audit methodologies and quality control policies and procedures, and this requirement would represent an unnecessary and costly administrative burden. We will comment separately on how this requirement might apply to audit documentation prepared by other firms (including affiliated firms) in our comments on the proposed amendment.

Paragraph 18

Although some would argue that the proposed standard should not require a lengthy implementation period, the proposed date of engagements completed after June 15, 2004 is not reasonable. As a practical matter, many such engagements may have already commenced. Firms need a reasonable amount of time to incorporate changes in auditing standards into their audit methodologies, to train their staff, and to implement the standards on procedures performed in advance of year-end. As a result, it is extremely difficult for firms to comply with changes in auditing standards earlier than approximately nine months from the date they are issued. Based on the expected timing of the issuance of this standard, we believe it would be much more reasonable to require implementation for audits of financial statements for periods beginning after December 15, 2003.

PROPOSED AMENDMENT TO INTERIM AUDITING STANDARDS, *Part of Audit Performed by Other Independent Auditors*

We agree that a principal auditor who assumes responsibility for the work of another auditor (including an affiliate) and decides not to make reference to the other auditor's work or report should have an obligation to review the other auditor's audit documentation to the extent necessary to provide reasonable assurance that such documentation meets the requirements of the PCAOB's standards. However, it is neither necessary nor practicable for the principal auditor to review the audit documentation of the other auditor to the same extent and in the same manner as the audit work performed by all those who

participated in the engagement. At most, the engagement and concurring partners should be required to review the audit documentation of the other auditor to the same extent and in the same manner as they would review the audit documentation of work performed in similar circumstances (based on an evaluation of audit risk, materiality, etc.) by another office of their firm. In addition, the proposed standard should acknowledge that the engagement and concurring partners might need to delegate some of their review responsibilities to others who possess a sufficient understanding of the applicable language and business environment. Finally, because auditing standards make no clear distinction between supervision and review, and the extent and manner of review procedures performed is largely a matter of audit judgment, it would not be practicable for an auditor to review all work (whether performed by the engagement office, another office in the firm, or another firm) to the same extent and in the same manner.

In the case of affiliated firms, common audit methodologies and quality control processes, including inspection, could also mitigate the need to review the work to the same extent and in the same manner. We are a member firm of RSM International, an affiliation of separate and independent legal firms. RSM International has made significant investments in common methodologies and processes and our firm has participated in the oversight of other members' inspection programs for several years. We believe that the proposed amendment does not give appropriate recognition to the safeguards over audit quality that result from these types of activities.

Similarly, we believe other less costly (and equally effective) alternatives exist to the proposed requirement that the principal auditor incorporate such documentation into his or her documentation. For example, the principal auditor could be required to obtain the other auditor's agreement to comply with the PCAOB's audit documentation standard, including the document retention standard, and to grant the principal auditor and the PCAOB access to the audit documentation.

We do not believe it would be reasonable to expect auditors to comply with the proposed amendment for audits of financial statements for engagements completed on or after June 15, 2004. At the very earliest, we suggest that the proposed amendment be effective for audits of financial statements for periods beginning on or after December 15, 2003. In any event, we believe that the implementation of the proposed standard should be delayed until a reasonable period of time after all significant legal issues related to the registration and inspection of foreign firms have been resolved. Principal auditors domiciled in foreign countries may need an even longer period to comply with the proposed amendment.

Thank you for the opportunity to comment on the proposed standard and the proposed amendment. Questions concerning our comments should be directed to Bruce Webb, National Director of Auditing (515.281.9240) or Leroy Dennis, Executive Partner – Audit & Accounting (952.921.7627).

Very truly yours,





National Association of State Boards of Accountancy

150 Fourth Avenue North ♦ Suite 700 ♦ Nashville, TN 37219-2417 ♦ Tel 615/880-4201 ♦ Fax 615/880/4291 ♦ dcostello@nasba.org

David A. Costello, CPA
President & CEO

January 9, 2004

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

VIA E-mail to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 012
PCAOB Release No. 2003-023, November 21, 2003
(Proposed Auditing Standard on Audit Documentation and
Proposed Amendment to Interim Auditing Standards)

Dear Board Members:

We appreciate the opportunity to offer comment to the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) on its proposed auditing standard on audit documentation and its proposed amendment to interim auditing standards. The Board is considering the proposed standards for adoption and submission to the Securities and Exchange Commission (the “Commission” or the “SEC”) pursuant to the Sarbanes-Oxley Act of 2002 (the “Act”).

As stated in our other letters of comment, the National Association of State Boards of Accountancy’s (NASBA’s) ongoing primary focus is upon rules and policies relating to enforcement (including the collection of information that will facilitate enforcement in appropriate cases), with special attention to fostering federal/state cooperation. We believe that close cooperation and a working partnership of the PCAOB and the SEC with NASBA and the State Boards will result in more effective regulatory efforts than otherwise would be achieved. We are pleased that the Commission Orders approving PCAOB rules for a registration system and PCAOB rules relating to compliance with auditing and related professional practice standards and advisory groups encouraged “continued close cooperation” between the PCAOB and state regulatory bodies.

Our Professional & Regulatory Response Committee offers the following comments on the proposed release:

Reviewability Standard. The Board’s proposed standard would require that “audit documentation contain sufficient information to enable an experienced auditor (reviewing auditor), having no previous connection with the engagement, to understand the work that was performed, who performed it, when it was completed, and the conclusions reached.”

We suggest that the proposed requirement specify that in addition to being experienced, the auditor should possess relevant knowledge of the industry or business. Given the complexity of many industries, the level of documentation required to provide sufficient background to someone lacking relevant industry knowledge, could go beyond to what is necessary to adequately document the audit work performed.

Office of the Secretary
Public Company Accounting Oversight Board
January 9, 2004
Page 2 of 2

Rebuttable Presumption. The release indicates that, “The Board contemplates that oral explanation alone would not constitute persuasive other evidence and invites comment on the addition of such a requirement to the proposed standard.”

We believe that there may be limited circumstances in which only oral explanation could subsequently be presented to support the results of an audited procedure or judgment when there is criticism of non-performance. While we agree that these instances would be unusual and would not overcome a lack of documentation, we believe that an absolute prohibition on oral explanation of evidence should not be added to the standard.

Retention of Audit Documentation. “The proposed standard would add a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after the auditor’s report is released. Such reasonable period of time ordinarily should not exceed 45 days.”

We support this requirement but suggest that 60 days might be a more reasonable period of time.

Subsequent Changes to Audit Documentation. We agree with the proposal that subsequent changes to the working papers should be properly documented. We suggest that the standard make it clear that the requirement to provide such documentation of changes should commence after the 60-day period allowed to assemble the work papers has expired.

Multi-Location Audits. “The proposed standard would require that sufficient audit documentation, including documentation of work performed by others, be retained in the office issuing the auditor’s report.”

We believe that requiring that audit working papers be physically retained in the office of the issuing auditor is unnecessary and inefficient. The requirements should be that the issuing office must have the right to obtain and have access to all work papers necessary to issue the report. We agree with the Board’s goal that all audit documentation be prepared consistently with the same standards of audit quality. However, we believe that this should be accomplished through the establishment of proper documentation procedures within a firm in accordance with professional requirements and the firm’s quality assurance program.

Using the Work of Other Auditors. Consistent with our comment on multi-location audits above, we believe that the principal auditor should not be required to maintain a complete set of working papers when relying upon the work of another firm. However, the principal audit firm must satisfy themselves that they can rely upon the work of the other audit firm and this should be properly documented in their working papers. There must also be procedures to ensure that all working papers are properly maintained and available in accordance with professional standards and the rules of the Board.

NASBA is pleased to provide these comments and would be happy to answer any specific questions you might have.

Sincerely,



David A. Vaudt, CPA
Chair



David A. Costello, CPA
President & CEO



National State Auditors Association

January 20, 2004

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

RE: PCAOB Rulemaking Docket Matter No. 012

Dear Mr. Seymour:

On behalf of the National State Auditors Association, we appreciate the opportunity to respond to the PCAOB's proposed auditing standard, *Audit Documentation*, and proposed amendment to the interim auditing standard, *Part of Audit Performed by Other Independent Auditors*.

We generally agree with the proposed standard and related amendment regarding audit documentation. We believe that the guidance in the proposed standard will assist auditors in determining the appropriate nature, timing, and extent of audit documentation. The proposed standard establishes minimum levels of acceptable documentation that we believe will provide for more uniform evidence of audit work among practitioners.

The PCAOB, in its summary of the proposed standard, specifically invited comments on the rebuttable presumption provision and the proposed implementation date. Following are our comments on these two issues.

Rebuttable Presumption

In general, we agree with paragraph 6 of the proposed standard that states that auditors should document procedures performed, evidence obtained and conclusions reached. However, we are concerned with the presumption that conclusions that are not adequately documented are not suitably supported. We believe there is a difference between not having done the testwork and not having adequately documented the conclusion. For example, a situation could arise where audit procedures were applied and documented, evidence was obtained and documented, and no exceptions were noted but the auditor did not document a conclusion. In this example, we believe the notion of rebuttable presumption would prevail (i.e., the conclusion was suitably supported although the conclusion was not documented). If this is not the intent of the Board, we believe the Board should provide clarification of this provision by providing examples.

We are also uncertain how evidence can be persuasive for providing sufficient support for the conclusions reached if it is not part of written audit documentation. We believe the Board should elaborate in the proposed rule examples of "persuasive other evidence" and how this type of evidence rebuts the presumption that procedures were not applied, evidence was not obtained, and the conclusions reached were not suitably supported when it was not part of audit documentation.

Effective Date

We believe that the implementation date should be changed from "*completed on or after*" to "*beginning on or after*". An audit that was planned to have ended prior to the proposed June 15, 2004 implementation date but unforeseeably ending after June 15, 2004 would potentially not be in compliance with the standard. The date itself could be made sooner so that the standard could take effect sooner if that is the desire of the Board.

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R. KINNEY POYNTER
Lexington, Kentucky

We do offer several other comments below which we believe would add clarification to the proposed standard and ask the Board to consider these suggestions as it finalizes this standard.

Paragraph 5.b – We have observed that, in practice, some audit organizations require those who perform the work, or those supervisors who review the work, to sign and date each working paper or audit document, while others note such responsibilities only on lead schedules or audit documentation folders. This has been a subject of discussion and disagreement, including during peer reviews. To clarify this requirement, we recommend the Board clearly identify the minimum level of documentation, for example a) at the lead schedule or file level, or b) for each working paper and audit document. This could be easily incorporated as a footnote to paragraph 5.b.

Paragraph 6 – We believe the Board should consider replacing “suitably” with “adequately” in the second sentence of this paragraph.

Paragraph 12 – The examples in the last sentence seem to imply that this particular documentation requirement relates only to significant findings or issues relating to the audit team or between the audit team and its consultants. It seems equally important to document these issues as they relate between the audit team and the auditee. If the Board also expects the auditor to document information about significant findings and issues relating to differences between the audit team and the auditee, this paragraph should be revised to reflect that expectation.

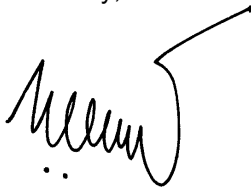
Paragraph 14 – The use of the phrase “grant permission to use the auditor’s report” is not terminology consistent with current standards or practice for financial statement audits, and has not been defined here. For clarity and consistency in how auditors implement this requirement, we recommend the Board revise the proposed standard to remove the references to “granting permission to use the auditor’s report” and instead, refer to “the release or issuance of the auditor’s report(s),” which better conforms to practice and the reality of what auditors currently do.

Paragraph 16 – It is unclear whether the requirements of this paragraph expect the principal auditor to retain audit documentation of the work of only those other auditors who the principal auditor does *not* make reference to in his or her report, or to *all* documentation of the work of other auditors, including those that the principal auditor relies upon and refers to in the principal auditor’s report. We believe the Board should clearly describe the level of documentation to which this requirement applies.

In those cases in which the principal auditor refers to the other auditors in the principal auditor’s report, we believe that the principal auditor should only have to retain the other auditor’s *report* being referenced, and not the entire set of audit documentation of those other auditors. To require retaining more than the auditor’s report defeats the reasons for referring to other auditors’ reports. It also establishes little difference between the two choices a principal auditor has, when in fact, the differences in the level of responsibilities to the principal auditor is substantial.

We appreciate the efforts of the Board and the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact Sherri Rowland of NSAA at (859) 276-1147 or me at (217) 782-3536.

Sincerely,



William G. Holland
President, NSAA

new york state society of

NYSSCPA

certified public accountants

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January 20, 2004

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By e-mail: comments@pcaobus.org

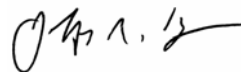
Re: Proposed Auditing Standard on Audit Documentation and Proposed Amendment to
Interim Auditing Standards

PCAOB Release No. 2003-023
PCAOB Rulemaking Docket Matter No. 012

The New York State Society of Certified Public Accountants, the oldest state accounting association, representing approximately 30,000 CPAs, welcomes the opportunity to comment on the Proposed Auditing Standard referenced above.

The NYSSCPA Auditing Standards and Procedures Committee deliberated the Proposed Auditing Standard and prepared the attached comments. If you would like additional discussion with the committee, please contact Margaret Wood, chair of the Auditing Standards and Procedures Committee, at (212) 542-9528, or Robert Colson, NYSSCPA staff, at (212) 719-8350.

Sincerely,



Jeffrey R. Hoops
President

Attachment

new york state society of

NYSSCPA

certified public accountants

530 fifth avenue, new york, ny 10036-5101
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**COMMENTS ON PCAOB PROPOSED AUDITING STANDARD ON
Audit Documentation and Proposed Amendment to Interim Auditing
Standards**

PCAOB Release No. 2003-023

PCAOB Rulemaking Docket Matter No. 012

January 20, 2004

Principal Drafters

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NYSSCPA Staff

Robert H. Colson

New York State Society of Certified Public Accountants
Comments to the PCAOB
Release No. 2003-23
Docket Matter No. 12

General Comments

This proposed rule will improve the quality of audits. The proposed rule is an improvement over SAS 96 because it is more clearly written in plain English and clarifies the auditor's obligation for documentation. Adopting the documentation approach of Generally Accepted Government Audit Standards and the rebuttable presumption that the failure to document work indicates that the work was not performed are consistent with the NYSSCPA's recommendations to the Regents of the State University of New York when they revised New York State's document retention rules (see attachment).

A glossary of terms would improve the proposed rule. Among the terms it would be beneficial to include are: "rebuttable presumption", "experienced auditor", "date of the auditors' report", "persuasive other evidence" as used in paragraph 6, "central repository", "significant contracts or agreements", "significant" as used in paragraph 9, "completion of the engagement" as used in paragraph 15, "engagement completion memorandum" as used in paragraph 10, "post-issuance procedures", "inspection" as used in paragraph 11, and "complete and final set of audit documentation" as used in paragraph 14.

Specific Comments

- Paragraph 9 – Disclosure changes. This paragraph should address in detail the changes in disclosure proposed by the auditor.
- Paragraph 9.d – Disagreements among audit team members. Clarification is needed about when a difference of opinion constitutes an unresolved disagreement between fully informed individuals rather than a difference caused by incomplete or different information.
- Paragraph 10 – Engagement completion memorandum. Clarify if this document is meant to be an executive summary, an index of where to find significant findings and issues, or an exhaustive discussion of the audit.
- Paragraph 11 FN 2 – Items tested. Clarify that audit sampling must follow a statistically valid method.
- Paragraph 11 FN 2 – Footnote. Consider placing the content of this footnote in the body of the rule by adding subparagraphs to paragraph 11, similar to the treatment in paragraph 9. The content of the footnote is not incidental or merely explanatory, but contains sufficient substance to be part of the body of the rule.

- Paragraph 12 – Inconsistent or contradictory findings. See the comment to paragraph 9.d above. Clarification is required in order not to burden the audit file with issues that might arise because of insufficient or incorrect knowledge of the facts and circumstances.

- Paragraph 15 – Subsequent additions to audit evidence. In addition to defining “completion of the engagement” in the glossary of terms suggested in the general comments, clarify whether there is a difference between the “completion of the engagement” and the “date of the auditors’ report”. The last day of field work may not be the best date for the “completion of the engagement” or the “date of the auditors’ report”. A more reasonable time would be the date when the financial statements and disclosures are completed.

- Paragraph 16 – Retention of audit documentation in the issuing office. This requirement may pose significant practical difficulties when dealing with audit documentation originating in foreign countries, such as documentation in the foreign language.

- Part of Audit Performed by Other Independent Auditors – An Amendment to Interim Standards. There may be significant practical issues in obtaining the required documentation on a timely basis.

Attachment to PCAOB Comments on Docket Matter No. 012



August 29, 2002

Mr. Daniel Dustin
Executive Secretary, State Board for Public Accountancy
NYS Education Department
Office of the Professions
Second Floor East Mezzanine
89 Washington Ave.
Albany, NY 12234

In Re: File No. S7-22-02

By email: Cpabd@mail.nysed.gov

Dear Mr. Dustin:

The New York State Society of Certified Public Accountants, the nation's oldest state accounting association, represents approximately 30,000 CPAs, many of whom would be affected by an amendment to the Rules of the Regents of the State University of New York, **Work Paper Documentation and Retention Proposal**. The NYSSCPA is grateful for the opportunity to comment on the proposed rule.

The NYSSCPA Task Force for Public Accountability drafted the attached comments. Members of the task force would be pleased to meet with you for additional discussion about the comments. Please contact the task force chair Vincent J. Love at (212) 338-0600 or NYSSCPA Staff Dennis O'Leary at (212) 719-8418 if such a meeting would be helpful.

Sincerely,

Jo Ann Golden
President

Attachment

Ec: Johann Duncan-Poitier

new york state society of

NYSSCPA

certified public accountants

530 fifth avenue, new york, ny 10036-5101

www.nysscpa.org

**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

COMMENTS ON

NYS Board of Regents Proposed Rule:

Work Paper Documentation and Retention

Principal Drafters

**Brian Caswell
Allen Fetterman
Dan Goldwasser
Vincent J. Love**

August 29, 2002

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**NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC
ACCOUNTANTS**

Task Force on Public Accountability Comments On

**NYS Board of Regents Proposed Rule on
Work Paper Documentation and Retention**

General Comments

Documenting audit evidence and retaining it for a reasonable period are essential components of CPAs' responsibility to the public interest, and it makes good business sense. Although the seven-year requirement is longer than the longest statute of limitation (6 years), and could be a burden on small practices, it is consistent with the Sarbanes-Oxley Act and justifiable in promoting public interest.

The proposed rule, however, should focus only on the statutory responsibility of CPAs for audits and on their other attestation engagements. The proposal rule's treatment of working paper documentation and retention for non-audit and non-attestation services is not only inappropriate but also detracts from the proposed rule's effectiveness. The standards of evidence for tax documentation and other services, which are properly set by the tax authorities and other regulatory and self-regulatory authorities, differ dramatically from the professional standards for audit evidence documentation.

The proposed rule should adopt by reference professional standards related to the definition and purpose of audit working papers. The adoption of CPA professional standards' definition for audit documentation would clarify whether the proposal covers client records (owned by the client), accountant working papers that support client records (owned by the accountant, but available to the client), and accountant work product (owned by the accountant). In addition, the incorporation of professional standards by reference would maintain the state rules at the most current standard without additional rule making.

Specific Comments

1. The proposed rule should reference the documentation requirements in Generally Accepted Auditing Standards (GAAS) as delineated in the Statements on Auditing Standards (SAS) and, where applicable, in Generally Accepted Government Auditing Standards (GAGAS). These standards encompass the definition of audit documentation (working papers) and the nature of evidence supporting audit conclusions.

2. Failure of the audit documentation to meet professional standards should raise a presumption that audit standards were not met. This presumption should be a rebuttable presumption affecting the burden of proof relative to those portions of the audit that are not documented as required. The standard of the burden of proof should be a preponderance of the evidence.
3. Audit documentation should be maintained for the longer of the following:
 - a) Seven years, which should be extended during any period of board investigation, disciplinary action, or legal action involving the licensee or the licensee's firm.
 - b) A period sufficient to satisfy professional standards and to comply with applicable laws and regulations.
4. There is no need to require a written documentation and retention policy because the proposed rule sets the standards that must be followed whether or not there is a written policy.
5. In addressing non-audit attestation engagements, the proposed rule should reference the documentation requirements in the General Standards, the Statements on Standards for Attestation Engagements, and the Statements on Standards for Accounting and Review Services, for the reasons stated above. Any evidential material required by those standards should be documented in the same manner and retained for the same period as audit documentation.
6. Substantive alteration should be defined as changes to audit documentation that alter
 - a) the nature, timing, extent, and results of the audit procedures performed,
 - b) the evidence obtained,
 - c) the conclusions reached or the reasons therefor, or
 - d) the identity of the persons who performed and reviewed the work.
7. The issues of secure retention of electronic files addressed in Section 29.10 (iv) (d) should also apply to files maintained in other media.

PIERCY BOWLER TAYLOR & KERN

Certified Public Accountants • Business Advisors

January 8, 2003

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

Re: PCAOB Rulemaking Docket Matter No. 012
Release No. 2003-023

Ladies and Gentlemen:

We are pleased to have the opportunity to offer our comments to the Public Company Accounting Oversight Board (referred to hereinbelow as PCAOB or the Board) specifically in response to its request regarding its Proposed Auditing Standard, *Audit Documentation*. Subject to our comments, detailed in the succeeding paragraphs, we believe, in general, that the proposed standard represents a significant and appropriate forward step in the standardization of audit documentation when compared to the current standard set forth in Statement on Auditing Standards No. 96, *Audit Documentation* (AU Sec. 339). SAS 96 affords little more than guidance as to what an auditor should consider documenting, while the proposed standard contains solid requirements.

For ease of reference, we have numbered the substantive paragraphs in the remainder of this letter.

Overriding Concerns

1. While we agree that SAS 96 permits too much auditor discretion as to the nature and extent of audit documentation required to reasonably assure achievement of its objectives, and that a more rigid standard is, therefore, appropriate, we nevertheless believe that the proposed auditing standard goes too far in some significant respects in eliminating both opportunities and obligations to apply sound professional judgment. We draw this conclusion largely based on the following facts and circumstances:
 - a. The nature and extent of documentation that is retained in an audit file typically has been (and should be, in our opinion) influenced in some significant respect, based on advice from attorneys, by a defense strategy to be employed in the event of civil litigation, an ever increasing risk to auditors in today's environment, despite the recent Congressional and regulatory efforts to improve audit quality. In this regard, while we believe that audit documentation should contain all information necessary in the auditor's judgment to support one's audit report, including evidence of the exploration of relevant material that may support alternative conclusions, if any, we do not believe that an auditing standard should require an auditor to retain erroneous, irrelevant or superseded material that can serve no useful purpose other than as a roadmap to enable an adversary to attack the auditor or successfully thwart his or her defense.

- b. In its proposed Rule 3101 (and in the Statement of Authority preceding each PCAOB standard), unlike its predecessor, the Auditing Standards Board, the PCAOB has carefully defined and uses terms like *must*, *shall*, and *is required* to indicate “unconditional obligations,” which, if not discharged, constitute violations of PCAOB Rule 3100. As pointed out in footnote 4 to proposed Rule 3101, the Sarbanes-Oxley Act of 2002 provides that any violation of the Board’s rules is to be treated for all purposes as a violation of the Securities Exchange Act of 1934, or the rules and regulations issued thereunder, and will expose the violator to the same penalties, and to the same extent, as many other violations of the federal securities laws, thus effectively criminalizing alleged violations of PCAOB rules and standards that may be merely the product of good faith differences in judgments or inadvertent. Accordingly, although we believe the use of such terms as *must*, *shall*, and *is require*, as defined, is warranted in some circumstances, we also believe Board should be extremely judicious in such use. (Specific examples of this concern follow below in paras. 7 and 10-12.)

