

NOTICE: This is an unofficial transcript of the Public Company Accounting Oversight Board Audit Documentation Roundtable that was convened by the Public Company Accounting Oversight Board at the Hilton Hotel Congressional Room on Monday, September 29, 2003. The Public Company Accounting Oversight Board does not certify the accuracy of this unofficial transcript. The transcript has not been edited, may contain typographical or other errors or omissions, and is presented for convenience only. An archive of the webcast of this program can be found on the Public Company Accounting Oversight Board's website at www.pcaobus.org.

1 PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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3 AUDIT DOCUMENTATION ROUNDTABLE

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6 Congressional Room
7 Capital Hilton
8 1001 16th Street, N.W.
9 Washington, D.C.

10 Monday, September 29, 2003

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12 The meeting was convened at 2:02 p.m., WILLIAM
13 J. McDONOUGH, Chairman, presiding.

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15 PRESENT FOR THE PCAOB:

- 16 WILLIAM J. McDONOUGH, Chairman, presiding
17 KAYLA J. GILLAN, Member DANIEL L. GOELZER, Member
18 BILL GRADISON, Member CHARLES D. NIEMEIER, Member
19 DOUGLAS R. CARMICHAEL, Chief Auditor
20 GEORGE H. DIACONT, Director of Registration and
21 Inspections
22 THOMAS RAY, Deputy Chief Auditor
23 GREG SCATES, Associate Chief Auditor

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<p>1 PARTICIPANTS:</p> <p>2 American Institute of Certified Public Accountants:</p> <p>3 CHUCK LANDES</p> <p>4 BDO Seidman, LLP: LYNFORD GRAHAM</p> <p>5 California Board of Accountancy: CHARLES R. DROTT</p> <p>6 Crowe Chizek and Company LLC: JAMES L. BROWN</p> <p>7 Council of Institutional Investors: ANN YERGER</p> <p>7 Deloitte & Touche LLP: JOHN A. FOGARTY</p> <p>8 Ernst & Young LLP: MARK PEARSON</p> <p>9 Financial Executives International: COLLEEN SAYTHER</p> <p>10 Grant Thornton LLP: KEITH NEWTON</p> <p>11 KPMG LLP: CRAIG W. CRAWFORD</p> <p>12 McGladrey & Pullen, LLP: BRUCE P. WEBB</p> <p>13 National Association of State Boards of Accountancy:</p> <p>14 DR. ROBERT L. GRAY, CPA</p> <p>15 PricewaterhouseCoopers LLP: JIM LEE</p> <p>16 U.S. General Accounting Office: JEFFREY C. STEINHOFF</p> <p>17 CHARLES A. BOWSHER - U.S. General Accounting Office (Retired)</p> <p>18 U.S. Securities and Exchange Commission:</p> <p>19 ROBERT BURNS</p> <p>20 SUSAN MARKEL</p> <p>21 MICHAEL H. SUTTON - U.S. Securities and Exchange Commission (Retired)</p> <p>22 Colorado State Univeristy: LYNN E. TURNER</p> <p>23</p> <p>24</p> <p>25</p>	<p>1 work papers and other information related to any audit</p> <p>2 report in sufficient detail to support the conclusions</p> <p>3 reached in such report."</p> <p>4 We have assembled an impressive group of people</p> <p>5 here and charged them with discussing a significant list</p> <p>6 of issues related to the topic of audit documentation. We</p> <p>7 have high expectation that this roundtable discussion,</p> <p>8 like the last one, will assist us in our standard-setting</p> <p>9 process moving forward.</p> <p>10 Investors, lenders, customers, and regulators</p> <p>11 require fair and reliable financial reporting by public</p> <p>12 companies. The independent auditor plays a crucial role</p> <p>13 in our capital markets by opining on the fairness of</p> <p>14 financial statements. Auditors back up their reports with</p> <p>15 a work product commonly referred to as work papers or</p> <p>16 audit documentation.</p> <p>17 One thing I want to make clear is that we at the</p> <p>18 PCAOB, now named, by the way, by the Senate Banking</p> <p>19 Committee as "PCAOB," we do not view the auditor's work</p> <p>20 papers as merely a byproduct of the audit process. We</p> <p>21 view the auditor's work papers as an integral part of a</p> <p>22 quality audit. That is, the work papers document not only</p> <p>23 the nature, timing, and extent of the work, but also the</p> <p>24 professional judgments made by members of a well-trained</p> <p>25 audit engagement team. Thus, the subject of audit</p>
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<p>1 PROCEEDINGS</p> <p>2 CHAIRMAN McDONOUGH: Good afternoon, everyone,</p> <p>3 if I could have your attention. We have reached the</p> <p>4 appointed hour. If I could ask everyone to please take</p> <p>5 their seats.</p> <p>6 Good afternoon, everyone. I'm Bill McDonough,</p> <p>7 Chairman of the Public Company Accounting Oversight Board.</p> <p>8 On behalf of my fellow Board members, Kayla Gillan and Dan</p> <p>9 Goelzer, Bill Gradison and Charlie Niemeier, welcome to</p> <p>10 our roundtable discussion on audit documentation. I'm</p> <p>11 very pleased to see the large turnout today, and I would</p> <p>12 also like to welcome those of you listening in by webcast.</p> <p>13 The Sarbanes-Oxley Act directs the Board</p> <p>14 specifically to consider adopting certain auditing and</p> <p>15 attestation standards. One of those standards is the</p> <p>16 auditor's attestation on internal control, which is under</p> <p>17 section 404 of the Act. We held a roundtable meeting in</p> <p>18 July to commence that standard-setting project. Some of</p> <p>19 you must have enjoyed it, because I see you're back.</p> <p>20 We are here today to commence another standard-</p> <p>21 setting project, on section 103 of the Act, which</p> <p>22 specifically requires the Board to, and I quote, "include</p> <p>23 in the auditing standards that it adopt requirements that</p> <p>24 each registered public accounting firm prepare and</p> <p>25 maintain for a period of not less than seven years audit</p>	<p>1 documentation is of utmost importance to the Board and its</p> <p>2 staff.</p> <p>3 Our Chief Auditor, Doug Carmichael, and his team</p> <p>4 have outlined a number of significant issues for the Board</p> <p>5 to consider as we weigh a new standard in audit</p> <p>6 documentation. We are very much looking forward to</p> <p>7 hearing the views of the participants here today. I see</p> <p>8 this roundtable discussion as an important part of our</p> <p>9 standard-setting process which will include further</p> <p>10 opportunities for participation and comment.</p> <p>11 Before I turn it over to Doug, I want to express</p> <p>12 my gratitude to the staff members who have made this</p> <p>13 roundtable possible. I also want to thank all of our</p> <p>14 participants here at the table, who have been so generous</p> <p>15 with your time. Finally, I would like to thank all of you</p> <p>16 who have taken time out of your busy schedules to be here,</p> <p>17 whether in person or on the web, to observe and listen to</p> <p>18 us. As one of the few people here who is neither an</p> <p>19 accountant nor a lawyer, I particularly look forward to</p> <p>20 both promoting ideas and learning a great deal.</p> <p>21 Doug, the floor is yours.</p> <p>22 MR. CARMICHAEL: Thank you, Chairman McDonough</p> <p>23 When you speak, please speak directly into the</p> <p>24 microphone. You can't get too close to the mike. We'd</p> <p>25 like what you have to say to be heard not only by people</p>

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1 in the room, but on our webcast. So if you do that we'd
 2 appreciate it.
 3 Just to reinforce what Chairman McDonough said,
 4 the standard-setting staff considers good audit
 5 documentation to be an integral part of an effective
 6 audit. We also consider good documentation to be integral
 7 to the Board's upcoming efforts in inspections and
 8 investigations.
 9 With that, let me now turn it over to the Deputy
 10 Chief Auditor, Tom Ray, who is going to moderate the
 11 discussion.
 12 MR. RAY: Thank you, Doug. Good afternoon.
 13 Today we will follow roundtable discussion
 14 procedures many of you are already familiar with. As you
 15 know, we prepared a briefing paper in anticipation of this
 16 event this afternoon. That includes the subjects and the
 17 questions that we have planned to cover today. Greg
 18 Scates, Associate Chief Auditor, and I will briefly
 19 introduce each of the questions, after which we will
 20 invite you to comment. We also will project each question
 21 on the screens located around the room, and we will take
 22 the questions in the same order as they were presented in
 23 the briefing paper.
 24 If you would like to speak, please indicate your
 25 desire to do so by taking your name card and standing it