Objectives of Audit Documentation

2. We noted that para. 3d of the proposed auditing standard lists among the implied objectives of audit documentation to provide for review of audit work by a successor auditor. Although perhaps beyond the scope of the proposed auditing standard, as presently envisioned, we also noted that the predecessor standards (now collectively referred to pursuant to PCAOB Rule 3200T as *Interim Auditing Standards*) have provided for successor responsibilities but never placed any professional responsibilities on predecessors to communicate with successors in connection with auditor changes. We believe that it would serve the investing public’s best interests for the Board to adopt (perhaps in a different release) enforceable requirements for predecessor auditors to share information with successors.

Content of Audit Documentation

3. In the introductory portion of Release No. 2003-023, the Board refers to what it calls a proposed “reviewability” standard that would include the substance of the General Accounting Office’s (GAO) documentation standard (*Government Auditing Standards*, § 4.22), which requires that audit documentation include, among other things, evidence that supports the auditors’ *significant judgments* and conclusions. We note that the reference to *significant judgments* in the GAO standard is conspicuously absent from para. 5a of the proposed PCAOB auditing standard, and we believe it should be inserted in the final version.
4. In addition, while adequate for governmental audits, because (as pointed out by the Board in the introductory portion of Release No. 2003-023) the requirement embodied in § 4.22 of the GAO standard serves primarily to enable experienced GAO auditors to complete their reviews efficiently, in the more diverse world of risks and other complexities that are inherent in private-sector, corporate financial reporting, a reviewer who is merely *experienced* should not be expected to complete the review effectively, regardless of the quality of the documentation. To be qualified to conduct the review, a reviewer should have to have *appropriate*, often industry-specific, experience. Auditors should not be burdened by the standard with an obligation to create documentation sufficient to overcome a reviewer’s lack of sufficient specific experience as may be appropriate for the assignment. Accordingly, we recommend that the word, *appropriately*, be inserted in the final version of the proposed auditing standard to modify the word, *experienced*, and that explanatory language be added (perhaps in a footnote) as to how the word, *appropriately*, should be interpreted.
5. Para. 5b of the proposed auditing standard would require that the audit documentation permit one “to determine who performed the work and the date such work was completed **as well as the person who reviewed the work and the date of such review.**” [Emphasis added.] We believe there is wide

diversity in practice particularly with regard documentation of the extent of the review. It is not clear whether the emphasized words (a) are intended to require a reviewer to sign and date every work paper reviewed, (b) would permit a reviewer to sign off on groups of related work papers, or (c) would permit a single signoff on a quality control checklist. Except for our views with respect to concurring reviewers as indicated in para. 6, hereinbelow, we believe alternative (b) to be both adequate and most practical among the three choices. It is also not clear whether the proposed requirement would be limited in its applicability only to a "primary" responsible reviewer or whether and how the requirement might apply to multiple levels of review. For example, would the proposed documentation standard require a concurring reviewer to document the specific matters selected for review by the concurring reviewer and when they were reviewed? We believe that if the intent of the proposed auditing standard includes reasonable standardization of the nature and content of audit documentation, then we also believe that these matters should be clarified in the final version.

6. To govern the performance of concurring reviews, PCAOB Rule 3400T adopts, as part of the *Interim Quality Control Standards*, the requirements of *SEC Practice Section Reference Manual* (SECPSRM) § 1000.08(f) (which, in turn, incorporates Appendix E (SECPSRM § 1000.39). Appendix E states that the concurring reviewer's responsibility "is not the equivalent of the audit engagement partner's responsibilities" and points out that a concurring reviewer "generally is not in a position to make the informed judgments on significant issues expected of an audit engagement partner." While certain items in the work papers are specified by Appendix E as requiring review, it states, in effect, that the extent of review of other documentation is a matter of the concurring reviewer's professional judgment. We believe that if the requirement in para. 5b of the proposed auditing standard were to be clarified to require that all individual work papers reviewed be signed and dated, and that such requirement be extended to multiple levels of review, including the concurring reviewer, it will have the undesirable effect of making the concurring reviewer accountable for the scope of his or her review. This will significantly change the character of the concurring review and likely cause the concurring reviewer to accept *de facto* responsibilities equal to that of the engagement partner, despite the reviewer's less intimate contact with and knowledge of the engagement. Therefore, it will likely cause the scope of concurring reviews to escalate beyond reason, for self-protective purposes. Not only will this add time and costs to audits, but it will also likely impair the ability of accelerated filers to meet the more stringent filing deadlines that apply to them. We do not believe that such a change is warranted and recommend that the final version of the auditing standard clearly set forth that a single sign-off on an appropriate conclusion (negatively expressed), such as provided for in SECPSRM § 1000.39¹, should be adequate with regard to the concurring review.
7. Para. 9 of the proposed auditing standard requires auditors to document, among other things, *significant findings or issues*, which term is defined also in para. 9. In contrast, para. 10 of the proposed auditing standard requires that auditors "**must identify all significant findings or issues ...**" [emphasis added]. Because it is rooted in the imprecise word, *significant*, the definition of *significant findings or issues* is inherently, and therefore necessarily, highly subjective. (In fact, six out of eight of the examples of *significant findings or issues* listed in para. 9, which are characterized as not all-inclusive, also include the word *significant*.) When a subjective term such as significant is coupled (as in para. 10 of the proposed standard) with word like *must*, as defined (see para. 1b, hereinabove), and *all*, it makes auditors extremely vulnerable to second guessing and causes them unwarranted exposure to unduly severe consequences in the form of civil liability, regulatory penalties and even criminal charges.

¹ Such a conclusion would state that based on performance of the required procedures, no matters came to the reviewer's attention that would cause him or her to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects or that the firm's audit was not performed in accordance with generally accepted auditing standards, except as set forth in the audit report.

Rebuttable Presumption

8. Para. 6 of the proposed auditing standard states that failure to “document the procedures performed, evidence obtained, and conclusions reached,” and that “failure to do² so creates a presumption that the procedures were not applied, the evidence was not obtained, and the conclusions reached were not suitably supported. This presumption is rebuttable by persuasive other evidence that the procedures were applied and the evidence was obtained to provide sufficient support for the conclusions reached.” The Board explains in the introductory portion of Release No. 2003-023 that this language was intended to represent the substance of California's statute on audit documentation.
9. We firmly believe that the California statute was ill-conceived and hastily drafted, that it inappropriately pre-judges facts and circumstances and denies auditors their rights to a fair consideration thereof in a court of law and, accordingly, that it should not be used as a model for other legislation or regulation. Moreover, we believe it is entirely inappropriate for a professional standard effectively to predetermine for a court the relative value of evidence that may come before the court, which predetermination is inherent both in the establishment of such a rebuttable presumption in the proposed auditing standard and in what we perceive to be extremely prejudicial language set forth, not in the body of the proposed standard, itself, but only in the introductory portion of Release No. 2003-023, that is, that “the Board contemplates that oral explanation alone would not constitute persuasive other evidence.” (Interestingly, this is the only matter about which the Board specifically requested comment.) We believe a court or other judicial body should have the discretion to freely consider and evaluate the relative weight and credibility of evidence brought before it without the influence of a standard-setting body that has not had the opportunity to hear the relevant facts and circumstances in the case. We believe a standard-setter's influence should extend only to the *performance* of professional services.

Retention of Audit Documentation

10. Para. 14 of the proposed auditing standard would require that the audit documentation must be assembled for retention within a “reasonable period of time” after the auditor's report is released, and prescribes without qualification that reasonable “ordinarily *should* not exceed 45 days” [emphasis added]. We observe that under proposed Rule 3101 (see para. 1b, hereinabove), the term *should* describes what is deemed to be a *presumptively mandatory obligation*. A *presumptively mandatory obligation* is almost as mandatory as one characterized with the word *must*, except that it permits certain exceptions, provided the auditor accepts the burden of demonstrating “by verifiable, objective, and documented evidence” that certain specified objectives were adequately met by alternative means. However, the meaning of the term *should* is significantly muddled in the cited instance by the modifier *ordinarily* thus making it virtually impossible to ascertain if the Rule 3101 justification burden applies.
11. We believe the seasonal and extreme deadline and economic pressures inherent and growing in the professional practice of auditing and other services typically offered by audit firms no longer permit auditors the luxury of carrying excess staff beyond the immediate needs of providing client services. We, therefore, believe that the need to get assigned staff out to uncompleted client engagements often must take priority over internal housekeeping needs. We also believe that this problem is often more severe in smaller firms such as ours, than in larger firms.
12. While we agree that final assembly should occur within a “reasonable period of time,” we believe it would be inappropriate to pre-judge a finite limit on what is reasonable in any given circumstances

² We believe that this can, and likely will, be interpreted, particularly by adversaries, as meaning “failure to *adequately* document ...”.

and, therefore, inappropriate to correct the inconsistency pointed out in para. 10, hereinabove, with an inflexible standard of 45 days. In fact, we believe that, based on circumstances, such a limit may be unreasonable as often as it is reasonable. We also believe that any failure to achieve the objective of this provision of the proposed standard when, in fact, the audit file in question was "buttoned up" in something more than 45 days, should not cause the auditor to be exposed to consequences as severe as criminal charges, regulatory penalties (for violating Rule 3100) or even onerous defensive justification burdens. Accordingly, we request that the words, "ordinarily should not exceed 45 days" be replaced in the final version of the proposed standard with an expression that would more clearly not qualify under Rule 3101 as a *presumptively mandatory obligation*, for example, "is ordinarily expected not to exceed 45-60 days, depending on the circumstances."

Subsequent Changes to Audit Documentation

13. Para. 15 of the proposed auditing standard would prohibit the deletion of any audit documentation after the period described in para. 14 thereof. It does not specify whether such documentation could or should be marked clearly as superseded and referenced to any replacement material, as we believe would be advisable to prevent confusion and undue reliance should this proscription survive the final version of the proposed auditing standard. We, however, request that the Board consider our overriding concern as expressed in para. 1a, hereinabove, and ultimately conclude that the final standard should not require an auditor to retain erroneous, irrelevant, superseded material that can serve no useful purpose other than as a roadmap to enable an adversary to attack the auditor or successfully thwart his or her defense.

Minor Editorial Point

14. Para. 2 of the proposed auditing standard states that "Audit documentation also may be referred to as *work papers* or *working papers*." We recommend that the commonly used, one-word version, *workpapers*, also be included in this sentence.

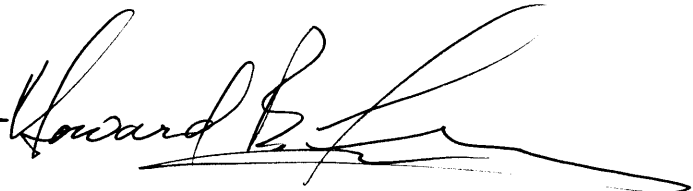
* * * * *

We hope we have clearly articulated our significant concerns about the proposed standard and that the Board will accept our recommendations. However, if there are any questions, please contact either of the undersigned.

PIERCY BOWLER TAYLOR & KERN



L. Ralph Piercy, President and
Managing Shareholder



Howard B. Levy, Senior Principal and
Director, Technical Services
(Former member, Auditing Standards Board)



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January 20, 2004

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

Re: PCAOB Rulemaking Docket Matter No. 012, Proposed Auditing Standard – Audit Documentation, and Proposed Amendment to Interim Auditing Standards – Part of Audit Performed by Other Independent Auditors (PCAOB Release No. 2003-023, November 21, 2003)

Dear Mr. Secretary:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the proposed auditing standard, *Audit Documentation*, and the proposed amendment to the interim standards, *Part of Audit Performed by Other Independent Auditors* (collectively referred to as “the proposed standard”), that have been circulated for comment by the Public Company Accounting Oversight Board (the “Board”).

An assessment of the quality of an audit necessarily involves an evaluation not only of audit documentation but also, and equally or perhaps even more important, matters such as the audit process and execution, audit judgments and the qualifications of the auditor. Considered in that context, some provisions in the proposed standard would advance that goal of audit quality and those we fully support. A few proposed provisions, however, would do little to advance that goal and might actually undermine it. Those few provisions should not, we believe, be adopted. At the very least, we urge the Board to consider other alternatives before doing so.

To summarize, we believe:

One, A rebuttable presumption standard is workable only if it applies exclusively to PCAOB proceedings to avoid impinging on the jurisdiction of the courts and other governmental bodies as well as to ensure that judges and juries who are not experienced auditors have all relevant evidence available to them and have the freedom to assess its importance. (Section A1 below.)

Two, A rebuttable presumption standard should be fully rebuttable. Auditors consider oral evidence; PCAOB inspectors should likewise be free to consider whether and to what extent oral evidence is relevant to their determination of audit quality. (Section A2 below.)

Three, Requiring principal auditors in multi-jurisdiction engagements to perform another review of the workpapers created and maintained by another firm (affiliated or not) to the same extent as they review their own would result in a delay in getting information to the investing public and an inefficient and ineffective—yet costly—duplication of effort because of, for example, language barriers. (Sections B and B1 below.)

Four, We understand that there are significant legal issues and potential difficulties in making certain information from outside the US available in the US to US regulators. Those issues vary country to country but, on an overarching basis, appear to relate to client, customer, supplier and employee confidentiality as well as professional legal duties. These issues should, we believe, be addressed in a direct, orderly and cooperative fashion with non-US firms and regulators, rather than indirectly through a documentation standard directed at the improvement of audit quality and the quality of financial reporting. (Section B2 below.)

Five, Even assuming the legal obstacles noted above can be overcome, requiring the principal auditor to maintain the thousands upon thousands of electronic and hard copy pages of workpapers of other firms involved in an audit would result in administrative distractions and confusion about respective responsibilities, again with no significant improvement in audit effectiveness. (Sections B and B2 below.)

We address below in more detail these few provisions that we believe are seriously flawed and the bases for our views. Appendix A reflects our proposed alternatives which we ask the Board to consider. Appendix B presents our other comments on the proposed standard and concerns provisions for which we are requesting clarification of some item or modification of the language as currently drafted.

A. Rebuttable Presumption (Paragraph 6)

As noted above, we believe that a rebuttable presumption standard is workable only if (a) it applies exclusively to PCAOB proceedings and (b) the presumption is fully rebuttable. As currently drafted, the proposed standard could be read as intended to apply to any proceeding, including court proceedings, in which an auditor's work is subject to review. The release also states that the Board is considering adding a provision that would prohibit oral rebuttal. For reasons discussed below, that proposal will not work, is fundamentally unfair and will cause more harm than good. (Our proposed alternative is described in Appendix A.)

1. Applicability to PCAOB proceedings. At the outset, we assume that the PCAOB intends to apply the proposed presumption only to PCAOB proceedings. That assumption is based on our trust that the Board recognizes that any broader application would not only impinge on the jurisdiction of the courts or government agencies to establish rules of evidence but also would impair the ability of those who are unlikely to have audit training and experience (e.g., judges and juries) to understand the evidence, including workpapers, and to decide the many different kinds of factual and legal issues that may be in dispute. Assuming our assumption is correct—and that the PCAOB agrees that it would be unfair and illogical to hold audit workpapers to the same strict standard of evidence when reviewed by courts and jurors as when reviewed by PCAOB audit inspectors—we urge the Board to clarify this point in the proposed standard and avoid any possible future misinterpretations that could arise from its silence.

2. Fully Rebuttable. We also believe strongly that a rebuttable presumption standard for PCAOB inspections can work only if there are no limits on the type of rebuttal evidence that PCAOB inspectors may consider. The objective of inspectors and auditors should be the same—to improve audit quality. Documentation alone is not sufficient to ensure the quality of the work. Because an auditor's judgment must always be based on the facts as he or she knows them, an inspector can fairly review that judgment only when the inspector is aware of, and able to consider, these same facts. Just as auditors must be free to reach their own independent judgments based on the available audit evidence, so too PCAOB inspectors, drawing on their training and experience as auditors, must be free to do the same. Both auditors and inspectors must have the ability to determine what they consider to be important. To be clear: This does not mean that PCAOB inspectors would be required to credit or give any weight to oral

evidence, including explanations, that an auditor might offer. PCAOB inspectors instead would be free to weigh the evidence as they thought best. In some cases, PCAOB inspectors might choose not to give much weight to undocumented oral explanations. But that decision should be for the PCAOB inspector to make after reviewing all of the evidence.

To exclude oral evidence not only deprives an inspector of important information, but also creates an unfair presumption of distrust of what the auditor has to say and the ability of the auditor, consistent with due process notions, to explain what otherwise may not be a full or accurate portrayal of the facts. Oral evidence does not just fill in perceived holes. It also provides context, adds and supplements information, and may even rebut what others might think and say. We all recognize that many judgments are made by the auditor in the course of an audit—judgments about, for example, scope, accounting, people, integrity and controls. The record of examination is not a diary; not every thought process or context for those judgments is likely to be written down. To effectively assess audit quality—indeed, to promote the perceived objectivity and fairness of PCAOB procedures and judgments—the inspector must have the ability to consider what was not written down, in addition to what was.

In short, would an inspector be comfortable with a process which prevented him or her from considering other available material, albeit oral information? Based on our experience as peer reviewers, internally and externally, we doubt it.

For these reasons and in the interests of fundamental fairness, we oppose any proposed limitation on the discretion of PCAOB inspectors to consider any type of rebuttal evidence, including oral explanations.

Indeed, we believe it is appropriate to go one step further. We believe that documentation must be judged in the context of the entire audit. An isolated instance where audit work was performed, but documentation was not considered to be in accordance with standards or persuasive with regard to the matter at hand, should not necessarily result in a conclusion that the entire audit was not conducted in accordance with PCAOB standards. Rather, the significance and pervasiveness of documentation deficiencies should be considered in relation to the overall documentation of the audit. Accordingly, we believe that auditors should be allowed to cure documentation deficiencies noted on inspection that are not significant or pervasive by documenting any work actually performed, without resulting in a conclusion that an audit was not performed in accordance with PCAOB standards.

B. Multinational Audits and Using the Work of Other Auditors (Paragraph 16)

Paragraph 16 of the proposed auditing standard, *Audit Documentation*, and paragraph AU 543.12 of the proposed amendment to the interim standards, *Part of Audit Performed by Other Independent Auditors*, contain provisions concerning the review and maintenance of audit workpapers prepared by a different auditor than the one who signs the audit opinion. We believe these proposals, as currently drafted, would result in significant delays in getting audited information to investors, create more problems than they solve and are not the most effective means of enhancing audit quality on multinational engagements. Indeed, we believe that the task, in many cases, might be overwhelming. We believe that requiring increased standardized reporting for multinational audits is a better approach. (Our proposed alternatives are reflected in Appendix A.)

In considering the proposed standard, we believe it is important to acknowledge at the outset, the way in which multinational audits are, generally and as a practical matter, conducted. In the first instance, the auditor obtains an understanding of the overall business, operations and risks of the company, including how the company consolidates its financial statements—for example, one consolidation at the parent

company level or multiple consolidations on, for example, a line of business or geography basis. The auditor then, as part of the planning process, makes risk-based assessments and determines where audit effort should principally be devoted and the scope of the work needed to be performed at other locations. Those risk-based assessments are a matter of judgment for which the principal auditor takes full responsibility.

Based on those judgments by the principal auditor, instructions generally are then sent to the auditors of those other locations where work is to be performed. Those instructions usually are not limited to the scope of the work to be performed on the company's consolidating schedules and specific procedures or programs but also may include such matters as interpretations of the company's accounting policies and how they are to be applied, materiality assessments, specific requests for information the principal auditor wants to know, (e.g., internal control deficiencies), all of which the principal auditor considers to be relevant to the other auditor's work. The other auditor then follows those instructions and applies audit procedures to the location's reporting schedules.

There may be communications during the year between the principal and other auditors relating to issues or new information that may come to their respective attention during the course of the year. At the conclusion of the work, however, and after year-end, the results are reported to the principal auditor who determines whether and to what extent to rely on them or whether further information, communication or work is necessary. The principal auditor then uses his or her knowledge, judgment and experience to evaluate the work performed and judgments made in order to come to the appropriate conclusion about the form and content of the report to be issued on the company's consolidated financial statements.

1. Review of and Responsibility for Audit Documentation. The proposed standard requires that, where the work of other firms/auditors is being relied on and the principal auditor decides not to make reference to the audit of the other auditor, the principal auditor signing the report should "review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed . . . as if the principal auditor had performed the work himself or herself. . . ." The proposed standard therefore appears to require that the principal auditor do the same amount of work with respect to other firms (both affiliated and non-affiliated firms) on which reliance is placed as the auditor does with respect to the work performed by offices of the same firm issuing the report. We address this provision of the proposed standard in the context of whether such a review requirement is appropriate—even if the review had to take place elsewhere.

This proposed standard would significantly alter the way in which current and historical standards require the principal auditor "to get comfortable" that the work of another auditor can be relied on for purposes of reporting on consolidated financial statements of a multinational company. Given the already-existing complexity of auditing a multinational company within the regulatory timeframe, to now impose additional review responsibilities on the principal auditor and yet another layer of review—even where no issue is identified and regardless of the significance of the other work—would create an unnecessary but significant delay in providing audited information to investors and is not consistent with—and may even frustrate—the goal of improving audit quality.

First, the time it undoubtedly would take for a principal auditor not only to perform and consider all of the work described above, but also to perform a substantive and meaningful re-review of thousands upon thousands of additional workpapers after year-end would undoubtedly result in a significant delay in a registrant's ability to file its consolidated financial statements.

Second, the other auditor—and not the principal auditor—is clearly the professional most knowledgeable about the subsidiary's operating environment, books and records, management and issues. Current standards recognize that the principal auditor, to rely, must establish that reliance on that other "expert" is

reasonable. Although the other auditor is responsible for the performance of the work as instructed, in all events the principal auditor is ultimately responsible for making the risk-based assessment and for its report and compliance with PCAOB standards.

Third, even if the principal auditor set out to review the other firm's workpapers, it is unlikely that such a review in many instances would even be meaningful since other firm's workpapers may very well be, in whole or in part, in a foreign language.

Fourth, this proposed standard raises a number of additional questions: Does the principal auditor have to review information not considered material or from a location not considered material in the auditor's risk-based judgment? What if there are consolidating layers? Does the principal auditor have to review all those layers and the underlying workpapers? How many layers of review should there really be? Is there any distinction between firms which are members of the same international organization and those which are not?

In sum, we believe that this standard would result in significant filing delays, impose an unwarranted additional but illusory responsibility on the principal auditor, and an undue cost to registrants and auditors for the significant amount of additional time and personnel that would be required to re-review other firms' work, with no corresponding increase in audit quality.

We would welcome the opportunity to meet with the Board and its staff to further explain our proposed alternatives and approach to multinational audits.

2. Retention of Audit Documentation. Paragraph 16 of the proposed auditing standard, *Audit Documentation*, and paragraph AU 543.12 of the proposed amendment to the interim standards, *Part of Audit Performed by Other Independent Auditors*, appear to require (although the requirement is not stated expressly) that all workpapers—wherever prepared and regardless of significance—be maintained together at the offices of the signing auditor, again whether in the US or not. In the case of audits of multinational companies, this would require that workpapers prepared by auditors from different firms and in different countries be shipped to the offices of the lead audit firm for review and storage.

For the purpose of this discussion, we address this aspect of the proposed standard on a stand-alone basis and assume, as discussed above, that a *pre-issuance* review by the principal auditor of the voluminous and hard-copy workpapers of other auditors would not be required because it would result in significant delays in public reporting and would not improve the audit process. The question we address is whether there are any other good and sufficient reasons why the benefits of transporting workpapers to the location of the principal auditor justify the difficulties and costs.

We appreciate the Board's interest in obtaining easier and quicker access to the workpapers of audit firms outside the US that participate in the audit of a US-based registrant. (We are not clear as to how this proposal would facilitate the SEC's reviews if a foreign private issuer is involved and the principal auditor is outside of the US.) That intent, however, requires consideration of the laws of other nations and of international comity. These issues continue to be the subject of significant conversation by the Board in connection with the non-US firm registration process and in various roundtables with and written submissions by numerous interested parties.

Due to the significance and pervasiveness of these issues, we recommend that the Board defer issuance of the portions of the proposed standard requiring all documentation to be retained by the signing office so that the consideration and conversations taking place in the registration context and otherwise can be resolved in an orderly and focused manner. Although we strongly believe that it would be inappropriate

to address this legal issue indirectly through this standard rather than directly through the rules relating to registration, our comments below address this proposal on its own merits in the context of whether it promotes or improves audit quality.

At the outset, we do not understand how this retention requirement relates to audit quality. The quality of international audits is not a function of where audit workpapers are stored. Simply shipping foreign workpapers to the US, or US workpapers to another country, would not ensure any improvement in audit effectiveness.

In addition, it is important to recognize that the audit process is an iterative one. At what point are the workpapers in other locations ready to be transported for review? Do they go back and forth? What if changes are made? Who keeps track of what was sent and what was not? The likely result would be less, not more, audit control as auditors ship documentation back and forth. The time and effort, not to mention expense and resources, of transporting workpapers in an orderly (and subsequently explainable) fashion would be clearly not insignificant. Beyond that, how would this requirement operate in view of the requirement to assemble a complete and final file within 45 days? Moreover, we assume the intention is for the firm preparing the workpapers to retain a copy so that it would have the necessary continuing access to the workpapers as it performs ongoing work. Consider the administrative burden of ensuring that every new document received from a client and every new workpaper created also is sent to the principal auditor in order to ensure consistent documentation.

We do not believe this significant additional effort and the attendant costs are, put simply, worth it.

* * * * *

We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions the staff may have. Please do not hesitate to contact Ray Bromark (973-236-7781) or Jim Lee (973-236-4478) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

Appendix A**TEXT OF SUGGESTED REVISIONS TO PROPOSED STANDARD**

Following are our suggested revisions to those paragraphs in the proposed standard relating to those matters discussed in our letter and dealing with the concept of rebuttable presumptions and the concept of multinational audits and using the work of other auditors.

Rebuttable Presumptions

We recommend that paragraph 6 of the proposed standard be replaced with the paragraph shown below.

6. Auditors, including any specialists employed or retained by the auditor, should document the procedures performed, evidence obtained, and conclusions reached. Solely for the purpose of PCAOB proceedings and inspections, there will be a rebuttable presumption that failure by an auditor or a specialist to document a procedure performed, evidence obtained, or a conclusion reached will result in a finding that the procedure was not applied, the evidence was not obtained, or the conclusion reached was not suitably supported. This presumption is rebuttable by persuasive other evidence, written or oral, that the PCAOB inspector decides to consider.

In the event that the rebuttable presumption is determined to be rebutted by other persuasive evidence, the auditor will be given the opportunity to cure the deficiency by documenting currently, consistent with the PCAOB standards, the work actually performed. In the event that the rebuttable presumption is not determined to be rebutted, in determining whether the audit overall complies with PCAOB standards, the PCAOB will consider the significance and pervasiveness of the deficiency in the context of the audit work and documentation taken as a whole.

Multinational Audits and Using the Work of Other Auditors

We believe that a more effective, and less problematic, approach versus what is in the proposed standard would be to impose increased, standardized reporting requirements for multinational and other multi-auditor engagements that would serve as a control over the quality of the auditors' work. Along these lines, we recommend that paragraph 16 in the proposed standard be replaced with the paragraph shown below.

16. Audit documentation sufficient to meet the requirements of paragraphs 4-12 must be retained by the firm(s) performing the audit work. Firms subject to this requirement would include the firm issuing the auditor's report as well as other firms that audit one or more affiliates or divisions of the company. Such other firms could include both affiliated and non-affiliated firms. In addition, where the firm issuing the auditor's report judges the audit work of the other firm(s) to be significant in terms of its report on the consolidated financial statements and decides to use but not make reference to the work of the other auditor, the other firm must submit to the issuing firm for its review and retention an audit summary memorandum, including a discussion of the following:

- All significant findings or issues, actions taken to address them, and the basis for the conclusions reached, as specified in paragraph 9. This information should be as specific as necessary in the circumstances for the issuing firm to gain a thorough understanding of the matter.
- Proficiency of the engagement team or firm specialists utilized with regard to applicable PCAOB auditing standards, US generally accepted accounting principles, and SEC rules.
- Procedures employed by the other firm to ensure compliance with regulations governing auditor independence.
- Significant fraud risks identified, the related audit response, and the results of the auditor's procedures.
- Findings affecting the consolidating or combining of accounts, e.g., intercompany accounts, in the consolidated financial statements.
- Sufficient information relating to any significant findings or issues that is inconsistent with or contradicts the other auditor's final conclusions, as specified in paragraph 12. This information should be sufficient to enable the issuing firm to gain an appropriate understanding of the matter(s) and should include procedures performed in response to the information and consultations on, or resolutions of, differences in professional judgment among members of the audit team or between the audit team and others consulted.
- Instances of actual or suspected fraud by senior management or non-compliance with laws and regulations.
- Sufficient information to enable the firm issuing the auditor's report to agree or reconcile the financial statement amounts audited by the other firm to the information underlying the consolidated financial statements.

We recommend that the proposed revision to AU 543.12 be replaced with the following:

.12 When the principal auditor judges the audit work of the other firm(s) to be significant in terms of its report on the consolidated financial statements and decides not to make reference to the audit of the other auditor, in addition to satisfying himself or herself as to the matters described in paragraph .10, he or she should obtain from the other auditor, review, and include in his or her audit documentation, the audit summary memorandum required under paragraph 16 of PCAOB Auditing and Related Professional Practice Standards No. X. In addition, he or she also should consider whether to perform one or more of the following procedures:

- a. Visit the other auditor and discuss the audit procedures followed and results thereof.
- b. Review the audit programs of the other auditor. In some cases, it may be appropriate to issue instructions to the other auditor as to the scope of his or her audit work.
- c. Review additional workpapers of the other auditor relating to significant findings or issues.

If the Board elects to retain the provision in the proposed standard that requires the principal auditor to retain the workpapers of all firms involved in the audit, we strongly recommend that a pilot program be initiated prior to roll-out of the standard. As we have indicated previously, we believe such a requirement will result in administrative distraction and confusion about respective responsibilities, particularly in the initial year of application. We believe a pilot program to field test this requirement on a small number of engagements would be highly beneficial in minimizing, to the extent possible, the administrative burden of the proposed standard.

Appendix B**ADDITIONAL COMMENTS**

The following are additional comments we wish to submit for the Board's consideration:

The Concept of Reviewer***Scope of "Reviewer"***

Key to the auditor's ability to develop high-quality audit documentation is the need to specify those "reviewers" whose efforts audit documentation is intended to facilitate and help make effective. We believe the scope of such specified reviewers should be restricted to members of the engagement team with responsibility for review and supervision, reviewers in connection with the firm's internal quality control and inspection processes, and PCAOB inspection teams. Accordingly, we recommend that the Board delete the references in paragraph 3 to others, such as successor auditors, parties engaged by the audit committee, and parties to an acquisition, as outside the scope of the proposed standard. These potential reviewers are subject to the auditor's decision as to whether to permit access to all or part of the audit documentation. This possible access need not, however, be explicitly considered by the auditor in preparing audit documentation.

Reviewability Standard

Important to the auditor's decisions regarding audit documentation is a reasonable understanding of the assumed knowledge and experience of the reviewer as a basis for the auditor's judgments regarding the sufficiency of the audit documentation for the reviewer's purposes:

- The Board's existing interim standard (AU 339.06) indicates that: "Audit documentation should be sufficient to ... enable members of the engagement team with supervision and review responsibilities to understand..." Importantly, these "reviewers" on the engagement team are known to the preparers of the audit documentation and, based on review of the audit documentation as well as discussion with the preparer, have had the ability to request additional audit documentation where needed and conclude on the sufficiency of documentation before the auditor's report is released.
- Conversely, paragraph 5 of the proposed standard, in extending the definition of "reviewer" beyond those on the engagement team, states that: Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement to understand..."

We agree with extending the concept of reviewer beyond the engagement team to those reviewing audit documentation as part of internal and external inspections. However, we believe the Board must provide more specific guidance as to the definition of "experienced auditor" and specifically require that the inspection team have or have available to it a level of audit experience, including appropriate industry and other knowledge, sufficient to have performed the audit themselves. Otherwise, auditors will be left to divine the needs of this hypothetical, undefined "experienced auditor." This would likely result in the preparation of excessive audit documentation of limited benefit to audit quality. Also, we believe greater specificity in this area would benefit the inspection process by enabling a more consistent understanding between auditors and PCAOB inspectors and providing a framework that meets the needs of the

inspection process while ensuring the auditor a reasonably appropriate assumed level of knowledge and experience on the part of the inspector.

Documentation of Conclusions

Paragraph 6 of the proposed standard could be read as requiring the auditor to specifically document all conclusions reached. We believe such a requirement would not improve audit quality but instead would lead audit teams to spend countless hours attempting to craft appropriate wording for the multitude of judgments auditors make in the course of their work. In such cases, the auditor's hesitation would be understandable and reflect the same logic that precludes auditors from issuing piecemeal opinions—the risk that the auditor's conclusions will be taken out of the context of the financial statements as a whole, thus implying a greater degree of evidence supporting the conclusion than may be appropriate or warranted.

Accordingly, we recommend that the auditor be required to document his or her conclusions only with regard to significant findings or issues as defined in the proposed standard, and where the auditor's conclusion or basis for a significant conclusion is not readily apparent from the documentation of the work performed.

Retention and Subsequent Changes to Audit Documentation

We support the requirement in paragraph 13 that audit documentation be retained for seven years after completion of the engagement as meeting the requirements of the Sarbanes-Oxley Act. However, we recommend that “completion of the engagement” be defined as “the date the company's financial statements and the auditor's report are first filed with the Securities and Exchange Commission” rather than the earlier date of the auditor's report, which represents the date the auditor completes fieldwork.

We support the requirement in paragraph 14 that a complete and final set of audit documentation be assembled for retention within a reasonable period of time, ordinarily not more than 45 days. We recommend that the standard delete the phrase “and final” as the auditor may obtain additional evidence in connection with procedures performed subsequently, for example, as part of keeping current procedures under SEC rules or as part of a subsequent year's audit. Consistent with our comment in the preceding paragraph, we believe the 45-day period should be described as the period of time following “the date the company's financial statements and the auditor's report are first filed with the Securities and Exchange Commission” rather than “the first time the auditor grants permission to use the auditor's report.”

We agree with the required procedures set forth in paragraph 15 for subsequent additions to the audit documentation after “the date the company's financial statements and the auditor's report are first filed with the Securities and Exchange Commission.” We believe the understandability of the paragraph would be improved if the discussion was clearly identified as the required protocol for additions and changes during the 45-day period. We also would recommend a separate discussion of the protocol for documenting and retaining any additional audit evidence obtained after the end of the 45-day period, for example, in connection with subsequent keeping current procedures or a subsequent year's updating/reissuance of the auditor's opinion.

Implementation Date

The proposed standard would apply to engagements completed on or after June 15, 2004. For example, as drafted, the proposed standard would require an auditor of a company with a June 30 year end to retroactively apply its guidance with regard to all audit documentation prepared prior to the issuance of the final standard. Instead, we believe any final standard should be effective for audits of periods beginning on or after an appropriate date subsequent to the standard's issuance. This would recognize the goal of having auditors appropriately document their work on a contemporaneous basis throughout the audit. Also, the effective date should allow registered firms sufficient time to make the necessary changes to their audit methodologies and policies as well as provide the appropriate communication and training to their personnel.

Changes to the Board's Interim Standards

We believe the proposed standard would entail modifications to the Board's existing interim standards beyond those identified. We recommend that the Board specifically identify and communicate in all cases how requirements in the proposed standard diverge from existing requirements and how issuance of the standard would affect the existing interim standards. For example, what would be the status of Appendix A to the Board's interim standard on audit documentation? Also, what would be the impact of the new standard on interpretations of the Board's interim standards on audit documentation and using the work of another auditor or with regard to the Board's interim standards on attest documentation?

Other Comments

General

We believe the proposed standard should acknowledge that audit documentation is the property of the auditor and that the auditor has an obligation to maintain confidentiality of client information.

Paragraph 1

We recommend that the concept of auditor judgment contained in paragraphs 1 and 9 of AU 339 be retained to recognize that no documentation standard can be so prescriptive as to encompass all the decisions auditors make based on the unique facts and circumstances of a particular audit. Related to this, we also recommend that the proposed standard incorporate the type of guidance contained in AU 339.07 on factors the auditor should consider in making decisions about the nature and extent of audit documentation for a particular audit area or audit procedure.

Paragraph 2

We recommend that, in the second sentence of the paragraph, the word "primary" be inserted before "basis for review of the quality" to reflect that reviewers employ other methods, including interview and discussion with those who performed the work, in making their judgments on the quality of the work.

Paragraph 4

The first sentence states that the auditor must prepare audit documentation in connection with "each engagement conducted in accordance with auditing and related professional practice standards." We

believe the proposed standard, as its title indicates, should be limited to reflect the appropriate documentation requirements for audits only. Other engagements, such as reviews of interim financial information and attestation engagements, while conducted in accordance with PCAOB standards, are substantially different from audits. We believe documentation standards, while the same in principle, should recognize these significant differences.

The current list of audit documentation, in the second sentence, does not include “audit programs.” This should be added so that it is clear that signed off program steps are one form of documentation of planned and completed procedures.

We believe the Board should clarify that it does not intend, in the second sentence, that the auditor be required to include as part of the audit documentation copies of all client documents that he or she may have obtained for purposes of performing the audit, for example, invoices, detailed IT reports, general ledgers, etc. We believe this requirement should be restricted to significant company contracts and agreements, consistent with the guidance contained in paragraph 11 of the proposed standard.

Paragraph 5

The third word “must” should be changed to “should.” Since PCAOB proposed rule 3101 defines “must” to mean an “unconditional obligation,” the proposed “rebuttable” presumption would become “irrebuttable” with the word “must.”

In subparagraph (a), we recommend that the word “understand” be changed to “determine,” since to fully understand some aspect of audit work it will often be necessary to speak with the auditor, in addition to reviewing the related audit documentation.

Paragraph 6

We believe the reference to specialists should be restricted to those specialists employed or retained by the auditor to distinguish them from specialists employed or retained by the company.

Paragraph 7

Subparagraph (a) should be re-written as “Support the auditor’s conclusions concerning compliance with auditing and related professional practice standards.” As currently written, the standard is overly broad and might be interpreted as requiring the auditor to write narratives discussing each of the governing standards even when otherwise unnecessary to document the audit work performed.

Regarding subparagraph (b), for the reasons indicated earlier in our comments on documentation of conclusions, we believe the auditor generally should not be required to document conclusions regarding “every material financial statement assertion.” Nevertheless, if this requirement is retained, we recommend that the wording be changed to “relevant financial statement assertions for all significant accounts” to be consistent with the Board’s proposed standard on an audit of internal control over financial reporting.

Paragraph 8

As part of the inspection process for a registered firm, the Board’s inspection teams would normally have gained an understanding of how the firm addresses certain matters, such as auditor independence and staff

training and proficiency, centrally. Accordingly, we believe requiring the documentation on each audit to contain a reference to a central firm repository is unnecessary and inefficient.

Paragraph 9

Inclusion of the phrase, “but not limited to,” in the sentence introducing items a–h is redundant and potentially troublesome in view of item h, which picks up “any other matters that could result in modification of the auditor’s report.” It implies that there are matters, not listed, that could be significant even though they could not result in modification of the auditor’s report. If there is any such item, it should be identified in the standard, rather than left to later speculation.

Regarding subparagraph (b), we believe the mention of material misstatements should be in terms of items that “could represent” material misstatements as opposed to restricting it only to items ultimately determined by the auditor to represent material misstatements.

Regarding subparagraph (c):

- We recommend that the phrase, “whether or not recorded by the company,” be added to the second sentence. As a result, the applicable section would read: “... an audit adjustment, whether or not recorded by the company, is a proposed correction....”
- We also recommend that the phrase, “financial reporting process,” at the end of the second sentence, be replaced with “financial statements.”
- We find the phrase in the last sentence, “audit adjustments ... that were or should have been proposed,” confusing. Auditors presently are required to inform management and the audit committee of (i.e., “propose”) all audit adjustments determined in the course of the audit other than de minimus items. Accordingly, we believe the proper emphasis should be on whether or not such adjustments were recorded by the company, rather than on whether or not the auditor proposed them.

Regarding subparagraph (e), we believe any requirements relating to documentation related to reviews of interim financial information should be reflected as revisions to the Board’s interim standard, AU 722, on reviews of interim financial information where standards for documentation of such reviews are presently located.

Paragraph 10

We agree with the Board’s requirement that significant findings or issues be summarized in one place for the use of reviewers. However, we believe the standard should allow for alternative forms of documentation, other than an “engagement completion memorandum” that achieve the same purpose. We believe mandating the specific form of this or other audit documentation would be overly prescriptive and require firms to make significant changes to their working practices that would not significantly improve audit quality.

We believe the Board should clarify whether the engagement completion memorandum or its equivalent is intended as a stand-alone document or whether, alternatively, the mention of cross-referencing to supporting audit documentation in the last sentence permits the auditor to use such supporting documentation to provide part of the required thorough understanding? In our view, the latter is the appropriate stance. Documentation of significant findings or issues should permit the auditor to make

appropriate use of other audit cross-referenced documentation without having to repeat it. Accordingly, we recommend that the last sentence in the paragraph be deleted and that the existing clause in the second sentence, “This memorandum should be as specific as necessary...” be replaced with, “This memorandum, together with any other supporting audit documentation that has been cross-referenced to the memorandum, should be as specific as necessary... .”

Also in the second sentence, we recommend that the phrase, “... to gain a thorough understanding of the significant findings or issues,” be replaced with “... to gain an understanding sufficient for the reviewer to perform his or her review.”

Paragraph 12

In the first sentence, we recommend that the proposed standard specifically state that the term “significant findings or issues” is intended to be used in the same context as in paragraph 9.

Paragraph 14

We recommend the Board clarify the implications of the paragraph, particularly as it relates to audit documentation in paper form (vs. electronic which is easier to deal with in terms of archiving/freezing) of continuing interest to the auditor such as client information, systems descriptions and important contracts. How is the auditor expected to file such documentation to meet the standard while preserving and filing it in an easily accessible manner? Can such documentation be accessed later? Any requirement that such “complete and final” files may not be accessed by the auditor after the 45-day period would require auditors to make copies of all such files. We believe this would be costly and fail to provide corresponding benefits in terms of improving audit quality.

Paragraph 16

We recommend that the parenthetical phrase, “(including documentation of work performed by others, such as affiliated firms),” be changed to, “(including documentation of work performed by other auditors, including affiliated firms).” We believe this revision is necessary to clarify that the auditor should not be required to retain documentation of work performed by others such as management and internal auditors, for example, in connection with the auditor’s audit of internal control.

RSM International

20 January 2004

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Office of the Secretary,
Public Company Accounting Oversight Board,
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Dear Sir,

PCAOB Rulemaking Docket Matter No. 012

RSM International appreciates the opportunity to comment on the Public Company Accounting Oversight Board's proposed Auditing Standard, *Audit Documentation*, and proposed amendment to the interim auditing standard *Part Of Audit Performed By Other Independent Auditors*.

RSM International is the world's sixth largest affiliation of independent accounting and consulting firms. Our members operate in more than 70 countries and employ over 19,000 individuals in over 500 offices. RSM International member firms provide a full range of audit and advisory services to clients domestically and internationally.

RSM International supports the PCAOB in its efforts to enhance the quality of financial reporting, corporate governance and auditing to restore public trust in the capital markets. We believe that some enhancements may be addressed immediately. However, other enhancements will require short-term solutions while further research and thought is pursued to develop workable long-term solutions.

We support a long-term solution that improves the quality of audit engagements for multi-national SEC registrants by imbedding quality, objectivity and competence into the audit process utilized by international audit firms, or networks of audit firms. To us, this means ensuring that these organizations (i) consistently maintain the appropriate tone at the top, (ii) are staffed with highly competent professionals who are supported by comprehensive audit tools and training programs, (iii) maintain robust audit and independence policies and practices that are current with professional standards and changing times, and (iv) maintain a comprehensive monitoring system to ensure compliance with professional standards and organization quality assurance policies and practices.

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This approach could mitigate, but not totally eliminate, the need for redundant reviews, duplicate workpaper copies and multi-lingual auditors. We also believe this approach is in line with the PCAOB's planned inspection program for all auditors of SEC registrants. However, we recognize that the implementation of this recommendation will require the efforts and cooperation of professionals, registrants and regulators across many borders. Unfortunately, this may be difficult to achieve unless we all focus on the needs of the public investor and work together to craft reasonable solutions.

We admit we are challenged to provide reasonable short-term solutions, which adequately consider the realities of differences in culture, language and laws and the costs and complexities of global logistics. To that end, we encourage the PCAOB to consider utilizing a series of steps that enhance audit quality for multi-national SEC registrants instead of requiring a major shift that is not realistically achievable over night.

We offer the following comments for your consideration in finalizing these two auditing standards. The comments relate primarily to those aspects that affect auditors outside the United States of America.

Detailed comments on the proposed new Auditing Standard, *Audit Documentation* Paragraph 16 and the proposed amendment to paragraph 12 of AU 543

When portions of the audit work is performed by a firm other than the principal auditor (such as affiliated firms or other independent auditors), paragraph 16 requires the principal auditor issuing the audit report to retain the original audit documentation or copies of such documentation for the work performed by other auditors. The proposed amendment to paragraph 12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, goes on to state that, when the principal auditor decides not to make reference to the work of the other auditor, the principal auditor should:

- Review the audit documentation of the other auditor to the same extent and in the same manner as the audit work of all those who participated in the engagement is reviewed, and
- Incorporate sufficient audit documentation of the work performed by the other auditor so as to meet all the requirements of the proposed Audit Documentation Standard, as if the principal auditor had performed the work himself or herself.

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Where the principal auditor does not intend to refer to the work of other auditors in the audit report for a multi-national SEC registrant, we believe that it will be very difficult in the short-term for the principal auditor to comply with the proposed review and document retention requirements. Our experience is that there are numerous practical and legal obstacles to compliance with these requirements which have not yet been resolved at the local country level. Some of these obstacles are briefly summarized below, followed by our suggestions on how they can be addressed.