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1 up on end, and I will call on you in turn. After you have
 2 finished your comments, please try to remember to put your
 3 name card back down again, because if you'd like to
 4 comment again on the same subject you can go ahead and put
 5 that card back up and we will call on you again.
 6 When you speak, let me just reiterate Doug's
 7 comment that you really do need to speak directly into the
 8 microphone. Now, I'm wired for a lavalier mike, so you
 9 don't see me talking very closely to the mike. But
 10 please, I urge you to pull it forward. Occasionally the
 11 sound technicians will have to turn your mike down because
 12 there are so many microphones in this room. So when you
 13 start speaking, if you don't hear your voice immediately
 14 please have patience and continue to speak, and we will
 15 adjust the microphone accordingly.
 16 Also, each time you speak please identify
 17 yourself and, although this may feel redundant for those
 18 who are sitting here looking at each other and in the
 19 audience, the people that are listening on line would
 20 greatly appreciate that. It will also facilitate our
 21 making an official record of the proceedings today,
 22 because the official record is very important to us. We
 23 will be using it as we move forward in consideration of
 24 the subject.
 25 Also, when you speak please try to be efficient

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1 in making your point as concise as possible. We do have a
 2 large number of issues to cover and we want everyone to
 3 have the opportunity to share their views.
 4 We will divide the discussion today into two
 5 sessions. After we get started, we will continue the
 6 discussion until about 3:30, at which time we are going to
 7 take a brief break for ten minutes; and then we will
 8 continue the discussion until 5:00 o'clock.
 9 During the last 10 to 15 minutes of the program,
 10 we will allow members of the audience to ask the
 11 roundtable participants questions on issues related to
 12 audit documentation, and members of the audience may
 13 indicate their desire to do so and also indicate their
 14 question by filling out one of the index cards that is
 15 being made available to them. Please complete the index
 16 card with your name, your e-mail address, and your
 17 question at any time during the day and turn it back in to
 18 the registration desk.
 19 After we sent out the briefing paper, we
 20 identified two additional questions we would like the
 21 roundtable to consider today and we sent those to you by
 22 e-mail on Friday. Let's go ahead and put those two
 23 questions on the screen and we will return to them later
 24 this afternoon.
 25 The first one: Should evidential matter that

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1 contradicts assertions in the financial statements be
 2 retained as a part of the audit documentation? Secondly:
 3 If a member of the audit engagement team disagrees with
 4 the conclusions reached on a particular accounting or
 5 auditing matter, should this be documented in the work
 6 papers, and should this disagreement also be noted in the
 7 engagement completion memorandum?
 8 One last administrative item. For everyone here
 9 in the room, please be sure any cell phones, pagers,
 10 Blackberries, or other noise-making devices are
 11 appropriately silenced during the discussion.
 12 With that, let's go ahead and get started. The
 13 first topic that we're going to discuss is the objectives
 14 of audit documentation. Standards for preparing and
 15 maintaining audit documentation have existed for many
 16 years. The stated purposes of audit documentation have
 17 been to provide the principal support for the
 18 representations in the auditor's report and to assist in
 19 the performance of the audit.
 20 Are there any other important objectives of
 21 audit documentation and what are they?
 22 We're pleased to take your comments at this
 23 point. Charlie.
 24 MR. DROTT: Yes. Charles Drott, California
 25 Board of Accountancy.

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1 In addition to the objectives that you cited in
 2 your briefing paper, it occurs to me that there are two
 3 points that I would like to see emphasized or incorporated
 4 into any new. One may seem pretty fundamental and basic,
 5 but it does come to the fore as a problem in a number of
 6 occasions. That is, to provide a clear record of the
 7 engagement that is complete and accessible at the location
 8 that issued the opinion on the financial statements.
 9 The reason I bring this up is that in many
 10 investigations that I have been a party to we find that in
 11 particular foreign affiliates of U.S. auditing firms
 12 perform significant audit work and many times those work
 13 papers are not available at the U.S. location that issued
 14 the audit opinion, and it becomes very difficult to
 15 evaluate the auditor's work if those work papers are not
 16 available.
 17 So I would propose that this standard at least
 18 give reference to the fact that work papers of foreign
 19 affiliates do need to be available and accessible at the
 20 location that issued the opinion.
 21 The second point that I'd like to make is I
 22 think another objective ought to be to better document and
 23 capture the logic and thought processes that support
 24 important audit judgments, because if the logic of those
 25 thought processes is not appropriately documented there's