- **Legal regulations in many countries that restrict access to audit working papers** - We understand that auditors in many European and Asian countries are prohibited from sending their original audit documentation, or even copies, to a principal auditor in the USA.
- **Language barriers on international engagements** - In the short term, it may be difficult for the principal auditor to locate persons with the requisite foreign language capabilities and auditing expertise to review audit documentation prepared by other auditors to the extent required by the proposed standard and amendment. We also believe that it will not be possible or beneficial to require auditors in other countries to prepare their working papers in the language of the principal auditor. This is primarily because of the legal requirement in certain countries to document audit work in the local language. Additionally, documenting audit work in a second or third language for some auditors could reduce the quality of the audit documentation in some circumstances.
- **The cost and logistical difficulties involved in the principal auditor reviewing and retaining all the audit documentation on a multi-location audit** – This is probably not a significant concern where improving audit quality is concerned, but we believe it will be costly and logistically difficult in terms of time and travel costs for the principal auditor to review all the work done by the other auditors given the global reach of certain SEC registrants. It would also be costly to acquire and retain all of the documentation from other auditors. These problems can and should be addressed in the interests of audit quality, but will create an immediate problem if the current implementation date is retained.
- **The cost and logistical difficulties involved in the principal office having to retain either the original or copies of the audit documentation produced at all locations** - On an international or large multi-locational engagement, it would be logistically challenging and

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costly to house all of the audit documentation in one central location and to store such large volumes of paperwork for a minimum of 7 years.

In order to address these obstacles, the PCAOB should consider issuing application guidance on the proposed standard and amendment. This guidance could consider the following proposals for each of the problems highlighted above:

- **Legal regulations** - We suggest the PCAOB issue recommendations on alternative types of arrangements that could be entered into between the principal and component auditors to minimize the legal restrictions relating to audit documentation. For example, it may be possible for the principal auditor to enter into an arrangement whereby the component auditor performs specified procedures on behalf of the principal auditor and then issues a summary report on their findings, together with copies of the working papers. This would not be a statutory audit engagement and some of the legal restrictions may be avoided. However, the principal auditor may need to perform additional audit procedures.
- **Language barriers** - We recommend that the PCAOB consider both a short-term and long-term solution to this problem. For the short-term, in situations where the principal auditor does not have the requisite language skills, we recommend that the principal auditor perform a robust dialog with the other auditor (i) during engagement planning about the subsidiary's business, risk matters, controls, culture, accounting policies, and about the audit plan, and (ii) during finalisation about findings, including unusual or unexpected items and their resolution, passed adjustments, etc. The primary auditor should document these matters and, if available, obtain copies of the other auditor's work.

For the long-term, we recommend that the PCAOB require the principal audit firm to employ the necessary language skills and to adopt and implement global quality assurance policies and practices.

- **Cost and logistical difficulties**- We believe further clarification would be useful on the extent of the review required by the principal auditor and which documents need to be retained by the principal auditor. In our view (i) the level of review to be performed on the work of other auditors should be based upon the judgment of the principal auditor after thoroughly considering the facts and circumstances, (ii) the documentation required to support the work of other auditors

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would include copies of the planning, workpapers relating to material risk areas and workpapers relating to the finalisation of the audit, and (iii) there is no need for all of the workpapers of an audit engagement served by multiple offices of a single audit firm to be stored in a single location.

Alternative Proposals

We recommend that the PCAOB retain the existing principles of AU 543 with regard to assessing the independence, objectivity and professional competence of other auditors. We also suggest that these requirements be expanded to require the principal auditor to understand the system of quality control in place at the other auditor's firm, whether this system is subject to internal and external inspection, the results of those inspections and remedial actions taken. The principal auditor should then determine the extent of any reliance on the work of the other auditor and determine the level of review that should be performed on their work. This judgement process and information should be clearly documented in the principal auditor's working papers.

We also believe that the additional procedures set out in paragraph 12 of AU 543 could be enhanced to require:

- Greater involvement by the principal auditor in the planning process, the assessment of risks and the extent of audit procedures to be performed,
- More detailed reporting from the other auditor to the principal auditor, particularly with regard to areas of risk and how these were addressed during the audit.

We believe that these amendments, taken together with the existing requirements of AU 543, will help ensure the quality of audit work done by other auditors.

Paragraph 18

The proposed implementation date for the new statement is all engagements completed on or after June 15, 2004.

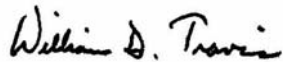
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If it is decided to retain the requirements of paragraph 16 in the proposed audit standard *Audit Documentation* and the requirements of the proposed amendment to AU 543, we recommend that the PCAOB reconsider the implementation date for these sections. We believe that until there is access to working papers in all countries outside the US, it will not be possible for a principal auditor to comply with the proposed requirements.

Please contact Tessa Rowland (+44 (20) 7865 2883) if you would like to discuss any of these comments.

Yours faithfully,



William D. Travis

Chairman, Transnational Assurance Services Executive Committee

RSM International

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January 8, 2004

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

Re: PCAOB Rulemaking Docket Matter No. 012, Release No. 2003-023
Proposed auditing standard, *Audit Documentation*, and proposed amendment to the Board's interim auditing standard, "Part of Audit Performed by Other Independent Auditors."

Dear Board Members and Staff:

In general I believe that the proposed auditing standard is reasonable. However, I do not believe the proposed amendment to interim auditing standards concerning circumstances when other independent auditors perform part of the audit is desirable. The following are my comments and suggestions relating to these proposals.

Overall Portrayal of Public Company Accounting Oversight Board Audit Standards

As noted in the Public Company Accounting Oversight Board ("PCAOB" or "Board") Release, Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act") expressly directs the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. It is clear from the Act that the Board's mandate relates to audits of publicly held companies. That is acknowledged in this Release's STATEMENT OF AUTHORITY with the statement: "The Board has adopted Rule 3100 to require all registered public accounting firms to adhere to the Board's auditing and related professional practice standards (including interim professional standards) *in the audits of public companies*" (Emphasis added).

Because the Board's mandate is limited to audits of publicly held companies, I do not believe it is appropriate for the Board to claim that this proposed audit documentation standard, when it becomes final, will supersede AU sec. 339 or that the accompanying proposed amendment to interim auditing standards would amend AU sec. 543. In performing an audit of financial statements, I believe that, in the absence of any compulsory written standards, an auditor has a professional

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responsibility to abide by standards that are sufficiently high and to apply procedures that are sufficient to obtain enough evidence to support an opinion about the fairness, in all material respects, of the financial statements being reported on. It is the auditor's opinion about the fairness of the financial statements that is the important factor. The adherence to any set of auditing standards simply lets those who place reliance on the audited financial statements know that the auditor has abided by a certain set of defined conventions in applying procedures to help form an opinion. Generally Accepted Auditing Standards ("GAAS") then are simply the defined conventions of the auditing profession. They are established by the auditing profession and, when they are referred to in an auditors report, are meant to provide assurance that the auditor stuck with the conventions of the auditing profession in providing assurance about the financial statements. GAAS provides assurance about the assurance an auditor provides on financial statements. Without GAAS, an auditors report on financial statements might read:

We have audited the accompanying balance sheet of X Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit by applying such procedures as we considered necessary to obtain reasonable assurance about whether the financial statements are free of material misstatement. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20XX, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In my view, the "Generally Accepted" phrase within GAAS implies that GAAS is a set of conventions established with the consent of the auditing profession. In the United States, GAAS has been established through the American Institute of Certified Public Accountants (AICPA) because that organization is the largest voluntary membership body of public accountants in the United States; thus it is the single most representative organization of the views of certified public accountants. While many individual members of the AICPA may not agree with the Statements on Auditing Standards (SAS's) emanating from it, the AICPA is still more representative of Certified Public Accountants (CPAs) as a group than any other body; thus it may be said that SAS's are issued with the consent of the accounting and auditing profession.

In contrast, audit standards issued by the PCAOB are imposed by law on auditors of publicly held companies rather than being issued with the consent of the profession. Auditors may abide by PCAOB Standards imposed on them but not agree with those standards; so in my view, Board imposed standards should not be considered "generally accepted." I am aware that some people will respond to this view by noting that the same thing might be said about the current GAAS established by the AICPA since there are certainly a number of auditors who do not fully agree with current GAAS. To that point I respond by referring to the

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above-mentioned notion that the AICPA remains the single most representative body of CPAs.

In addition to the reasons discussed above, I do not believe that the Board has the right to supersede AU sec. 339 or to amend AU sec. 543 because all AU sections simply represent the codified SAS's, which are the copyrighted property of the AICPA. I would also state that the AICPA and each individual CPA has a right to disagree with the Board and to concoct what ever standards they please. It is the perception that the audit standards in use were not sufficiently effective that lead to the establishment of the Board, but another view is that the audit standards in existence were not being followed. Still another view might be that both of these views are true to some extent. It can be difficult to determine whether the current standards are just not enough or whether they have just not been followed and I suspect that many people would say that both of those conditions have existed. History is repeating itself in the sense that audit failures have lead to the establishment of more and more effective standards. However, as standards become more and more refined, adherence to them becomes more difficult. Difficulties in adhering to audit standards come about from their complexity, their practicability, the sheer volume of them, and from economic factors. Needless to say, as standards become more complex, less feasible, more voluminous, and more costly, the more they will be ignored or compromised. There is a challenge to find a sensible mix. In addition, and to me more important, individual auditors and firms must be held to high standards as professionals. It is simply not possible to write standards that anticipate every possible situation. As professionals, CPAs must be prepared to apply judgment and perform procedures that may not be specifically required if the situation so demands. The public does have a right to expect professional judgment and behavior. Therefore, CPAs cannot simply fall back on the excuse that they followed the standards required of them; however, at the same time, the public cannot expect auditors to be watchdogs or guardians. As the auditing profession has matured from infancy 100 years ago the standards added along the way, in my view, have become more oriented toward building in specifics as opposed to establishing broader requirements. The Board certainly has the legal right to impose audit standards for public company audits, but that right does not extend to audit standards for audits of nonpublic entities. There is a difference in the realities of operations between public and nonpublic entities. That difference requires differences in the professional approach taken in audits of the two types of entities that to me does not imply differences in the quality of audit services performed.

Because of the foregoing considerations, I believe that the Board should portray the auditing standards it imposes as supplemental to GAAS and required for audits of publicly held companies. This approach is not unprecedented. For example, auditors of state and local governmental entities must apply so-called "yellow book" standards where the entity receives federal funding in excess of a defined amount. In that case, auditors apply Generally Accepted Governmental Auditing Standards ("GAGAS") as well as GAAS in conducting their audits.

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Following that example, an auditor's report on a publicly held company might read:

We have audited the accompanying balance sheets of X Company as of December 31, 20X2 and 20X1 and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to audits of publicly-held companies issued by the Public Company Accounting Oversight Board. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

This view can raise the question as to differences in the way that Board imposed auditing standards are treated when compared with accounting principles issued and/or approved by the Financial Accounting Standards Board (FASB). Both the PCAOB and the FASB are established as independent not-for-profit organizations and adherence to the standards of both are required by the Securities and Exchange Commission ("Commission" or "SEC").

The subjects of whether generally accepted accounting principles (GAAP) are truly "generally accepted" and of "Big-GAAP" and "Little-GAAP" have often been addressed and I do not believe it is appropriate to discuss those topics in this letter. From the auditor's standpoint, the requirements of the PCAOB have a direct relationship to the auditor, whereas the requirements of the FASB directly relate to the entity subject to the audit and are subject to testing by the auditor.

Audit Documentation

Reviewability Standard

This proposed rule would adopt the substance of the General Accounting Offices' ("GAO") documentation standard for government and other audits conducted according to GAGAS. As stated, "the Board's proposed standard would require that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, who performed it, when it was completed, and the conclusions reached. This experienced auditor also must be able to determine who reviewed the work and the date of such review."

I support this proposal without qualification. These requirements should not need explanation or justification. They are necessary to demonstrate that the proper audit procedures were performed and that standards adhered to on a timely basis.

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This proposal is in the best interest of the auditor should the audit work ever come into question.

Rebuttable Presumption

As stated, “the proposed standard would adopt the substance of the state of California's statute on audit documentation, which creates a rebuttable presumption that the failure to document work performed indicates that the work was not performed.” Further, “the proposed presumption could be rebutted by persuasive evidence that the procedures were applied, the evidence was obtained, or sufficient support was provided for the conclusions reached.” However, “the Board contemplates that oral explanation alone would not constitute persuasive other evidence and invites comment on the addition of such a requirement to the proposed standard.”

As with the proposal concerning reviewability, the merits of this proposal seem obvious. It also is in the best interest of the auditor should the audit work ever come into question and is obviously necessary to demonstrate that the work was performed on a timely basis.

Retention of Audit Documentation

In addition to requiring that an auditor retain audit documentation for seven years after completion of the engagement, the minimum period permitted under the Act, “the proposed standard would add a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after the auditor's report is released. Such reasonable period of time ordinarily should not exceed 45 days.”

I also wholeheartedly support this proposal and also believe it is in the best interest of the auditor. The notion of assembling the audit documentation within a reasonable period of time after the auditor's report is released is sensible since it becomes more difficult to assemble documentation as time moves the farther away from the release date and auditors become involved with other matters and is necessary to demonstrate that the work was performed on a timely basis. Whether 45 days should constitute “a reasonable period” could be the subject of endless debate; however, unless there are extenuating circumstances causing a late start to the audit, the period should not extend beyond the commencement of the limited review of the next fiscal year's first quarter.

Subsequent Changes to Audit Documentation

As stated, “the proposed standard would also require that any changes to the working papers after completion of the engagement be documented without deleting or discarding the original documents. Such documentation must indicate the date the information was added, by whom it was added, and the reason for adding it.”

This proposal is also in the best interest of the auditor should the audit work ever come into question. It too serves as a further demonstration that the required

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work was performed on a timely basis and as a demonstration of the auditor's integrity.

Multi-location Audits

As stated, "the proposed standard would require that sufficient audit documentation, including documentation of work performed by others, be retained by the office issuing the auditor's report. With respect to the audit documentation related to the work performed by others, the auditor issuing the report ordinarily should retain the original audit documentation or copies of such documentation. The auditor issuing the report may, however, prepare and retain audit documentation of the work performed by others as a part of the review of such work, as long as this documentation complies with the requirements of this proposed standard."

I do not believe it is necessary for the issuing office to retain all audit documentation as long as that office can be assured that the documentation it expects other offices to retain exists and is in compliance with the standards and requirements for audit documentation. To a great extent, this seems to be a matter of firm choice. It would always be acceptable for a firm to choose to retain all audit documentation at the issuing office, but not always necessary to ensure high audit quality. It is important that the office issuing the auditor's report be in full control of the audit work performed, so there is a need for some amount of audit documentation at that location. The Board may wish to refine the term "sufficient audit documentation" as it applies to these circumstances. For multi-office firms, the firm's structure could be an important factor to consider. If, for example, the firm is tightly controlled with requirements that each participating office follow exacting procedures in accordance with firm-wide policy and originating office instructions, then the amount of audit documentation maintained at the originating office may not need to be very much if the participating offices are required to maintain the documentation of all the audit work required of them in accordance with applicable standards. However, if the firm operates more as a confederation of independent offices, each being relatively autonomous, then a greater amount of audit documentation should be maintained at the office issuing the auditor's report. Since it can be more difficult to control a firm's foreign affiliates it may be important that working papers from the audits of foreign affiliates be available and accessible at the accounting firm's office issuing the audit report so that that office is assured about the audit quality of its foreign affiliates work and about the sufficiency of the audit documentation they maintain.

If a particular multi-office engagement is chosen for PCAOB inspection, the audit documentation from participating offices could be sent to the issuing office for the inspection.

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Using the Work of Other Auditors

When reporting on a company's consolidated financial statements, an auditor may use the work of other auditors who have audited one or more affiliates or divisions of the company. Current standards require the principal auditor to consider performing certain procedures designed to provide assurance about the quality of the audit work performed by another auditor when it is decided not to make reference to the work of that other auditor. Under this release, sufficient audit documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor as if the principal auditor had performed the work himself or herself. In addition to reviewing the audit documentation of the other auditor, the principal auditor should consider whether it is necessary to visit the other auditor and discuss the audit procedures followed and the results thereof and whether it is necessary to instruct the other auditor as to the scope of work to be performed.

This proposal is in the best interest of the principal auditor should the audit work ever come into question and can help to ensure that the other auditor performs as he or she should under required standards. This is a proposal that provides the principal auditor with the added leverage that might be necessary to insist upon access to another auditors' audit documentation. Nevertheless, this proposal should not be necessary. If a principal auditor believes that the procedures required by the current AU §543.12 must be applied in order not to have to make reference to the work of another auditor then he or she must be prepared to insist on that access or, if necessary, resign from the engagement. I believe there are negative implications if an auditor must rely on a requirement such as the one proposed to force legitimate access to the audit documentation of another auditor for the purpose of determining whether reliance on the work of that other auditor is warranted. If a principal auditor believes the procedures contained in the current AU §543.12 should be applied but does not carry out those procedures because of resistance from the other auditor or the client, then questions arise about the principal auditor's independence, the integrity of the other auditor, and/or the integrity of the client. Therefore, I do not support this part of the Board's proposals because they are not necessary.

Attached is a copy of the Board's Proposed Audit Documentation Standard and a copy of the Board's Proposal on Part of the Work Performed by Other Independent Auditors, both marked with my suggestions for changes. Thank you for the opportunity to comment.

Sincerely,
s Robert J. Sonnelitter, Jr.
Robert J. Sonnelitter, Jr., CPA
Principal
Sonnelitter Professional Services, LLC

RELEASE

PCAOB Release 2003-023
November 21, 2003
Page A1-4 – Standard

Auditing and Related Professional Practice Standards

Proposed Auditing Standard

Audit Documentation

[[Supplements AICPA Professional Standards, AU sec. 339](#)]

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Introduction

1. This standard establishes general requirements for documentation the auditor should prepare and retain in connection with any engagement conducted in accordance with auditing and related professional practice standards. This standard does not supplant specific documentation requirements of other auditing and related professional practice standards.

Objectives of Audit Documentation

2. *Audit documentation* is the principal record of the basis for the auditor's conclusions and provides the principal support for the representations in the auditor's report. Audit documentation also facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Audit documentation includes records on the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

3. Audit documentation is reviewed by members of the engagement team performing the work and by others. For example:

- a. Auditors who are new to an engagement review the prior year's documentation to understand the work performed as an aid in planning and performing the current engagement.
- b. Supervisory personnel review documentation prepared by assistants on the engagement.
- c. Engagement partners and engagement quality control reviewers review documentation to understand how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions.
- d. A successor auditor reviews a predecessor auditor's audit documentation.

- e. Internal and external inspection teams review documentation to assess audit quality and compliance with auditing and related professional practice standards; applicable laws, rules, and regulations; and the firm's own quality control policies.
- f. Others, including advisors engaged by the audit committee or representatives of a party to an acquisition might review audit documentation.

Content of Audit Documentation

4. The auditor must prepare audit documentation in connection with each engagement conducted in accordance with auditing and related professional practice standards. Audit documentation ordinarily consists of memoranda, correspondence, schedules, and other documents created or obtained in connection with the engagement and may be in the form of paper, electronic files, or other media.
5. Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:
 - a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and
 - b. To determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.
6. Auditors, including any specialists, should document the procedures performed, evidence obtained, and conclusions reached. Failure to do so creates a presumption that the procedures were not applied, the evidence was not obtained, and the conclusions reached were not suitably supported. This presumption is rebuttable by persuasive other evidence that the procedures were applied and the evidence was obtained to provide sufficient support for the conclusions reached.
7. Because audit documentation provides the principal support for the representations in the auditor's report, it should:
 - a. Demonstrate how the audit complied with auditing and related professional practice standards;
 - b. Support the basis for the auditor's conclusions concerning every material financial statement assertion; and
 - c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.
8. Certain matters, such as auditor independence and staff training and proficiency, may be documented in a central repository for the firm or the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the

engagement should contain a reference to the central repository. Documentation of matters unique to a particular engagement should be included in the audit documentation of the pertinent engagement.

9. The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. *Significant findings or issues* include, but are not limited to, the following:

- a. Significant matters involving the selection, application, and consistency of accounting principles, including related disclosures. Such significant matters include accounting for complex or unusual transactions, accounting estimates, and uncertainties as well as related management assumptions.
- b. Results of auditing procedures that indicate a need for significant modification of planned auditing procedures or the existence of material misstatements or omissions in the financial statements or the existence of significant deficiencies in internal control over financial reporting.
- c. Audit adjustments and the ultimate resolution of these items. For purposes of this standard, an *audit adjustment* is a proposed correction of a misstatement of the financial statements that could, in the auditor's judgment, either individually or in the aggregate, have a material effect¹ on the company's financial reporting process. Audit adjustments include corrections of misstatements, of which the auditor is aware, that were or should have been proposed based on the known audit evidence.
- d. Disagreements among members of the engagement team or with others consulted on the engagement about conclusions reached on significant accounting or auditing matters.
- e. Significant findings or issues identified during the review of quarterly financial information.
- f. Circumstances that cause significant difficulty in applying auditing procedures.
- g. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.
- h. Any other matters that could result in modification of the auditor's report.

10. The auditor must identify all significant findings or issues in an engagement completion memorandum. This memorandum should be as specific as necessary in the circumstances for a reviewer to gain a

¹ Materiality includes both quantitative and qualitative considerations as discussed in SEC Staff Accounting Bulletin No. 99.

thorough understanding of the significant findings or issues. This memorandum should include cross-references, as appropriate, to other supporting audit documentation.

11. Documentation of auditing procedures that involve the inspection of documents or confirmation, such as tests of details and tests of operating effectiveness of controls, should include identification of the items tested.² Documentation of auditing procedures that involve the inspection of significant contracts or agreements should include abstracts or copies of the documents.

12. In addition to the documentation necessary to support the auditor's final conclusions, information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions must also be included in the audit documentation. The relevant records to be retained include, but are not limited to, procedures performed in response to the information, and records documenting consultations on, or resolutions of, differences in professional judgment among members of the audit team or between the audit team and others consulted.

² The identification of the items tested may be satisfied by indicating the source from which the items were selected and the specific selection criteria, for example:

- If an audit sample is selected from a population of documents, the documentation should include identifying characteristics (for example, the specific check numbers of the items included in the sample).
- If all items over a specific dollar amount are selected from a population of documents, the documentation need describe only the scope and the identification of the population (for example, all checks over \$10,000 from the October disbursements journal).
- If a systematic sample is selected from a population of documents, the documentation need only provide an identification of the source of the documents and an indication of the starting point and the sampling interval (for example, a systematic sample of sales invoices was selected from the sales journal for the period from October 1 to December 31, starting with invoice number 452 and selecting every 40th invoice).

Retention of and Subsequent Changes to Audit Documentation

13. Audit documentation must be retained for seven years from the date of completion of the engagement, as indicated by the date of the auditor's report,³ unless a longer period of time is required by law.

14. Prior to granting permission to use the auditor's report in connection with the issuance of the company's financial statements, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation must be assembled for retention within a reasonable period of time following the first time the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. Such reasonable period of time ordinarily should not be more than 45 days.

15. Circumstances may require subsequent additions to the audit documentation. If evidence is obtained after completion of the engagement, or if work performed before engagement completion is documented after completion, the documentation added must indicate the date the information was added, by whom it was added, and the reason for adding it. Audit documentation must not be deleted or discarded; however, information may be added, including an explanation of its relevance, as long as the information identifies the date the information was added; by whom it was added; and the reason for adding it. The auditor should also identify and document changes to audit documentation as a result of post-issuance procedures. Documentation should include the nature of the change, the date of such change, by whom the change was made, and the reason for the change.

16. Audit documentation sufficient to meet the requirements of paragraphs 4-12 that relates to work performed by other offices of the principal auditor must be available to the office issuing the auditor's report. Documentation of work performed by others, such as affiliated firms that is sufficient to satisfy the principal auditor that those other auditors have met all required auditing standards including the requirements of paragraphs 4-12, must be retained by the office issuing the auditor's report. If the auditor issuing the report might retain the original audit documentation of the other auditors or copies of such documentation or alternatively, prepare and retain audit documentation of the work performed by others as a part of the review required by paragraph 12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, as long as the audit documentation complies with paragraphs 4-12 of this standard.

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³ If a report is not issued in connection with an engagement, then the date of completion of the engagement would be the date that fieldwork was substantially completed.

17. The auditor also may be required to maintain documentation in addition to that required by this standard.⁴

Implementation Date

18. This standard will apply to engagements completed on or after June 15, 2004.

⁴ 4/ For example, the SEC requires auditors to retain memoranda, correspondence, communications (for example, electronic mail), other documents, and records (in the form of paper, electronic, or other media) that are created, sent, or received in connection with an engagement conducted in accordance with auditing and related professional practice standards and that contain conclusions, opinions, analyses, or data related to the engagement. (Retention of Audit and Review Records, 17 CFR § 210.2-06, effective for audits or reviews completed on or after October 31, 2003.)

RELEASE**Part of Audit Performed by Other Independent Auditors – An Amendment to Interim Standards**

This proposal would supplement AICPA Professional Standards, AU sec. 543.12 as follows:

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When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in AU sec. 543.10, the principal auditor should consider the need to review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed. In those cases where the other auditor is issuing a report on the financial statements of a material consolidated subsidiary or affiliate of the client, the audit documentation of the work performed by the other auditor should be reviewed by the principal auditor to the extent he or she considers necessary to satisfy himself or herself that all the requirements of GAAS and PCAOB Auditing and Related Professional Practice Standards have been met. In the planning phase of the audit, throughout the audit, and later upon reviewing the audit documentation of the other auditor, the principal auditor should consider the degree to which it is necessary to visit the other auditor and discuss the audit procedures followed and the results thereof and the degree to which it is necessary to instruct the other auditor as to the scope of work to be performed.

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
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January 5, 2004

Thomas Ray
Deputy Chief Auditor
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006

Dear Mr. Ray:

On behalf of the Tennessee Department of Audit we would like to thank you for the opportunity to comment on the Exposure Draft (ED) of the *Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards*.

We generally support the proposed standard and amendments included in the exposure draft. The increased specificity in the proposed standard will be beneficial in providing a better framework to exercise professional judgment in determining the nature, timing, and extent of audit documentation. The proposed standard establishes minimum levels of acceptable documentation that should provide for more uniform evidence of audit work among practitioners. We support how closely the proposed standard parallels *Government Auditing Standards*, particularly in ¶5.

While we generally support the ED, we have identified various suggestions for improvement:

- 1) In the last sentence of ¶2 (“Audit documentation also may be referred to as *work papers* or *working papers*.”), we suggest that the Board consider rewording the sentence to convey the idea that “audit documentation was formerly referred to as work papers or working papers.” Audit documentation conveys other types of media could be used (e.g., electronic documentation, microfiche, etc.) and should be used in establishing a new framework.
- 2) For ¶3c, consider rewording the last phrase to “... and whether there is adequate **and sufficient** evidential support for those conclusions.”

- 3) In the last sentence of ¶6, consider providing examples of what “persuasive other evidence” represents. Also, how can this evidence be persuasive for providing sufficient support for the conclusions reached if it is not part of written audit documentation? The Board needs to clarify how this type of evidence could rebut the presumption that procedures were not applied, evidence was not obtained, and the conclusions reached were suitably supported when not part of audit documentation. Also, consider replacing “suitably” with “adequately.”
- 4) In ¶9c and footnote 1 (page A1-7), the Board correctly indicates that materiality includes both quantitative and qualitative considerations; however, because materiality is mentioned much sooner (i.e., ¶7b) in the standard, we suggest that the Board first point this out in ¶7.

We appreciate the efforts of the PCAOB and the opportunity to provide our comments. Should you have questions or need clarification on any of our comments, please contact Gerry Boaz or me at (615) 741-3697.

Sincerely,

Arthur A. Hayes, Director
Division of State Audit

**Swiss Institute of Certified Accountants
and Tax Consultants**

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Location/Date Zurich, January 20, 2004

Recipient Secretary, Public Company Accounting Oversight Board

Sender Hans Wey, Member of the Executive Committee, and Walter Hess, General
Secretary

PCAOB Rulemaking Docket Matter No. 012 PCAOB Release No. 2003-023:

**Proposed Auditing Standard on Audit Documentation and proposed
Amendment to Interim Auditing Standards
General Comments**

Also by e-mail: comments@pcaobus.org

PCAOB

Office of the Secretary

Mr. Gordon Seymour

1666 K Street, N.W.

Washington, D.C. 20006-2803

U.S.A.

Dear Mr. Seymour

The Swiss Institute of Certified Accountants and Tax Consultants (the "Institute") appreciates the opportunity to submit our general comments to the U.S. Public Company Accounting Oversight Board ("PCAOB") regarding the rulemaking proposed in PCAOB Release No. 2003-023, *Proposed Auditing Standard on Audit Documentation and Amendment to Interim Auditing Standards* (PCAOB Rulemaking Docket Matter No. 012, the "Proposed Standard") by which it implements Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act").

In our three previous letters to the PCAOB and the SEC dated March 27, 2003 (the "March Letter"), July 2, 2003 (the "July Letter") and August 18, 2003 (the "August Letter"), we have provided comments as to how the Act and the proposed registration system for foreign public accounting firms will affect our members. Furthermore, in these letters we highlighted areas where the PCAOB's proposed rules conflict with Swiss law. We refer to our March, July and August Letters and declare them as integral parts of this submission, as many of our comments made therein also apply to the Proposed Standard.

A. General Comments

With regard to the Proposed Standard, we would like to re-emphasize the following:

We have the same intention and are aiming for the same goal as the U.S. legislator, the SEC and the PCAOB, namely "to protect the interests of investors and further the public interest in the

preparation of informative, accurate and independent audit reports for companies the securities of which are sold to, and held by and for, public investors" (Sec. 101(a) of the Act).

Nevertheless, we would like to take this opportunity to emphasize that the Proposed Standard contains certain provisions that would create serious conflicts with Swiss Law.

B. Topics of Concern regarding the Proposed Standard

The chief topics of concern to us are the following:

- I. Reviewability Standard and Presumption
- II. Period for Assembly of Audit Documentation
- III. Multi-location Audits
- IV. Part of Audit Performed by Other Independent Auditors

I. Reviewability Standard and Presumption

(1) Objectives and Use of Audit Documentation

We completely support the PCAOB's assessment of the importance of audit documentation in para. 2 of the Proposed Standard. For the avoidance of notional unclarity, we would like to distinguish two types of documentation:

- (a) Opinions, client memoranda, inter-office memoranda and related correspondence between an audit firm and its client or the lead auditor (principal auditor), which are designed to be released to the audit client, the lead auditor (in case of a contribution to a consolidated audit), and (regarding opinions, but not client memoranda, management letters or similar) to third parties, even the public at large, and
- (b) workpapers (one word) (internal memoranda, internal correspondence, work schedules, document lists, internal e-mails etc.), which are designed for internal use within the audit firm exclusively, and which are not normally released to third parties, not even the audit client, except under very particular circumstances.

Thus, contrary to para. 3 lit. d and f of the Proposed Standard, workpapers would not normally be available to advisors engaged by the audit committee or representatives of a party to an acquisition.

As regards the Swiss legal situation, non-Swiss quality control reviewers and non-Swiss external inspection teams (para. 3 lit. c and e of the Proposed Standard) may under certain circumstances

review workpapers, but are not normally being sent workpapers except after consultation with and specific approval by the client, and after deletion/elimination of information covered by secrecy duties which cannot be waived by the audit client (data protection, banking secrecy regarding bank client information, business secrets of business contacts of the audit client, employee data, information whose release would constitute economic espionage, etc.¹)

(2) GAGAS as inappropriate Standards

GAGAS (Generally Accepted Government Auditing Standards) are auditing standards established by the U.S. General Accounting Office publication "Government Auditing Standards". They are promulgated by a U.S. governmental agency, designed for the specific purpose of auditing governmental agencies and bodies (public and private) acting under a governmental contract or grant. The scope and underlying premises of such an audit are substantially different from one performed in accordance with GAAS or similar standards, *e.g.*, an auditor under GAGAS also has the responsibility for "Detecting Material Misstatements Resulting from Violations of Contract Provisions or Grant Agreements, or from Abuse" (GAGAS § 4.17, 4.19).

The nature, scope and underlying premises of an audit performed in accordance with GAGAS are so profoundly different from an audit performed by accounting firms under GAAS as to make the application of GAGAS to public company audits appear unrealistic and unnatural.

Also GAGAS are not known outside the U.S. and thus impractical to be applied in an international context and to non-U.S. accounting firms.

(3) Reviewability Standard, in particular Personal Discussions as Source for Audit Opinion

The concept that "audit documentation must contain sufficient information to enable an experienced auditor... to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached" (para. 5 of the Proposed Standard, which, unlike para. 9, does not provide for a materiality threshold) in our view neglects the importance of oral discussions held with representatives of the audit client and within the audit firm at all levels, and also of the professional judgment applied by individual partners and senior managers responsible for an audit. It would be impractical, even counter-productive, and in any case not cost-effective, to document all of such discussions in writing in sufficient detail so that such documentation would be understandable on its own, without oral commenting by the responsible auditor.

¹ See B.III(2) below. We refer to our March Letter and July Letter for a more encompassing description of applicable Swiss secrecy duties.

We would, however, not object to a standard that would require documenting of **material information** (gained from whatever source and in whether form, oral or in writing), and of the **results** of the audit and the **conclusions** drawn therefrom (*cf.* para. 9 of the Proposed Release).

(4) Disagreements and Inconsistent Findings and Issues

While we agree that there should be a possibility for partners and senior managers responsible for an audit engagement to put any differing opinions, professional discussions and non-resolvable disagreements on record, it seems impracticable and counter-productive to evidence any and all disagreements among members of the engagement team (para. 9 lit. d, para 12 second sentence of the Proposed Standard), in particular if they relate to non-material items or are later withdrawn by the person that has brought them up.

Similarly any conclusion in an audit process is reached by weighing factors and information that, taken individually, may be seen as supporting contradictory conclusions, but that may be reconcilable in light of the overall situation of the audited company. Documenting them in the auditor's final conclusions statement would give them a weight unwarranted in the overall process. Doing so, again, would be impracticable and counter-productive (para. 12 first sentence of the Proposed Standard).

(5) Presumption

The exclusion of oral testimony as a means to rebut the presumption of para. 6 second sentence of the Proposed Standard, as set forth in Part A of the Proposed Standard², cannot be reconciled with the concept that partners and senior managers responsible for an audit may form their professional opinion (also) on the basis of oral discussions and other soft factors that do not lend themselves to complete and encompassing documentation. These persons should, under any circumstance, be allowed to testify in support of the work performed in the course of an audit and the conclusions drawn therefrom, even if not reflected, or not reflected in all detail, in the audit documentation. Insofar as the presumption excludes oral testimony as means for rebuttal, it is unacceptable for us.

II. Period for Assembly of Audit Documentation

While we agree that audit documentation should be completed within a reasonable period of time after completion of the audit process and release of the audit, we feel that the 45 day period set as a maximum for such assembly in para. 14 third sentence of the Proposed Standard would pose an incommensurate burden on the audit firm without any corresponding benefit. Having to assemble the documentation immediately after conclusion of an audit would bind staff that the audit firm

² Part A of the Proposed Standard , page 4, end of third para.: "The Board contemplates that oral explanation alone would not constitute persuasive other evidence ..."

should be free to assign according to most pressing needs. This short maximum assembly period would be particularly burdensome for smaller auditing firms with a limited number of qualified personnel.

We thus propose not to specify the maximum duration, or at least to extend the period for assembly of audit documentation to a maximum of 90 days.

III. Multi-location Audits

Paragraph 16 first and second sentence³ of the Proposed Standard, taken literally, would require the auditor of a Swiss subsidiary of a non-Swiss issuer to submit its audit documentation (originals or copies) to the principal audit firm.

In our understanding, such encompassing document production to the principal auditor outside Switzerland would violate Swiss law in several aspects, and would impose an impracticable and unduly costly burden on audit firms and their clients.

Audit documentation often contains detailed information regarding the business operations of a Swiss subsidiary, such as information on its employees, bank or security trader's clients, suppliers, governmental agencies, or other third parties as well as transactional and contractual data that may be protected under Swiss law.

- (1) Summary of conflicts between the PCAOB's requirement to produce audit documentation and Swiss law

Any document production to the principal auditor outside Switzerland would violate Swiss law and expose the Swiss audit firms, their partners and employees to criminal and civil liability:

- (a) where doing so is prohibited by, or would conflict with mandatory Swiss and other applicable law,
- (b) where prohibitions by or conflicts with Swiss law could be avoided by consents and waivers of our clients and third parties but such consents and waivers are either unobtainable or invalid, including instances where the validity of such consent and waiver is doubtful and cannot be confirmed or has not yet been confirmed when documents are due for production,

³ "Audit documentation sufficient to meet the requirements of paragraphs 4 - 12 (including documentation of work performed by others, such as affiliated firms) must be retained by the office issuing the auditor's report. With respect to the audit documentation related to the work performed by others, the auditor issuing the report ordinarily should retain the original audit documentation or copies of such documentation."

- (c) where doing so could reasonably be expected to expose the Swiss audit firm or its associated persons to civil liability towards other parties or legal sanctions (civil or criminal, financial or otherwise) with potentially significant negative impact.

The alternative provided by the third sentence of para. 16 of the Proposed Standard⁴, as we read it, does not bring any remedy to this problem because it refers back to para. 4 - 12 of the Proposed Standard, so that the principal auditor appears to be obliged to redo the audit work in order to achieve the required degree of completeness of documentation.

(2) Details of legal conflicts

- (a) First of all, since the duty for such document production rests on a standard promulgated by the PCAOB, it is obvious that its chief purpose would be to allow the PCAOB or the SEC direct and unhindered access to such documentation in case of an investigation. It would thus be viewed from a Swiss perspective as a preparatory measure for and circumvention of the limitations imposed by Swiss law on acts of a foreign states performed in Switzerland. There is thus a substantial risk that an audit firm in Switzerland, complying with the request set forth in para. 16 first and second sentence of the Proposed Standard, would violate article 271 of the Penal Code (“PC”), a provision of criminal law protecting the **Swiss sovereignty on Swiss territory**. As such, a Swiss audit firm, its partners and employees that gather documentation from third parties to comply with such a request would be acting in violation of article 271 PC and thus would expose themselves to criminal liability.
- (b) Furthermore, a Swiss audit firm, its partners and employees that produce audit documentation pursuant to para. 16 first and second sentence of the Proposed Standard would violate **auditors’ secrecy**, which is provided for under Swiss criminal law (article 321 PC) as well as by private company law (in particular article 730 of the Swiss Code of Obligations, “CO”); **data secrecy** which is provided for under article 35 of the Federal Law on Data Protection (“DPL”); and **manufacturing and business secrecy** which is provided for under article 162 PC. Furthermore, article 273 PC (economic espionage) of the Swiss criminal law may also be violated.
- (c) If the audit client is a bank or a securities dealer, the production of audit work papers under these circumstances is very likely also to violate **banking secrecy** duties, which are provided for under the Banking Act (“BA”) and / or **stock exchange and securities**

⁴ “Alternatively, if the auditor considers it necessary in the circumstances, the auditor issuing the report should prepare and retain audit documentation of the work performed by others as part of the review required by paragraph 12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, as long as the audit documentation complies with paragraphs 4-12 of this standard.” This provision also does not consider the situation where part of the audit is conducted by an audit firm belonging to the same network.

traders secrecy duties, which are provided for under the Stock Exchange and Securities Traders Act (“SESTA”); the violation of both regulations constitutes a criminal offence punishable by imprisonment or a fine.

- (d) Furthermore, the production of audit documentation under these circumstances could be in conflict with the **principles of the Data Protection Law** (“DPL”) in Switzerland.

In order to avoid violations of the Swiss legal provisions referred to in the four preceding paragraphs, the audit documentation would have to be cleansed of any sensitive information before delivery to the principal auditor. So cleansed, however, it would lose its characteristics as audit documentation and would no longer satisfy the requirements set forth in para. 4 through 12 of the Proposed Standards.

(3) Consent or waivers

A **consent or waiver** by the audit client may avoid some of the conflicts with Swiss Law detailed above. However, in those instances where the information is also protected in favor of a third party (such as clients of the audit client, in particular but not limited to bank clients), the consent or waiver by such third parties would also be required prior to the production of workpapers to the principal auditor outside Switzerland. It can be anticipated that consents from such third parties would not be obtainable. In particular, with respect to audit clients who are banks or securities traders in the sense of the BA or the SESTA, respectively, we consider it not only impossible to obtain such consents from all of the third parties who could potentially be affected by the production of audit workpapers, but such consent gathering would also be against Swiss public policy.

We stress that the violation of article 271 PC and article 273 PC (regarding information of Swiss national interest) may not be avoided by a consent or waiver.

Where a consent can avoid the violation of Swiss law, the consent must be given (i) on a fully informed basis (about the information which will be disclosed and the consequences of the disclosure) and (ii) by free will in order to be legally valid. The consent can be revoked at any time before the production of the audit workpapers. Thus, a consent to produce documents to the principal auditor would not automatically cover the production by the principal auditor upon request by the PCAOB or SEC in the course of an investigation. Client and third party consents, where obtained and valid, would have to be re-confirmed in light of a specific PCAOB request, without which release of documentation to the PCAOB or SEC, even if permitted under U.S. law as the *lex actae sitae*, would violate Swiss law and expose the Swiss auditor to criminal and penal sanctions.

(4) Problems for Principal Auditors

Central retention of audit workpapers pursuant to paragraph 16 first sentence of the Proposed

Standard does not only pose problems for our members as contributing auditors, but also in their role as principal auditors, where they are unable to meet their respective duties because contributing auditors in third countries for similar reasons as set forth above are unable or unwilling to produce their audit documentation as requested.

It goes without saying that the cleansing and consent gathering process could not be completed within the time period of 45 days.

(5) Conclusion

We recommend that the PCAOB amend and clarify paragraph 16 third sentence of the Proposed Standard so as to allow for audit documentation to be stored at the site of the auditor who has performed the work, where it would be open for review by the principal auditor in view of assuring uniformity of standards and reviewing specific results and conclusions, of course respecting the limitations imposed by Swiss law. Documentation evidencing such a review process and conclusions drawn therefrom could then be kept at the principal auditor's offices. Such review documentation itself would have to meet the requirements of para. 4 through 12 of the Proposed Standard only insofar as this is warrant for a review documentation.

IV. Part of Audit Performed by Other Independent Auditors

We do not agree with the amendment applied by the PCAOB to the documentation requirements of AU sec. 543.12 as a conclusion and part of the Proposed Standard. Where the principal auditor elects not to make reference to the audit of the other auditor (because all auditors involved are members of the same network), he or she is supposed to perform his or her duties regarding selection, quality control and selective review. The principal auditor should not, however, be required to "review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those [employees and other associated persons] who participated in the engagement is reviewed". This approach neglects the very nature of a network of auditors, where one member relies on the work of other members of the network on the basis of common training, quality standards and uniform review procedures.

We also object to the requirement that "sufficient documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor to meet all the requirements of the [Proposed Standard]" (*cf.* what we have said in part B.I above).

We also think that a PCAOB Release regarding audit documentation standard should not use expressions that could be used to buttress theories of joint liability between the principal auditor and an independent contributing audit firm of the same network, irrespective of whether the principal auditor has fulfilled its specific duties. We thus propose to re-word the phrase "the principal auditor decides to assume responsibility for the work of other auditors" (page A2-2 second para., second sentence) by eliminating the expression "responsibility".

c. Overall Conclusions

Neither principle nor duration of audit documentation retention as prescribed by the Proposed Standard would pose any problems to our members who are affected by it in their roles as principal auditors for issuers (and as such have to register as foreign public accounting firms pursuant to Sec. 102 and 106(a) of the Act) or contributing auditors in the course of consolidated audits (and as such are subject to Section 106(b) of the Act). The Proposed Standard, however, in our opinion does not make reference to a body of standards appropriate for international audit assignments, and does not take into consideration the problems posed by international consolidated audits with their diversity of scope and procedures of review, let alone divergence of applicable laws. In particular and foremost, the reviewability standard (without reference to materiality), the exclusion of oral testimony as a means to rebut the presumption, the minimum period for assembly of documentation, and the central retention of audit documentation in a multi-location audit (including the proposed amendment to AU sec. 543.12) are unacceptable for us for incompatibility with Swiss law as well as for practical and cost reasons.

We appreciate the opportunity to express the serious concerns of our members with regard to the Proposed Standard.

We look forward to continuing discussions with the PCAOB regarding these matters until a solution has been found that achieves our common cause, while fairly balancing the interests of the parties involved and finding practical solutions for mitigating conflicts imposed by different legal systems.

Respectfully submitted,

Swiss Institute of Certified Accountants and Tax Consultants

Hans Wey
Member of the Executive Committee

Walter Hess
General Secretary



January 20, 2004

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

RE: PCAOB Rulemaking Docket Matter No. 12
Proposed Auditing Standard on Audit Documentation and Proposed Amendment
to Interim Auditing Standards

To Whom It May Concern:

One of the expressed goals of the Texas Society of Certified Public Accountants (TSCPA) is to speak on behalf of its members when such action is in the best interest of its members and serves the cause of Certified Public Accountants in Texas, as well as the public interest. The TSCPA has established a Professional Standards Committee (PSC) to represent those interests on accounting and auditing issues. This communication is in accordance with that goal and refers to PCAOB Release No. 2003-023.

Our committee supports the issuance of the proposed auditing standard. We believe it addresses issues that are critical in establishing sound guidance in the area of audit documentation. We believe the draft of the proposed standard on audit documentation appropriately considered many of the issues raised during the September 29, 2003 roundtable dealing with this topic.

We do wish to comment on two issues related to the proposed auditing standard. Paragraph 5 of the proposed standard requires that audit documentation be sufficient to enable "an experienced auditor" to understand procedures performed, evidence obtained, and conclusions reached. To accomplish these objectives, we believe "an experienced auditor" should possess sufficient knowledge of the industry in which the auditee operates. We believe it would be unreasonable to expect an auditor, no matter how experienced, to possess the ability to accomplish these objectives in a wide range of industries. Thus, we suggest that the first part of paragraph 5 be amended to read:

"Audit documentation must contain sufficient information to enable an experienced auditor, with sufficient knowledge of the auditee's industry, having no previous connection with the engagement. . ."

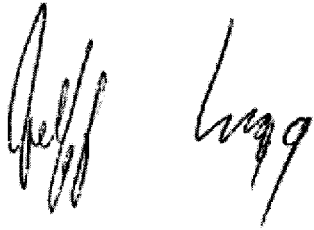
Our second issue concerns paragraph 6. No guidance is given as to what constitutes "persuasive other evidence." We assume that oral evidence would not constitute

PCAOB
Docket Matter No. 12
January 20, 2004
Page Two

“persuasive other evidence.” Thus, if oral evidence is excluded, then any “persuasive other evidence” must be capable of being documented. If so, there is no need for any of the information included in paragraph 6 other than the first sentence.

We appreciate the opportunity to present these comments in accordance with the goals of our committee.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeff Gregg". The signature is written in a cursive, somewhat stylized font.

C. Jeff Gregg, CPA
Chair, Professional Standards Committee
Texas Society of Certified Public Accountants



G A O

Accountability * Integrity * Reliability

Comptroller General
of the United StatesUnited States General Accounting Office
Washington, DC 20548

January 12, 2004

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

Subject: *PCAOB Rulemaking Docket Matter No.012—Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards*

This letter provides the U.S. General Accounting Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) November 21, 2003, proposed standard on audit documentation and the proposed amendment to the interim auditing standards dealing with cases where part of an audit is performed by other independent auditors.

We commend the PCAOB for giving these important issues priority. Overall, we support the proposed standard. We are especially pleased that the proposed standard adopts the substance of the audit documentation standard from *Government Auditing Standards*, which requires that "audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions."¹ Given PCAOB's responsibility for conducting inspections of registered public accounting firms, we believe the adoption of such a documentation standard is appropriate and necessary. We also support the PCAOB's "rebuttable presumption" standard, which states that the failure to document procedures performed, evidence obtained, and conclusions reached creates a presumption (rebuttable with persuasive evidence) that the procedures were not applied, the evidence was not obtained, and conclusions reached were not suitably supported.

GAO believes that any new standards on audit documentation should balance the desire to improve audit quality and value against the danger of becoming overly prescriptive, while adhering to the primary objective of audit documentation, which is providing sufficient, competent evidence to support the opinions in the auditor's report. Audit documentation is an essential element of audit quality.

Enclosure 1 contains GAO's comments on the following provisions of PCAOB's Proposed Auditing Standard on audit documentation:

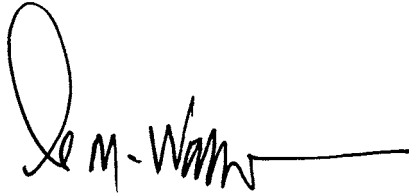
¹ *Government Auditing Standards* (GAO-03-673G, June 2003), paragraph 4.22.

- Dating audit documentation
- Reference to documentation stored in a central repository
- Documentation of significant findings or issues
- Documentation of significant audit adjustments
- Requirement to prepare engagement completion memo
- Requirement to identify items tested
- Retention of audit documentation
- Open-ended retention requirement
- Implementation date

GAO's comments on the PCAOB's Proposed Amendment to Interim Auditing Standards on dealing with cases in which part of an audit is performed by other independent auditors are contained in Enclosure 2.

We thank you for considering our comments on this very important issue.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D M Walker", followed by a horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

Enclosures

cc: The Honorable William H. Donaldson, Chairman
Securities and Exchange Commission

The Honorable William J. McDonough, Chairman
Public Company Accounting Oversight Board

GAO's Comments on the Proposed Auditing Standard on Audit Documentation

Dating audit documentation (paragraph 5.b.)

GAO believes that the requirements in paragraph 5.b. of the proposed standard for preparers and reviewers to date **all** audit documentation would be difficult to implement due to the continuous, ongoing nature of audit procedures. We believe that audit documentation should indicate who performed the work as well as the name of the person who reviewed the work. On the other hand, dating the documentation is more problematic because of the difficulty of determining when a working paper is actually completed and when a review is actually finished. We believe it is important to have preparation and review dates for **key** documentation, such as the audit completion checklist and the report or product clearance document, which demonstrate that the auditor's report is supported and reviewed. However, any requirement for dating other working papers should be left up to the individual audit organization.

Reference to documentation stored in a central repository (paragraph 8)

We recommend deleting from paragraph 8 the requirement for audit documentation to specifically refer to the central repository when applicable engagement information, such as independence and training records, is stored there. We believe that the best way to handle this situation is by looking to the firm's policies and procedures rather than requiring references in each engagement file.

Documentation of significant findings or issues (paragraph 9)

Paragraph 9 of the proposed standard includes types of significant findings that auditors must document. We recommend adding to this list all material weaknesses, significant deficiencies, fraud, illegal acts, and significant instances of noncompliance with applicable rules and regulations. We would also add to this list identification and resolution of potential finding in audits of internal control over financial reporting.

Documentation of significant audit adjustments (paragraph 9.c.)

We recommend clarifying paragraph 9.c. with the following changes:

Significant findings or issues include, but are not limited to, the following . . . **proposed and actual** audit adjustments and the ultimate resolution of these items. For purposes of this standard, an *audit adjustment* is a proposed correction of a misstatement of the financial statements that could, in the auditor's judgment, either individually or in the aggregate, have a material effect on the company's financial **statements reporting process**. Audit adjustments include corrections of misstatements of which the auditor is aware that were or should have been proposed based on the known audit evidence.

GAO's Comments on the Proposed Auditing Standard on Audit DocumentationRequirement to prepare engagement completion memo (paragraph 10)

Paragraph 10 of the proposed standard would require an engagement completion memo for all engagements. Instead, we recommend requiring important information to be included in a format and location that will assure review by the principal auditor who will sign the audit report. The key concern is to assure that the report signer is informed of significant findings and issues. The format and location of the information within the audit documentation are details that can be handled by firm policies and procedures.

Requirement to identify items tested (paragraph 11)

We recommend clarifying the wording of footnote 2 to indicate that the auditor is not required to make copies of all documents examined. Without clarification, the wording of paragraph 11 and footnote 2 could lead auditors to believe that this type of detailed documentation is needed as identification of items tested.

Retention of audit documentation (paragraph 13)

We recommend adding to paragraph 13 of the proposed standard a requirement for documentation to be stored in retrievable form. This is especially important in light of the new 7-year retention requirement and the evolving nature of audit software, and could also be relevant in situations where part of the audit work was performed at different offices of the audit organization or by other auditors.

Open-ended retention requirement (paragraph 17)

We recommend revising paragraph 17 of the proposed standard in order to clarify the Board's intent in this paragraph. The transcript of the PCAOB's September 29, 2003, Audit Documentation Roundtable indicates that retention requirements for other audit-related documentation have caused significant confusion. Footnote 4 to paragraph 17 provides guidance on what constitutes audit-related documentation; however, the reason for including this paragraph in the standard is unclear.

Implementation date (paragraph 18)

We believe that the provisions of paragraph 18 of the proposed standard, which would apply it to engagements completed on or after June 15, 2004, would be difficult for audit organizations to implement because it would affect engagements that are already underway. We recommend that the PCAOB adopt an implementation date for engagements beginning on or after June 15, 2004, or the date that the final standard is issued, whichever is earlier.

**GAO's Comments on the Proposed Amendment to Interim Auditing Standards
on Part of an Audit Performed by Other Independent Auditors**

We believe that confusion could result from the requirement in the proposed standard that “sufficient documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor to meet all the requirements of PCAOB Auditing and Related Professional Practice Standards No. X, **as if the principal auditor had performed the work himself or herself**” [our emphasis added]. We are unsure of what this requirement means in that it is not specific enough and could cause firms to go to varying lengths in trying to adhere to it. This could result in burden and unintended consequences if firms go too far. We believe that the guidance provided in the GAO/PCIE *Financial Audit Manual* (FAM)² provides balanced and specific guidance for handling reviews of other auditors' work.

The FAM includes guidelines for the principal auditor's review of other auditors' documentation and uses a risk-based approach in which the principal auditor would consider the independence and qualifications of the other auditors as well as audit risk and materiality in determining the extent of the review. The FAM also provides guidelines for documenting the principal auditor's review when the principal auditor does not make reference to the work of the other auditors. After the principal auditor has completed reviewing the other auditors' work, the FAM requires the principal auditor to determine whether their work is sufficient and acceptable for the principal auditor's use and to document this determination in the audit file. We recommend that, in order to improve the quality of audit documentation and auditor practice in these situations, the PCAOB should adopt requirements similar to those in the FAM.

The FAM also notes the importance of distinguishing between the principal auditor's responsibilities to review the documentation of other auditors versus the principal auditor's responsibilities to document the procedures performed and the results of the review of other auditors' documentation. The FAM cautions the principal auditor to use judgment in deciding which of the other auditors' documents to copy and retain, and notes that copies of documents readily available from the other auditors or the auditee (such as invoices and contracts) need not be retained.

²General Accounting Office / President's Council on Integrity & Efficiency, *Financial Audit Manual* (GAO-03-466G, April 2003), pages 650-18 to 650 A-3.



Via email: comments@pcaobus.org

January 20, 2004

Office of the Secretary
Public Company Accounting Oversight Board (PCAOB) - U.S.
1666 K Street N.W.
Washington, DC 20006-2803

RE: Proposed Rulemaking 2003-023
Docket Matter No. 012

Dear Sir or Madam:

Following are our general comments with respect to the proposed rulemaking.

VisageSolutions supports the PCAOB's direction to require more meaningful audit documentation. This includes capturing dissenting opinions and findings as proposed in the text. This also includes requiring the auditor to capture and document inconsistencies and deficiencies that have material potential. Lastly, this includes summarizing and documenting the audit engagement and findings in a manner to allow an unfamiliar auditor to re-construct the audit, as if from scratch, to arrive at a concurring or dissenting conclusion. All of this is in keeping with the objective of a fair, public audit. If the audit report can not withstand legitimate, professional scrutiny and questioning from an unbiased third party, then the audit report has no reason to exist.

We would expect that certain Public Accounting Firms may take issue with the notion that dissenting opinions should be captured in the permanent audit record. **VisageSolutions** believes that requiring that such opinions be captured will have several positive effects:

1. Credible dissenters can mitigate or avoid downstream (personal) liability for an erroneous or fraudulent audit opinion by going on record in the audit workpapers opposing the erroneous or fraudulent work, practice and/or findings
2. If no dissenting opinions are offered and documented, then the entire audit team can/will be liable if malpractice or fraud in connection with the audit is established downstream. That is, lack of evidence of a dissenting opinion in the audit workpapers would be interpreted as though no dissenting opinion existed - therefore the audit team is or was in full agreement with the findings. This should mitigate attempts to avoid accountability downstream as all will be presumed complicit or in agreement with the (erroneous) findings
3. It will impel honest accountants to challenge potentially dishonest or illegal acts and interpretations. This will impel Accounting firms to recognize and, presumably, resolve the different opinions for a fair audit finding

4. Public Accounting firms may be forced to address these matters to recognize their obligation for a fair, objective assessment

As a practical matter, **VisageSolutions** would expect that dissenting opinions in the audit work papers will only exist when and if a dissenting Accountant/Auditor/Specialist believes that a significant misrepresentation or illegal representation is being considered by one or more parties to the audit. Dissenting opinions over insignificant matters and/or over different (but otherwise legal) interpretations, will probably not find their way into the audit work papers. At least initially, entering a dissenting opinion into the audit work papers may be a 'career limiting move' for the dissenter. Accordingly, dissenting opinions will not be taken lightly. They will probably exist only when and if the dissenter feels very strongly about his or her dissent and is prepared to suffer the organizational consequences of his or her conviction (and/or integrity).

With respect to the seven-year requirement for protection and preservation of audit work papers, the PCAOB might consider requiring the Public Auditor to separately archive a full set of the audit work papers in a third party or Federal repository, and seal the copy under postmark. This would mitigate the possibility of work paper loss, adulteration or modification after the audit is concluded. If the archived information is protected from unauthorized disclosure and is not subject to Open Records Acts or curious parties, then the existence of the archived copy should not cause concern to the auditor or the company. It would not be opened or reviewed for any reason unless the PCAOB, SEC, or other Federal bureau had cause to open the file, or if the PCAOB decided to review the audit. But the fact that the archived copy is the "of record" copy would prompt the auditor to fully document the audit within the 45 day retention timeframe, and to file the work papers intact. Absence of information in the filed copy or differences between the filed and "original" copies could/would be interpreted to mean that other papers or notes in the "original" audit document set are/were added after the fact. Though making a copy of the audit and filing it in this manner represents added work, the cost of replication and filing is small in comparison with the actual audit expense.

Thank you for the opportunity to comment on the propose rulemaking. **VisageSolutions** supports the PCAOB's initiatives to restore integrity in the financial reporting and auditing process.

Sincerely,

Glenn W. Conway
Partner, **VisageSolutions** LLC



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AUDIT DOCUMENTATION AND AMENDMENT)	PCAOB Release No. 2004-006
TO INTERIM AUDITING STANDARDS)	June 9, 2004
)	
)	PCAOB Rulemaking
)	Docket Matter No. 012
)	
)	
)	

Summary: After public comment, the Public Company Accounting Oversight Board (the "PCAOB" or "Board") has adopted Auditing Standard No. 3, *Audit Documentation*, and an amendment to AU sec. 543 of the interim auditing standards. The Board will submit this standard and amendment to the Securities and Exchange Commission ("SEC" or "Commission") for approval pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the "Act"). This standard will not take effect unless approved by the Commission.

Board
Contacts: Greg Scates, Associate Chief Auditor (202/207-9114; scatesg@pcaobus.org), and Greg Fletcher, Assistant Chief Auditor (202/207-2203; fletcher@pcaobus.org).

* * *

Section 103(a)(2)(A)(i) of the Act expressly directs the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. Audit documentation is one of only a few topics that the Act expressly requires the Board to adopt standards. Accordingly, the Board made audit documentation a priority in its standards setting responsibilities.

The Board commenced a standards-development project on audit documentation by convening a public roundtable discussion on September 29, 2003, to discuss issues



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and hear views on audit documentation. Before that roundtable discussion, the Board prepared and released a briefing paper on audit documentation, which posed several questions to help identify the objectives – and the appropriate scope and form – of audit documentation.^{1/} In addition, the Board asked participants to address specific practice issues relating to, among other things, changes in audit documentation after an audit report has been released; the essential elements and the appropriate amount of detail of audit documentation; the effect on audit documentation of a principal auditor's decision to use the work of other auditors; and retention of audit documentation.

Taking into consideration comments from participants in this roundtable discussion, advice from the Board's staff, and other input, the Board determined that the existing interim auditing standard on audit documentation was not sufficient in providing direction to ensure that auditors appropriately document both the work they perform and the conclusions they reach in connection with audits and other engagements. On November 21, 2003, the Board issued a proposed auditing standard entitled *Audit Documentation*, as well as a related amendment to an interim auditing standard (paragraph .12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*).

The Board received 38 comment letters from a variety of interested parties, including auditors, regulators, professional associations, and government agencies. Those comments led to some changes in the requirements of the standard.

The Board's standard on audit documentation will be one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest. The integrity of an audit depends, in large part, on the existence of a complete and understandable record of the work that the auditor performed, the evidence gathered, and the conclusions reached. Meaningful review by managers and partners, or by the Board in the context of its inspections, would be difficult, if not impossible, without adequate documentation. Clear and comprehensive audit documentation is essential for auditors to enhance the quality of the audit and for the Board to fulfill its mandate to

^{1/} See Briefing Paper for the Roundtable on Audit Documentation, dated September 10, 2003. The transcript of the September 29, 2003 roundtable discussion and copies of the briefing paper are available on the Board's Web site (www.pcaobus.org).



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inspect registered public accounting firms "to assess the degree of compliance" of those firms with applicable standards and laws.

Appendices 1 and 2 to this release contain, respectively, the text of Auditing Standard No. 3, *Audit Documentation*, and the amendment to AU sec. 543. Appendix A to Auditing Standard No. 3 includes the Board's analysis of the comments received and the Board's responses.

A. Introduction

Auditors document the evidence supporting the conclusions reached in their reports with a work product commonly referred to as *audit documentation* or *working papers*. Sufficient audit documentation is an integral part of a quality audit. That is, the auditor documents not only the nature, timing, and extent of the work performed, but also the professional judgments made by members of the engagement team and others.

In addition to providing the basis for the conclusions in the auditor's report, audit documentation facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions.

First and foremost, the objectives of this audit documentation standard are to improve audit quality and to enhance public confidence in the quality of auditing and other engagements. Complete and thorough audit documentation improves the quality of the work performed in many ways. One important example is that quality audit documentation is a record of the actual work performed, which provides assurance that the auditor accomplished the planned objectives. Further, the need to document the procedures performed, the evidence obtained, and the conclusions reached demands a disciplined approach to planning and performing the engagement. Also, audit documentation facilitates the reviews performed by supervisors, managers, partners, and PCAOB inspectors.

Inadequate audit documentation diminishes audit quality on many levels. First, if audit documentation does not exist for a particular procedure or conclusion related to a significant matter, its absence casts doubt as to whether the necessary work was done.



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If the work was not documented, then it becomes difficult for members of the engagement team, and others, to know what was done, what conclusions were reached, and how those conclusions were reached.

The more significant differences between existing requirements under the interim auditing standards and this new standard on audit documentation, along with the related amendment, are described in the following sections.

B. Auditors Must Document Their Work

As previously mentioned, the principal objective of this standard is to improve the quality of audits and other engagements. In so doing, this standard affirmatively requires that auditors document procedures performed, evidence obtained, and conclusions reached. Likewise, a deficiency in documentation is a departure from the Board's standard. The Board emphasizes that, in the event of a deficiency in documentation, the auditor must be prepared to present persuasive other evidence that the procedures were performed, evidence was obtained, and appropriate conclusions were reached.

If it is questionable whether audit procedures were performed or evidence was obtained, the auditor must determine, and if so demonstrate, that the necessary procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. There may be circumstances (for example, a Board inspection) in which the auditor may be required to demonstrate with persuasive other evidence that the procedures were actually performed, the evidence was actually obtained, and appropriate conclusions were actually reached. In this and similar contexts, oral explanation alone does not constitute persuasive other evidence. However, oral evidence may be used to clarify other written evidence.

The failure to prepare adequate documentation is serious. The severity of that failure depends on the factors that determine the nature and extent of the documentation for a particular audit area or auditing procedure. For example, when the risk of material misstatement associated with an assertion is high, the failure to document the procedures, evidence, and conclusions related to that assertion is a very serious violation of PCAOB standards. Failure to provide adequate documentation could limit an auditor's ability to demonstrate that the work was actually performed.



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C. An Experienced Auditor Must Understand the Work

Audits and reviews of issuers' financial statements are now, under the Act, subject to review by PCAOB inspectors. Therefore, the Board determined that a documentation standard that enables a PCAOB inspector to understand the work that was performed is essential. Similar to the U.S. General Accounting Office's documentation standard for government and other audits conducted in accordance with generally accepted government auditing standards,^{2/} this standard requires audit documentation to contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, the name of the person(s) who performed it, the date it was completed, and the conclusions reached.

This standard also defines an *experienced auditor* as one who has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

D. Two Significant Dates Defined in this Standard

To ensure quality and consistency in the preparation and retention of audit documentation, the standard defines two important dates: (1) the report release date and (2) the documentation completion date. The *report release date* is the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. After the report release date, auditors will have 45 days to assemble a complete and final set of audit documentation. The end of this 45-day period is the *documentation completion date*.

Prior to the report release date, the auditor must have –

- Completed all necessary auditing procedures, including clearing review notes and providing support for all final conclusions, and

^{2/} U.S. General Accounting Office, *Government Auditing Standards*, "Field Work Standards for Financial Audits" (2003 Revision), paragraph 4.22.



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- Obtained sufficient evidence to support the representations in the auditor's report.

If the auditor obtains and documents evidence after the report release date, the auditor should refer to the interim auditing standards, AU sec. 390, *Consideration of Omitted Procedures After the Report Date* and AU sec. 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* for related guidance. Auditors should not discard any previously existing documentation in connection with obtaining and documenting evidence after the report release date.

If procedures are performed subsequent to the report release date, auditors must identify and document any additions to audit documentation as a result of those procedures. This documentation must include the nature of the change, the date of the change, the name of the person who prepared the change, and the reason for the change. Furthermore, audit documentation must not be deleted or discarded after the documentation completion date.

E. Subsequent Changes to Audit Documentation

This standard requires that changes to audit documentation after the documentation completion date be documented without deleting or discarding the original documents. Such documentation must indicate the date the information was added, who added it, and the reason for adding it. The SEC has articulated its position on working papers, as well as the importance of documenting any subsequent changes to the working papers.

Working papers prepared or collected by auditors in the course of an audit provide the single most important support for their representation regarding compliance with generally accepted auditing standards. They serve as the repository for the competent evidential matter necessary to afford the auditors with a reasonable basis for opining on an issuer's financial position. Transactions or events occurring long after the balance sheet date often require reference to prior working papers, and such working papers may have significant usefulness in future audits. It is therefore imperative that auditors preserve their working papers in a complete and unaltered form.



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Auditors should be encouraged to devise orderly procedures for the proper control over the contents of working papers. Moreover, the Commission recognizes that the necessity for evidential matter to be included in the auditor's working papers varies substantially depending on individual audits. When any alterations or additions are made to the working papers subsequent to the issuance of the auditor's report, however, such alterations or additions should themselves be properly documented and indicate the time and circumstances under which they are made.^{3/}

F. Documentation Deficiencies

Documentation added to the working papers well after completion of the audit or other engagement is likely to be of a lesser quality than that produced contemporaneously when the procedures were performed. It is very difficult to reconstruct and recall specific activities related to gathering audit evidence months, and perhaps years, after the work was actually performed. The turnover of both firm and company staff can cause difficulty in reconstructing conversations, meetings, data, or other evidence. Also, with the passage of time memories fade. "Research has shown that minutes, hours or days after an experience, memory preserves a relatively detailed record, allowing us to reproduce the past with reasonable if not perfect accuracy. But with the passing of time, the particulars fade and opportunities multiply for interference – generated by later, similar experiences – to blur our recollections."^{4/}

The Board believes that audit evidence should be documented at the time the procedures are performed and that oral explanation should not be the primary source of evidence. Furthermore, any oral explanation should not contradict the documented evidence, and appropriate consideration should be given to the credibility of the individual providing the oral explanation.

^{3/} In the Matter of S.D. Leidesdorf & Co., Kenneth Larsen, Joseph Grendi (*Accounting Series Release No. 209, February 1977*).

^{4/} Dr. Daniel Schacter, "The Seven Sins of Memory: How the Mind Forgets and Remembers," *Psychology Today* (May 2001).



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G. Multi-location Audits

In this standard, the Board reminds auditors that the office of the accounting firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the requirements of this standard is prepared and retained. Audit documentation supporting the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms), must be retained by or be accessible to the office issuing the auditor's report. The Board believes this requirement will improve audit quality by enhancing the probability that *all* audit documentation will be prepared consistently with the same standards of audit quality.

In addition, the office issuing the auditor's report must obtain and review, prior to the report release date, certain documentation – outlined in this standard – related to the work performed by other auditors. Thus, the firm issuing an audit report on consolidated financial statements of a multinational company may not release that report without the specific documentation described in this standard.

H. Part of Audit Performed by Others

In reporting on a company's consolidated financial statements, an auditor may use the work of other auditors who have audited one or more affiliates or divisions of the company. When more than one auditor is involved in an audit engagement, one of the firms typically serves as the principal auditor. The principal auditor then must decide whether to make reference in the auditor's report to the audit performed by the other auditor.

If the principal auditor decides to assume responsibility for the work of other auditors, then the principal auditor will not make reference to the work of other auditors in the audit report. However, if the principal auditor decides not to assume that responsibility, then the principal auditor should indicate clearly the division of responsibility between the principal auditor and other auditors in expressing an opinion on the consolidated financial statements. Existing guidance in AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, applies when using the work of other auditors. However, this existing guidance does not establish any specific documentation requirements.



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In connection with PCAOB Auditing Standard No. 3, *Audit Documentation*, the Board adopted an amendment to paragraph .12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, addressing appropriate audit documentation when a principal auditor *decides not to make reference* to the work of other auditors. In this amendment, the Board imposes the same unconditional responsibility on the principal auditor, as with multi-location audits, to obtain certain audit documentation from the other auditor prior to the report release date. In addition, the amendment provides that the principal auditor should consider performing one or more of the procedures described in the amendment, such as discussing the audit procedures and related results with the other auditors and reviewing the audit programs of the other auditors.

The Board believes this amendment will enable the principal auditor to gain considerably more assurance about the quality of the other auditor's work without creating an unreasonable burden.

I. Retention of Audit Documentation

This standard requires that an auditor retain audit documentation for seven years after the report release date, which is the minimum period permitted under Section 103(a) of the Act.

As previously discussed, auditors will have 45 days after the report release date to assemble the complete and final set of audit documentation. If an auditor's report is not issued on a completed engagement, as is common in a review of interim financial information of a public company, then the audit documentation is to be retained for seven years from the date that fieldwork was substantially completed.

J. Effective Date

On March 9, 2004, the Board issued PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. Since documentation issues are prevalent in PCAOB Auditing Standard No. 2 and the key objective of this standard is to improve the quality of audits and other engagements, the Board determined that the implementation date of this standard should coincide with that of PCAOB Auditing Standard No. 2. Therefore, this standard will be effective for audits of financial statements with respect to fiscal years



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ending on or after the later of November 15, 2004, or 30 days after the date of approval of this standard by the SEC.

The effective date for quarterly reviews and other engagements, conducted pursuant to the standards of the PCAOB, would occur beginning with the first quarter ending after the first financial statement audit covered by this standard.

* * *

On the 9th day of June, in the year 2004, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Acting Secretary

June 9, 2004

APPENDICES –

1. Auditing Standard No. 3 – Audit Documentation
2. Amendment to Interim Auditing Standards – Part of Audit Performed by Other Independent Auditors



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Appendix 1 – Auditing Standard No. 3

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AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

Auditing Standard No. 3 –

AUDIT DOCUMENTATION





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Auditing and Related Professional Practice Standards

Auditing Standard No. 3, *Audit Documentation* **[supersedes SAS No. 96, *Audit Documentation*]**

Introduction

1. This standard establishes general requirements for documentation the auditor should prepare and retain in connection with engagements conducted pursuant to the standards of the Public Company Accounting Oversight Board ("PCAOB"). Such engagements include an audit of financial statements, an audit of internal control over financial reporting, and a review of interim financial information. This standard does not replace specific documentation requirements of other standards of the PCAOB.

Objectives of Audit Documentation

2. *Audit documentation* is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

Note: An auditor's representations to a company's board of directors or audit committee, stockholders, investors, or other interested parties are usually included in the auditor's report accompanying the financial statements of the company. The auditor also might make oral representations to the company or others, either on a voluntary basis or if necessary to comply with professional standards, including in connection with an engagement for which an auditor's report is not issued. For example, although an auditor might not issue a report in connection with an engagement to review interim financial information, he or she ordinarily would make oral representations about the results of the review.



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3. Audit documentation is reviewed by members of the engagement team performing the work and might be reviewed by others. Reviewers might include, for example:

- a. Auditors who are new to an engagement and review the prior year's documentation to understand the work performed as an aid in planning and performing the current engagement.
- b. Supervisory personnel who review documentation prepared by assistants on the engagement.
- c. Engagement supervisors and engagement quality reviewers who review documentation to understand how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions.
- d. A successor auditor who reviews a predecessor auditor's audit documentation.
- e. Internal and external inspection teams that review documentation to assess audit quality and compliance with auditing and related professional practice standards; applicable laws, rules, and regulations; and the auditor's own quality control policies.
- f. Others, including advisors engaged by the audit committee or representatives of a party to an acquisition.

Audit Documentation Requirement

4. The auditor must prepare audit documentation in connection with each engagement conducted pursuant to the standards of the PCAOB. Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. Also, the documentation should be appropriately



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organized to provide a clear link to the significant findings or issues.^{1/} Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files, or other media.

5. Because audit documentation is the written record that provides the support for the representations in the auditor's report, it should:

- a. Demonstrate that the engagement complied with the standards of the PCAOB,
- b. Support the basis for the auditor's conclusions concerning every relevant financial statement assertion, and
- c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.

6. The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.^{2/} Audit documentation must clearly demonstrate that the work was in fact performed. This documentation requirement applies to the work of all those who participate in the engagement as well as to the work of specialists the auditor uses as evidential matter in evaluating relevant financial statement assertions. Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and

^{1/} See paragraph 12 of this standard for a description of significant findings or issues.

^{2/} *Relevant financial statement assertions* are described in paragraphs 68-70 of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*.



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- b. To determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.

Note: An *experienced auditor* has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

7. In determining the nature and extent of the documentation for a financial statement assertion, the auditor should consider the following factors:

- Nature of the auditing procedure;
- Risk of material misstatement associated with the assertion;
- Extent of judgment required in performing the work and evaluating the results, for example, accounting estimates require greater judgment and commensurately more extensive documentation;
- Significance of the evidence obtained to the assertion being tested; and
- Responsibility to document a conclusion not readily determinable from the documentation of the procedures performed or evidence obtained.

Application of these factors determines whether the nature and extent of audit documentation is adequate.

8. In addition to the documentation necessary to support the auditor's final conclusions, audit documentation must include information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions. The relevant records to be retained include, but are not limited to, procedures performed in response to the information, and records documenting consultations on, or resolutions of, differences in professional judgment among members of the engagement team or between the engagement team and others consulted.



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9. If, after the documentation completion date (defined in paragraph 15), the auditor becomes aware, as a result of a lack of documentation or otherwise, that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must determine, and if so demonstrate, that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. To accomplish this, the auditor must have persuasive other evidence. Oral explanation alone does not constitute persuasive other evidence, but it may be used to clarify other written evidence.

- If the auditor determines and demonstrates that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached, but that documentation thereof is not adequate, then the auditor should consider what additional documentation is needed. In preparing additional documentation, the auditor should refer to paragraph 16.
- If the auditor cannot determine or demonstrate that sufficient procedures were performed, sufficient evidence was obtained, or appropriate conclusions were reached, the auditor should comply with the provisions of AU sec. 390, *Consideration of Omitted Procedures After the Report Date*.

Documentation of Specific Matters

10. Documentation of auditing procedures that involve the inspection of documents or confirmation, including tests of details, tests of operating effectiveness of controls, and walkthroughs, should include identification of the items inspected. Documentation of auditing procedures related to the inspection of significant contracts or agreements should include abstracts or copies of the documents.

Note: The identification of the items inspected may be satisfied by indicating the source from which the items were selected and the specific selection criteria, for example:



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- If an audit sample is selected from a population of documents, the documentation should include identifying characteristics (for example, the specific check numbers of the items included in the sample).
- If all items over a specific dollar amount are selected from a population of documents, the documentation need describe only the scope and the identification of the population (for example, all checks over \$10,000 from the October disbursements journal).
- If a systematic sample is selected from a population of documents, the documentation need only provide an identification of the source of the documents and an indication of the starting point and the sampling interval (for example, a systematic sample of sales invoices was selected from the sales journal for the period from October 1 to December 31, starting with invoice number 452 and selecting every 40th invoice).

11. Certain matters, such as auditor independence, staff training and proficiency and client acceptance and retention, may be documented in a central repository for the public accounting firm ("firm") or in the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the engagement should include a reference to the central repository. Documentation of matters specific to a particular engagement should be included in the audit documentation of the pertinent engagement.

12. The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached in connection with each engagement. *Significant findings or issues* are substantive matters that are important to the procedures performed, evidence obtained, or conclusions reached, and include, but are not limited to, the following:

- a. Significant matters involving the selection, application, and consistency of accounting principles, including related disclosures. Significant matters include, but are not limited to, accounting for complex or unusual transactions, accounting estimates, and uncertainties as well as related management assumptions.



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- b. Results of auditing procedures that indicate a need for significant modification of planned auditing procedures, the existence of material misstatements, omissions in the financial statements, the existence of significant deficiencies, or material weaknesses in internal control over financial reporting.
 - c. Audit adjustments. For purposes of this standard, an *audit adjustment* is a correction of a misstatement of the financial statements that was or should have been proposed by the auditor, whether or not recorded by management, that could, either individually or when aggregated with other misstatements, have a material effect on the company's financial statements.
 - d. Disagreements among members of the engagement team or with others consulted on the engagement about final conclusions reached on significant accounting or auditing matters.
 - e. Circumstances that cause significant difficulty in applying auditing procedures.
 - f. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.
 - g. Any matters that could result in modification of the auditor's report.
13. The auditor must identify all significant findings or issues in an *engagement completion document*. This document may include either all information necessary to understand the significant findings, issues or cross-references, as appropriate, to other available supporting audit documentation. This document, along with any documents cross-referenced, should collectively be as specific as necessary in the circumstances for a reviewer to gain a thorough understanding of the significant findings or issues.

Note: The engagement completion document prepared in connection with the annual audit should include documentation of significant findings or issues identified during the review of interim financial information.



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Retention of and Subsequent Changes to Audit Documentation

14. The auditor must retain audit documentation for seven years from the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements (*report release date*), unless a longer period of time is required by law. If a report is not issued in connection with an engagement, then the audit documentation must be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the audit documentation must be retained for seven years from the date the engagement ceased.

15. Prior to the report release date, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (*documentation completion date*). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 45 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased.

16. Circumstances may require additions to audit documentation after the report release date. Audit documentation must not be deleted or discarded after the documentation completion date, however, information may be added. Any documentation added must indicate the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it.

17. Other standards require the auditor to perform procedures subsequent to the report release date in certain circumstances. For example, in accordance with AU sec. 711, *Filings Under Federal Securities Statutes*, auditors are required to perform certain procedures up to the effective date of a registration statement.^{3/} The auditor must identify and document any additions to audit documentation as a result of these procedures consistent with the previous paragraph.

^{3/} Section 11 of the Securities Act of 1933 makes specific mention of the auditor's responsibility as an expert when the auditor's report is included in a registration statement under the 1933 Act.



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18. The office of the firm issuing the auditor's report is responsible for ensuring that all audit documentation sufficient to meet the requirements of paragraphs 4-13 of this standard is prepared and retained. Audit documentation supporting the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms), must be retained by or be accessible to the office issuing the auditor's report.^{4/}

19. In addition, the office issuing the auditor's report must obtain, and review and retain, prior to the report release date, the following documentation related to the work performed by other auditors (including auditors associated with other offices of the firm, affiliated firms, or non-affiliated firms):

- a. An engagement completion document consistent with paragraphs 12 and 13.

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

- b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures.
- c. Sufficient information relating to any significant findings or issues that are inconsistent with or contradict the final conclusions, as described in paragraph 8.
- d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.
- e. Sufficient information to enable the office issuing the auditor's report to agree or to reconcile the financial statement amounts audited by the other auditor to the information underlying the consolidated financial statements.

^{4/} Section 106(b) of the Sarbanes-Oxley Act of 2002 imposes certain requirements concerning production of the work papers of a foreign public accounting firm on whose opinion or services the auditor relies. Compliance with this standard does not substitute for compliance with Section 106(b) or any other applicable law.



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- f. A schedule of audit adjustments, including a description of the nature and cause of each misstatement.
- g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.
- h. Letters of representations from management.
- i. All matters to be communicated to the audit committee.

If the auditor decides to make reference in his or her report to the audit of the other auditor, however, the auditor issuing the report need not perform the procedures in this paragraph and, instead, should refer to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*.

20. The auditor also might be required to maintain documentation in addition to that required by this standard.^{5/}

Effective Date

21. This standard is effective for audits of financial statements, which may include an audit of internal control over financial reporting, with respect to fiscal years ending on or after [the later of November 15, 2004, or 30 days after the date of approval of this standard by the SEC]. For other engagements conducted pursuant to the standards of the PCAOB, including reviews of interim financial information, this standard takes effect beginning with the first quarter ending after the first financial statement audit covered by this standard.

^{5/} For example, the SEC requires auditors to retain, in addition to documentation required by this standard, memoranda, correspondence, communications (for example, electronic mail), other documents, and records (in the form of paper, electronic, or other media) that are created, sent, or received in connection with an engagement conducted in accordance with auditing and related professional practice standards and that contain conclusions, opinions, analyses, or data related to the engagement. (*Retention of Audit and Review Records*, 17 CFR §210.2-06, effective for audits or reviews completed on or after October 31, 2003.)



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APPENDIX A

Background and Basis for Conclusions

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Introduction

A1. This appendix summarizes considerations that the Public Company Accounting Oversight Board ("PCAOB" or "Board") deemed significant in developing this standard. This appendix includes reasons for accepting certain views and rejecting others.

A2. Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act") directs the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report. Accordingly, the Board has made audit documentation a priority.

Background

A3. Auditors support the conclusions in their reports with a work product called *audit documentation*, also referred to as *working papers* or *work papers*. Audit documentation supports the basis for the conclusions in the auditor's report. Audit documentation also facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Examples of audit documentation include memoranda, confirmations, correspondence, schedules, audit programs, and letters of representation. Audit documentation may be in the form of paper, electronic files, or other media.

A4. The Board's standard on audit documentation is one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest. The Board believes that the quality and integrity of an audit depends, in large part, on the existence of a complete and understandable record of the work the auditor performed, the conclusions the auditor reached, and the evidence the auditor obtained that supports those conclusions. Meaningful reviews, whether by the Board in the context of its inspections or through other reviews, such as internal quality control reviews, would be difficult or impossible without adequate documentation. Clear and comprehensive audit documentation is essential to enhance the quality of the audit and, at the same time, to allow the Board to fulfill its mandate to inspect registered public accounting firms to assess the degree of compliance of those firms with applicable standards and laws.



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A5. The Board began a standards-development project on audit documentation by convening a public roundtable discussion on September 29, 2003, to discuss issues and hear views on the subject. Participants at the roundtable included representatives from public companies, public accounting firms, investor groups, and regulatory organizations.

A6. Prior to this roundtable discussion, the Board prepared and released a briefing paper on audit documentation that posed several questions to help identify the objectives – and the appropriate scope and form – of audit documentation. In addition, the Board asked participants to address specific issues in practice relating to, among other things, changes in audit documentation after release of the audit report, essential elements and the appropriate amount of detail of audit documentation, the effect on audit documentation of a principal auditor's decision to use the work of other auditors, and retention of audit documentation. Based on comments made at the roundtable, advice from the Board's staff, and other input the Board received, the Board determined that the pre-existing standard on audit documentation, Statement on Auditing Standards ("SAS") No. 96, *Audit Documentation*, was insufficient for the Board to discharge appropriately its standard-setting obligations under Section 103(a) of the Act. In response, the Board developed and issued for comment, on November 17, 2003, a proposed auditing standard titled, *Audit Documentation*.

A7. The Board received 38 comment letters from a variety of interested parties, including auditors, regulators, professional associations, government agencies, and others. Those comments led to some changes in the requirements of the standard. Also, other changes made the requirements easier to understand. The following sections summarize significant views expressed in those comment letters and the Board's responses to those comments.

Objective of This Standard

A8. The objective of this standard is to improve audit quality and enhance public confidence in the quality of auditing. Good audit documentation improves the quality of the work performed in many ways, including, for example:

- Providing a record of actual work performed, which provides assurance that the auditor accomplishes the planned objectives.



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- Facilitating the reviews performed by supervisors, managers, engagement partners, engagement quality reviewers,^{1/} and PCAOB inspectors.
- Improving effectiveness and efficiency by reducing time-consuming, and sometimes inaccurate, oral explanations of what was done (or not done).

A9. The documentation requirements in this standard should result in more effective and efficient oversight of registered public accounting firms and associated persons, thereby improving audit quality and enhancing investor confidence.

A10. Inadequate audit documentation diminishes audit quality on many levels. First, if audit documentation does not exist for a particular procedure or conclusion related to a significant matter, it casts doubt as to whether the necessary work was done. If the work was not documented, then it becomes difficult for the engagement team, and others, to know what was done, what conclusions were reached, and how those conclusions were reached. In addition, good audit documentation is very important in an environment in which engagement staff changes or rotates. Due to engagement staff turnover, knowledgeable staff on an engagement may not be available for the next engagement.

Audit Programs

A11. Several commenters suggested that audit documentation should include audit programs. Audit programs were specifically mentioned in SAS No. 96 as a form of audit documentation.

A12. The Board accepted this recommendation, and paragraph 4 in the final standard includes audit programs as an example of documentation. Audit programs may provide evidence of audit planning as well as limited evidence of the execution of audit procedures, but the Board believes that signed-off audit programs should generally not be used as the sole documentation that a procedure was performed, evidence was obtained, or a conclusion was reached. An audit program aids in the conduct and

^{1/} The engagement quality reviewer is referred to as the concurring partner reviewer in the membership requirements of the AICPA SEC Practice Section. The Board adopted certain of these membership requirements as they existed on April 16, 2003. Some firms also may refer to this designated reviewer as the second partner reviewer.



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supervision of an engagement, but completed and initialed audit program steps should be supported with proper documentation in the working papers.

Reviewability Standard

A13. The proposed standard would have adapted a standard of reviewability from the U.S. General Accounting Office's ("GAO") documentation standard for government and other audits conducted in accordance with generally accepted government auditing standards ("GAGAS"). The GAO standard provides that "Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions."^{2/} This requirement has been important in the field of government auditing because government audits have long been reviewed by GAO auditors who, although experienced in auditing, do not participate in the actual audits. Moreover, the Panel on Audit Effectiveness recommended that sufficient, specific requirements for audit documentation be established to enable public accounting firms' internal inspection teams as well as others, including reviewers outside of the firms, to assess the quality of engagement performance.^{3/} Audits and reviews of issuers' financial statements will now, under the Act, be subject to review by PCAOB inspectors. Therefore, a documentation standard that enables an inspector to understand the work that was performed in an audit or review is appropriate.

A14. Accordingly, the Board's proposed standard would have required that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, the name of the person(s) who performed it, the date it was completed, and the conclusions reached. This experienced auditor also should have been able to determine who reviewed the work and the date of such review.

^{2/} U.S. General Accounting Office, *Government Auditing Standards*, "Field Work Standards for Financial Audits" (2003 Revision), paragraph 4.22.

^{3/} Panel on Audit Effectiveness, *Report and Recommendations* (Stamford, Ct: Public Oversight Board, August 31, 2000).



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A15. Some commenters suggested that the final standard more specifically describe the qualifications of an experienced auditor. These commenters took the position that only an engagement partner with significant years of experience would have the experience necessary to be able to understand all the work that was performed and the conclusions that were reached. One commenter suggested that an auditor who is reviewing audit documentation should have experience and knowledge consistent with the experience and knowledge that the auditor performing the audit would be required to possess, including knowledge of the current accounting, auditing, and financial reporting issues of the company's industry. Another said that the characteristics defining an experienced auditor should be consistent with those expected of the auditor with final responsibility for the engagement.

A16. After considering these comments, the Board has provided additional specificity about the meaning of the term, *experienced auditor*. The standard now describes an experienced auditor as one who has a reasonable understanding of audit activities and has studied the company's industry as well as the accounting and auditing issues relevant to the industry.

A17. Some commenters also suggested that the standard, as proposed, did not allow for the use of professional judgment. These commenters pointed to the omission of a statement about professional judgment found in paragraph 4.23 of GAGAS that states, "The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment." A nearly identical statement was found in the interim auditing standard, SAS No. 96, *Audit Documentation*.

A18. Auditors exercise professional judgment in nearly every aspect of planning, performing, and reporting on an audit. Auditors also exercise professional judgment in the documentation of an audit and other engagements. An objective of this standard is to ensure that auditors give proper consideration to the need to document procedures performed, evidence obtained, and conclusions reached in light of time and cost considerations in completing an engagement.

A19. Nothing in the standard precludes auditors from exercising their professional judgment. Moreover, because professional judgment might relate to any aspect of an audit, the Board does not believe that an explicit reference to professional judgment is necessary every time the use of professional judgment may be appropriate.



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Audit Documentation Must Demonstrate That the Work was Done

A20. A guiding principle of the proposed standard was that auditors must document procedures performed, evidence obtained, and conclusions reached. This principle is not new and was found in the interim standard, SAS No. 96, *Audit Documentation*, which this standard supersedes. Audit documentation also should demonstrate compliance with the standards of the PCAOB and include justification for any departures.

A21. The proposed standard would have adapted a provision in the California Business and Professions Code which provides that if documentation does not exist, then there is a rebuttable presumption that the work had not been done.

A22. The objections to this proposal fell into two general categories: the effect of the rebuttable presumption on legal proceedings and the perceived impracticality of documenting every conversation or conclusion that affected the engagement. Discussion of these issues follows.

Rebuttable Presumption

A23. Commenters expressed concern about the effects of the proposed language on regulatory or legal proceedings outside the context of the PCAOB's oversight. They argued that the rebuttable presumption might be understood to establish evidentiary rules for use in judicial and administrative proceedings in other jurisdictions.

A24. Some commenters also had concerns that oral explanation alone would not constitute persuasive other evidence that work was done, absent any documentation. Those commenters argued that not allowing oral explanations when there was no documentation would essentially make the presumption "irrebuttable." Moreover, those commenters argued that it was inappropriate for a professional standard to predetermine for a court the relative value of evidence.

A25. The Board believes that complete audit documentation is necessary for a quality audit or other engagement. The Board intends the standard to require auditors to document procedures performed, evidence obtained, and conclusions reached to improve the quality of audits. The Board also intends that a deficiency in documentation is a departure from the Board's standards. Thus, although the Board removed the



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phrase *rebuttable presumption*, the Board continues to stress, in paragraph 9 of the standard, that the auditor must have persuasive other evidence that the procedures were performed, evidence was obtained, and appropriate conclusions were reached with respect to relevant financial statement assertions.

A26. The term *should* (presumptively mandatory responsibility) was changed to *must* (unconditional responsibility) in paragraph 6 to establish a higher threshold for the auditor. Auditors have an unconditional requirement to document their work. Failure to discharge an unconditional responsibility is a violation of the standard and Rule 3100, which requires all registered public accounting firms to adhere to the Board's auditing and related professional practice standards in connection with an audit or review of an issuer's financial statements.

A27. The Board also added two new paragraphs to the final standard to explain the importance and associated responsibility of performing the work and adequately documenting all work that was performed. Paragraph 7 provides a list of factors the auditor should consider in determining the nature and extent of documentation. These factors should be considered by both the auditor in preparing the documentation and the reviewer in evaluating the documentation.

A28. In paragraph 9 of this standard, if, after the documentation completion date, as a result of a lack of documentation or otherwise, it appears that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must determine, and if so demonstrate, that sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. In those circumstances, for example, during an inspection by the Board or during the firm's internal quality control review, the auditor is required to demonstrate with persuasive other evidence that the procedures were performed, the evidence was obtained, and appropriate conclusions were reached. In this and similar contexts, oral explanation alone does not constitute persuasive other evidence. However, oral evidence may be used to clarify other written evidence.

A29. In addition, more reliable, objective evidence may be required depending on the nature of the test and the objective the auditor is trying to achieve. For example, if there is a high risk of a material misstatement with respect to a particular assertion, then the auditor should obtain and document sufficient procedures for the auditor to conclude on the fairness of the assertion.



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Impracticality

A30. Some commenters expressed concern that the proposed standard could be construed or interpreted to require the auditor to document every conversation held with company management or among the engagement team members. Some commenters also argued that they should not be required to document every conclusion, including preliminary conclusions that were part of a thought process that may have led them to a different conclusion, on the ground that this would result in needless and costly work performed by the auditor. Commenters also expressed concern that an unqualified requirement to document procedures performed, evidence obtained, and conclusions reached without allowing the use of auditor judgment would increase the volume of documentation but not the quality. They stated that it would be unnecessary, time-consuming, and potentially counterproductive to require the auditor to make a written record of everything he or she did.

A31. The Board's standard distinguishes between (1) an audit procedure that must be documented and (2) a conversation with company management or among the members of the engagement team. Inquiries with management should be documented when an inquiry is important to a particular procedure. The inquiry could take place during planning, performance, or reporting. The auditor need not document each conversation that occurred.

A32. A final conclusion is an integral part of a working paper, unless the working paper is only for informational purposes, such as documentation of a discussion or a process. This standard does not require that the auditor document each interim conclusion reached in arriving at the risk assessments or final conclusions. Conclusions reached early on during an audit may be based on incomplete information or an incorrect understanding. Nevertheless, auditors should document a final conclusion for every audit procedure performed, if that conclusion is not readily apparent based on documented results of the procedures.

A33. The Board also believes the reference to *specialists* is an important element of paragraph 6. Specialists play a vital role in audit engagements. For example, appraisers, actuaries, and environmental consultants provide valuable data concerning asset values, calculation assumptions, and loss reserves. When using the work of a specialist, the auditor must ensure that the specialist's work, as it relates to the audit



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objectives, also is adequately documented. For example, if the auditor relies on the work of an appraiser in obtaining the fair value of commercial property available for sale, then the auditor must ensure the appraisal report is adequately documented. Moreover, the term *specialist* in this standard is intended to include any specialist the auditor relies on in conducting the work, including those employed or retained by the auditor or by the company.

Audit Adjustments

A34. Several commenters recommended that the definition of *audit adjustments* in this proposed standard should be consistent with the definition contained in AU sec. 380, *Communication with Audit Committees*.

A35. Although the Board recognizes potential benefits of having a uniform definition of the term *audit adjustments*, the Board does not believe that the definition in AU sec. 380 is appropriate for this documentation standard because that definition was intended for communication with audit committees. The Board believes that the definition should be broader so that the engagement partner, engagement quality reviewer, and others can be aware of all proposed corrections of misstatements, whether or not recorded by the entity, of which the auditor is aware, that were or should have been proposed based on the audit evidence.

A36. Adjustments that should have been proposed based on known audit evidence are material misstatements that the auditor identified but did not propose to management. Examples include situations in which (1) the auditor identifies a material error but does not propose an adjustment and (2) the auditor proposes an adjustment in the working papers, but fails to note the adjustment in the summary or schedule of proposed adjustments.

Information That Is Inconsistent with or Contradicts the Auditor's Final Conclusions

A37. Paragraph .25 of AU sec. 326, *Evidential Matter*, states: "In developing his or her opinion, the auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements." Thus, during the conduct of an audit, the auditor should consider all relevant evidential matter even though it might contradict or be inconsistent with other conclusions. Audit



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documentation must contain information or data relating to significant findings or issues that are inconsistent with the auditor's final conclusions on the relevant matter.

A38. Also, information that initially appears to be inconsistent or contradictory, but is found to be incorrect or based on incomplete information, need not be included in the final audit documentation, provided that the apparent inconsistencies or contradictions were satisfactorily resolved by obtaining complete and correct information. In addition, with respect to differences in professional judgment, auditors need not include in audit documentation preliminary views based on incomplete information or data.

Retention of Audit Documentation

A39. The proposed standard would have required an auditor to retain audit documentation for seven years after completion of the engagement, which is the minimum period permitted under Section 103(a)(2)(A)(i) of the Act. In addition, the proposed standard would have added a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after the auditor's report is released. Such reasonable period of time should not exceed 45 days.

A40. In general, those commenting on this documentation retention requirement did not have concerns with the time period of 45 days to assemble the working papers. However, some commenters suggested the Board tie this 45-day requirement to the filing date of the company's financial statements with the SEC. One commenter recommended that the standard refer to the same trigger date for initiating both the time period during which the auditor should complete work paper assembly and the beginning of the seven-year retention period.

A41. For consistency and practical implications, the Board agreed that the standard should have the same date for the auditor to start assembling the audit documentation and initiating the seven-year retention period. The Board decided that the seven-year retention period begins on the *report release date*, which is defined as the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. In addition, auditors will have 45 days to assemble the complete and final set of audit documentation, beginning on the report release date. The Board believes that using the report release date is preferable to using the filing date of the company's financial statements, since the auditor has ultimate control over granting permission to use his or her report. If an auditor's report is not issued, then the



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audit documentation is to be retained for seven years from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the seven-year period begins when the work on the engagement ceased.

Section 802 of Sarbanes-Oxley and the SEC's Implementing Rule

A42. Many commenters had concerns about the similarity in language between the proposed standard and the SEC final rule (issued in January 2003) on record retention, *Retention of Records Relevant to Audits and Reviews*.^{4/} Some commenters recommended that the PCAOB undertake a project to identify and resolve all differences between the proposed standard and the SEC's final rule. These commenters also suggested that the Board include similar language from the SEC final rule, Rule 2-06 of Regulation S-X, which limits the requirement to retain some items.

Differences between Section 802 and This Standard

A43. The objective of the Board's standard is different from the objective of the SEC's rule on record retention. The objective of the Board's standard is to require auditors to *create* certain documentation to enhance the quality of audit documentation, thereby improving the quality of audits and other related engagements. The records retention section of this standard, mandated by Section 103 of the Act, requires registered public accounting firms to "prepare and maintain for a period of not less than 7 years, *audit work papers, and other information related to any audit report*, in sufficient detail to support the conclusions reached in such report." (emphasis added)

A44. In contrast, the focus of the SEC rule is to require auditors to *retain* documents that the auditor does create, in order that those documents will be available in the event of a regulatory investigation or other proceeding. As stated in the release accompanying the SEC's final rule (SEC Release No. 33-8180):

Section 802 of the Sarbanes-Oxley Act is intended to address the destruction or fabrication of evidence and the preservation of "financial and audit records." We are directed under that section to promulgate

^{4/} SEC Regulation S-X, 17 C.F.R. § 210.2-06 (SEC Release No. 33-8180, January 2003). (The final rule was effective in March 2003.)



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rules related to the retention of records relevant to the audits and reviews of financial statements that companies file with the Commission.

A45. The SEC release further states, "New rule 2-06 ... addresses the retention of documents relevant to enforcement of the securities laws, Commission rules, and criminal laws."

A46. Despite their different objectives, the proposed standard and SEC Rule 2-06 use similar language in describing documentation generated during an audit or review. Paragraph 4 of the proposed standard stated that, "Audit documentation ordinarily consists of *memoranda, correspondence, schedules, and other documents created or obtained in connection with* the engagement and may be in the form of paper, electronic files, or other media." Paragraph (a) of SEC Rule 2-06 describes "records relevant to the audit or review" that must be retained as, (1) "workpapers and other documents that form the basis of the audit or review and (2) *memoranda, correspondence, communications, other documents, and records (including electronic records), which: [a]re created, sent or received in connection with* the audit or review and [c]ontain conclusions, opinions, analyses, or financial data related to the audit or review. ..." (numbering and emphasis added).

A47. The SEC makes a distinction between the objectives of categories (1) and (2). Category (1) includes audit documentation. Documentation to be retained according to the Board's standard clearly falls within category (1). Items in category (2) include "desk files" which are more than "what traditionally has been thought of as auditor's 'workpapers'." The SEC's rule requiring auditors to retain items in category (2) have the principal purpose of facilitating enforcement of securities laws, SEC rules, and criminal laws. This is not an objective of the Board's standard. According to SEC Rule 2-06, items in category (2) are limited to those which: (a) are created, sent or received in connection with the audit or review, and (b) contain conclusions, opinions, analyses, or financial data related to the audit or review. The limitations, (a) and (b), do not apply to category (1).

A48. Paragraph 4 of the final standard deletes the reference in the proposed standard to "other documents created or obtained in connection with the engagement." The Board decided to keep "correspondence" in the standard because correspondence can be valid audit evidence. Paragraph 20 of the standard reminds the auditor that he or



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she may be required to maintain documentation in addition to that required by this standard.

Significant Matters and Significant Findings or Issues

A49. Some commenters asked how the term *significant matters*, in Rule 2-06, relates to the term *significant findings or issues* in the Board's standard. The SEC's release accompanying its final Rule 2-06 states that "... *significant matters* is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer. ..." This is very similar to the term *significant findings or issues* contained in paragraph 12 of the Board's standard which requires auditors to document *significant findings or issues*, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. Examples of significant findings or issues are provided in the standard.

A50. Based on the explanation in the SEC's final rule and accompanying release, the Board believes that *significant matters* are included in the meaning of *significant findings or issues* in the Board's standard. The Board is of the view that *significant findings or issues* is more comprehensive and provides more clarity than *significant matters* and, therefore, has not changed the wording in the final standard.

Changes to Audit Documentation

A51. The proposed standard would have required that any changes to the working papers after completion of the engagement be documented without deleting or discarding the original documents. Such documentation must indicate the date the information was added, by whom it was added, and the reason for adding it.

A52. One commenter recommended that the Board provide examples of auditing procedures that should be performed before the report release date and procedures that may be performed after the report release date. Some commenters also requested clarification about the treatment of changes to documentation that occurred after the completion of the engagement but before the report release date. Many commenters recommended that the Board more specifically describe post-issuance procedures. The Board generally agreed with these comments.



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A53. The final standard includes two important dates for the preparation of audit documentation: (1) the report release date and (2) the documentation completion date.

- Prior to the report release date, the auditor must have completed all necessary auditing procedures, including clearing review notes and providing support for all final conclusions. In addition, the auditor must have obtained sufficient evidence to support the representations in the auditor's reports before the report release date.
- After the report release date and prior to the documentation completion date, the auditor has 45 calendar days in which to assemble the documentation.

A54. During the audit, audit documentation may be superseded for various reasons. Often, during the review process, reviewers annotate the documentation with clarifications, questions, and edits. The completion process often involves revising the documentation electronically and generating a new copy. The SEC's final rule on record retention, *Retention of Records Relevant to Audits and Reviews*,^{5/} explains that the SEC rule does not require that the following documents generally need to be retained: superseded drafts of memoranda, financial statements or regulatory filings; notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking; previous copies of workpapers that have been corrected for typographical errors or errors due to training of new employees; and duplicates of documents. This standard also does not require auditors to retain such documents as a general matter.

A55. Any documents, however, that reflect information that is either inconsistent with or contradictory to the conclusions contained in the final working papers may not be discarded. Any documents added must indicate the date they were added, the name of the person who prepared them, and the reason for adding them.

A56. If the auditor obtains and documents evidence after the report release date, the auditor should refer to the interim auditing standards, AU sec. 390, *Consideration of Omitted Procedures After the Report Date* and AU sec. 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*. Auditors should not discard any

^{5/} See footnote 4.



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previously existing documentation in connection with obtaining and documenting evidence after the report release date.

A57. The auditor may perform certain procedures subsequent to the report release date. For example, pursuant to AU sec. 711, *Filings Under Federal Securities Statutes*, auditors are required to perform certain procedures up to the effective date of a registration statement. The auditor should identify and document any additions to audit documentation as a result of these procedures. No audit documentation should be discarded after the documentation completion date, even if it is superseded in connection with any procedures performed, including those performed pursuant to AU sec. 711.

A58. Additions to the working papers may take the form of memoranda that explain the work performed, evidence obtained, and conclusions reached. Documentation added to the working papers must indicate the date the information was added, the name of the person adding it, and the reason for adding it. All previous working papers must remain intact and not be discarded.

A59. Documentation added to the working papers well after completion of the audit or other engagement is likely to be of a lesser quality than that produced contemporaneously when the procedures were performed. It is very difficult to reconstruct activities months, and perhaps years, after the work was actually performed. The turnover of both firm and company staff can cause difficulty in reconstructing conversations, meetings, data, or other evidence. Also, with the passage of time memories fade. Oral explanation can help confirm that procedures were performed during an audit, but oral explanation alone does not constitute persuasive other evidence. The primary source of evidence should be documented at the time the procedures are performed, and oral explanation should not be the primary source of evidence. Furthermore, any oral explanation should not contradict the documented evidence, and appropriate consideration should be given to the credibility of the individual providing the oral explanation.

Multi-Location Audits and Using the Work of Other Auditors

A60. The proposed standard would have required the principal auditor to maintain specific audit documentation when he or she decided not to make reference to the work of another auditor.



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A61. The Board also proposed an amendment to AU sec. 543 concurrently with the proposed audit documentation standard. The proposed amendment would have required the principal auditor to review the documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed.

A62. Commenters expressed concerns that these proposals could present conflicts with certain non-U.S. laws. Those commenters also expressed concern about the costs associated with the requirement for the other auditor to ship their audit documentation to the principal auditor. In addition, the commenters also objected to the requirement that principal auditors review the work of other auditors as if they were the principal auditor's staff.

Audit Documentation Must be Accessible to the Office Issuing the Auditor's Report

A63. After considering these comments, the Board decided that it could achieve one of the objectives of the proposed standard (that is, to require that the issuing office have access to those working papers on which it placed reliance) without requiring that the working papers be shipped to the issuing office. Further, given the potential difficulties of shipping audit documentation from various non-U.S. locations, the Board decided to modify the proposed standard to require that audit documentation either be retained by or be accessible to the issuing office.

A64. In addition, instead of requiring that all of the working papers be shipped to the issuing office, the Board decided to require that the issuing office obtain, review, and retain certain summary documentation. Thus, the public accounting firm issuing an audit report on consolidated financial statements of a multinational company may not release that report without the documentation described in paragraph 19 of the standard.

A65. The auditor must obtain and review and retain, prior to the report release date, documentation described in paragraph 19 of the standard, in connection with work performed by other offices of the public accounting firm or other auditors, including affiliated or non-affiliated firms, that participated in the audit. For example, an auditor that uses the work of another of its offices or other affiliated or non-affiliated public accounting firms to audit a subsidiary that is material to a company's consolidated



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financial statements must obtain the documentation described in paragraph 19 of the standard, prior to the report release date. On the other hand, an auditor that uses the work of another of its offices or other affiliated or non-affiliated firms, to perform selected procedures, such as observing the physical inventories of a company, may not be required to obtain the documentation specified in paragraph 19 of the standard. However, this does not reduce the need for the auditor to obtain equivalent documentation prepared by the other auditor when those instances described in paragraph 19 of the standard are applicable.

Amendment to AU Sec. 543, *Part of Audit Performed by Other Independent Auditors*

A66. Some commenters also objected to the proposed requirement in the amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, that the principal auditor review another auditor's audit documentation. They objected because they were of the opinion such a review would impose an unnecessary cost and burden given that the other auditor will have already reviewed the documentation in accordance with the standards established by the principal auditor. The commenters also indicated that any review by the principal auditor would add excessive time to the SEC reporting process, causing even more difficulties as the SEC Form 10-K reporting deadlines have become shorter recently and will continue to shorten next year.

A67. The Board accepted the recommendation to modify the proposed amendment to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*. Thus, in the final amendment, the Board imposes the same unconditional responsibility on the principal auditor to obtain certain audit documentation from the other auditor prior to the report release date. The final amendment also provides that the principal auditor should consider performing one or more of the following procedures:

- Visit the other auditors and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditors. In some cases, it may be appropriate to issue instructions to the other auditors as to the scope of the audit work.



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- Review additional audit documentation of the other auditors relating to significant findings or issues in the engagement completion document.

Effective Date

A68. The Board proposed that the standard and related amendment would be effective for engagements completed on or after June 15, 2004. Many commenters were concerned that the effective date was too early. They pointed out that some audits, already begun as of the proposed effective date, would be affected and that it could be difficult to retroactively apply the standard. Some commenters also recommended delaying the effective date to give auditors adequate time to develop and implement processes and provide training with respect to several aspects of the standard.

A69. After considering the comments, the Board has delayed the effective date. However, the Board also believes that a delay beyond 2004 is not in the public interest.

A70. The Board concluded that the implementation date of this standard should coincide with that of PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, because of the documentation issues prevalent in PCAOB Auditing Standard No. 2. Therefore, the Board has decided that the standard will be effective for audits of financial statements with respect to fiscal years ending on or after [the later of November 15, 2004, or 30 days after the date of approval of this standard by the SEC]. The effective date for reviews of interim financial information and other engagements, conducted pursuant to the standards of the PCAOB, would occur beginning with the first quarter ending after the first financial statement audit covered by this standard.

Reference to Audit Documentation As the Property of the Auditor

A71. Several commenters noted that SAS No. 96, *Audit Documentation*, the interim auditing standard on audit documentation, referred to audit documentation as the property of the auditor. This was not included in the proposed standard because the Board did not believe ascribing property rights would have furthered this standard's purpose to enhance the quality of audit documentation.



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Confidential Client Information

A72. SAS No. 96, *Audit Documentation*, also stated that, "the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information," and referenced Rule 301, *Confidential Client Information*, of the AICPA's Code of Professional Conduct. Again, the Board's proposed standard on audit documentation did not include this provision. In adopting certain interim standards and rules as of April 16, 2003, the Board did not adopt Rule 301 of the AICPA's Code of Professional Conduct. In this standard on audit documentation, the Board seeks neither to establish confidentiality standards nor to modify or detract from any existing applicable confidentiality requirements.



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ADDENDUM

This addendum is not a part of PCAOB Auditing Standard No. 3.

Additional Documentation Requirements of SEC Rule 2-06

B1. Auditors should be aware of the additional record retention requirements in SEC Rule 2-06 of Regulation S-X ("Rule 2-06"). The Board is providing additional information below to remind auditors of the SEC requirements. This addendum is not an interpretation of Rule 2-06. Instead, this addendum provides excerpts from the SEC release accompanying the final rule which provides the SEC's interpretation of the rule's requirements, particularly paragraphs (a) and (c) of Rule 2-06.

B2. Paragraph (a) of Rule 2-06 requires that:

... the accountant shall retain ... memoranda, correspondence, communications, other documents, and records (including electronic records) which:

- (1) Are created, sent or received in connection with the audit or review, and
- (2) Contain conclusions, opinions, analyses, or financial data related to the audit or review.

B3. Paragraph (c) of Rule 2-06 states:

Memoranda, correspondence, communications, other documents, and records (including electronic records) described in paragraph (a) of this section shall be retained whether they support the auditor's final conclusions regarding the audit or review, or contain information or data relating to a significant matter, that is inconsistent with the auditor's final conclusions regarding that matter or the audit or review. Significance of a matter shall be determined based on an objective analysis of the facts and circumstances. Such documents and records include, but are not limited to, those documenting a consultation on or resolution of differences in professional judgment.



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Other Statements by the SEC

B4. In the excerpt below, from the SEC's release accompanying its final Rule 2-06, the SEC discusses documents that generally are not required to be retained under Rule 2-06.

In the Proposing Release, we stated that non-substantive materials that are not part of the workpapers, such as administrative records, and other documents that do not contain relevant financial data or the auditor's conclusions, opinions or analyses would not meet the second of the criteria in rule 2-06(a) and would not have to be retained. Commentators questioned whether the following documents would be considered substantive and have to be retained:

- Superseded drafts of memoranda, financial statements or regulatory filings,
- Notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking,
- Previous copies of workpapers that have been corrected for typographical errors or errors due to training of new employees,
- Duplicates of documents, or
- Voice-mail messages.

These records generally would not fall within the scope of new rule 2-06 provided they do not contain information or data, relating to a significant matter that is inconsistent with the auditor's final conclusions, opinions or analyses on that matter or the audit or review. For example, rule 2-06 would require the retention of an item in this list if that item documented a consultation or resolution of differences of professional judgment.



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B5. The excerpt below, from the SEC's release accompanying its final Rule 2-06, provides further explanation about documents to be retained under Rule 2-06:

In consideration of the comments received, we have revised paragraph (c) of the rule. We have removed the phrase "cast doubt" to reduce the possibility that the rule mistakenly would be interpreted to reach typographical errors, trivial or "fleeting" matters, or errors due to "on-the-job" training. We continue to believe, however, that records that either support or contain significant information that is inconsistent with the auditor's final conclusions would be relevant to an investigation of possible violations of the securities laws, Commission rules, or criminal laws and should be retained. Paragraph (c), therefore, now provides that the materials described in paragraph (a) shall be retained whether they support the auditor's final conclusions or contain information or data, relating to a significant matter that is inconsistent with the final conclusions of the auditor on that matter or on the audit or review. Paragraph (c) also states that the documents and records to be retained include, but are not limited to, those documenting consultations on or resolutions of differences in professional judgment.

The reference in paragraph (c) to "significant" matters is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer or registered investment company. Rule 2-06(c) requires that the documentation of such matters, once prepared, must be retained even if it does not "support" the auditor's final conclusions, because it may be relevant to an investigation. Similarly, the retention of records regarding a consultation about, and resolution of, differences in professional judgment would be relevant to such an investigation and must be retained. We intend for Rule 2-06 to be incremental to, and not to supersede or otherwise affect, any other legal or procedural requirement related to the retention of records or potential evidence in a legal, administrative, disciplinary, or regulatory proceeding.

Finally, we recognize that audits and reviews of financial statements are interactive processes and views within an accounting firm on accounting, auditing or disclosure issues may evolve as new information or data



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comes to light during the audit or review. We do not view "differences in professional judgment" within subparagraph (c) to include such changes in preliminary views when those preliminary views are based on what is recognized to be incomplete information or data.

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Appendix 2 – Amendment to Interim Auditing Standards

June 9, 2004
AUDITING AND RELATED PROFESSIONAL PRACTICE STANDARDS

Amendment to Interim Auditing Standards –

***PART OF AUDIT PERFORMED BY OTHER INDEPENDENT
AUDITORS***





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AU sec. 543.12 is amended as follows:

When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in AU sec. 543.10, the principal auditor must obtain, and review and retain, the following information from the other auditor:

- a. An engagement completion document consistent with paragraphs 12 and 13 of PCAOB Auditing Standard No. 3

Note: This engagement completion document should include all cross-referenced, supporting audit documentation.

- b. A list of significant fraud risk factors, the auditor's response, and the results of the auditor's related procedures.
- c. Sufficient information relating to significant findings or issues that are inconsistent with or contradict the auditor's final conclusions, as described in paragraph 8 of PCAOB Auditing Standard No. 3.
- d. Any findings affecting the consolidating or combining of accounts in the consolidated financial statements.
- e. Sufficient information to enable the office issuing the auditor's report to agree or reconcile the financial statement amounts audited by the other firm to the information underlying the consolidated financial statements.
- f. A schedule of audit adjustments, including a description of the nature and cause of each misstatement.
- g. All significant deficiencies and material weaknesses in internal control over financial reporting, including a clear distinction between those two categories.
- h. Letters of representations from management.
- i. All matters to be communicated to the audit committee.



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The principal auditor must obtain, and review and retain, such documents prior to the report release date.^{1/} In addition, the principal auditor should consider performing one or more of the following procedures:

- Visit the other auditor and discuss the audit procedures followed and results thereof.
- Review the audit programs of the other auditor. In some cases, it may be appropriate to issue instructions to the other auditor as to the scope of the audit work.
- Review additional audit documentation of the other auditor relating to significant findings or issues in the engagement completion document.

^{1/} As it relates to the direction in paragraph .19 of AU sec. 324, for the auditor to "give consideration to the guidance in section 543.12," the auditor need not, in this circumstance, obtain the previously enumerated documents.