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1 no real effective manner for a reviewer of those work
 2 papers or documentation to evaluate the soundness of those
 3 judgments. In many situations we find, while conclusions
 4 and judgments may be referenced or cited, the thought
 5 process and the logic behind them are not clearly
 6 documented. I would like to see that also -- would highly
 7 recommend that that be part of the overall objectives.
 8 Thank you.
 9 MR. RAY: Jim Brown.
 10 MR. BROWN: Jim Brown, Crowe Chizek.
 11 I think there is possibly a couple of other
 12 objectives, looking at it from an auditor's standpoint,
 13 which I think is what your question is saying: Why do we
 14 as auditors prepare work papers? I can think of a big
 15 one, which is training. We have a lot of people out there
 16 that are just starting their audit careers. They haven't
 17 had much experience in preparing memos or other documents,
 18 and this is a way that they can get their judgments
 19 written down and sort of doublecheck what they're doing
 20 and what they're thinking and saying, sort of ride herd on
 21 them, so to speak. I think that's a very important part
 22 of it.
 23 Another goal is keeping track of things for next
 24 year. You keep a record of what you do one year so that
 25 in the following year you can have a guide to where

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1 problems may have been or where problems were solved.
 2 That's a great point, thinking ahead to the following
 3 year's audit engagement.
 4 MR. RAY: Would anyone else like to comment on
 5 that? Yes, go ahead, Jeff.
 6 MR. STEINHOFF: I'll echo what the first two
 7 gentlemen stated. I'm Jeff Steinhoff from GAO.
 8 I think that the standard should probably state
 9 in the objectives that it's an essential element of audit
 10 quality, so it's not viewed as something extra, but is an
 11 essential element of audit quality. And I agree with the
 12 previous two speakers.
 13 MR. RAY: Keith Newton.
 14 MR. NEWTON: Keith Newton, Grant Thornton.
 15 With respect to the objectives, if the
 16 objectives as set forth in SAS 96 are achieved, we believe
 17 that would suffice for the other parties that might be
 18 interested in the audit documentation. So it should be
 19 sufficient for all parties.
 20 As for Charles's comments, I might add that,
 21 while certainly it's reasonable that audit work papers
 22 should be available, it would be quite a hardship to have
 23 them all at the location where the report was issued. So
 24 it seems like a reasonable request to make, if there's
 25 work papers available, but with some of these

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1 international assignments that are quite large and
 2 locations all around the world it would be quite hard to
 3 have all the work papers on every assignment at the place
 4 where the report's issued.
 5 MR. RAY: Lynn Turner.
 6 MR. TURNER: With the comment about quality and
 7 the fact that documentation is there for quality, I've
 8 found from my experience that documentation does a
 9 tremendous job of meeting the objective that there be a
 10 discipline in the audit process, that when you turn around
 11 and ask people to document their work they behave in a
 12 different fashion than if they don't have to document
 13 their work. It provides a discipline to the process which
 14 I think greatly enhances the quality of the work.
 15 So I think the comments from the gentleman from
 16 GAO are right on, that it enhances quality, but it brings
 17 through that tremendous discipline to the product that
 18 gets done and I think enhances the overall audit overall.
 19 As far as the comment about the foreign work
 20 papers, which has always been a controversial issue from
 21 day one, having worked on a number of international
 22 audits, I do think that there's a point to be made here.
 23 It's more than just boxing them up and shipping them home
 24 certainly if there are some confidentiality issues. But
 25 in the numerous foreign audits that I've participated in,

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1 either us going that way or that way coming back here, I
 2 don't think it would be a tremendous hardship to gain
 3 access to those provided you can deal with the appropriate
 4 governmental regulations in terms of confidentiality. I
 5 just don't see there being that big an issue to get them
 6 here.
 7 MR. RAY: Let's move on to the second question,
 8 which is really a subset of the first, and if you have any
 9 additional remarks you'd like to make about the first
 10 question I think it would be appropriate to make them as
 11 we talk about the second one, which is: Should a stated
 12 objective of audit documentation also be to assist in the
 13 review of the quality of the audit work?
 14 I open it up to your comments. Bob Gray.
 15 DR. GRAY: I'm Bob Gray. I'm representing the
 16 National Association of State Boards of Accountancy. Our
 17 acronym is NASBA.
 18 Just as a prelude to the answer to this
 19 question, I really want to point out that historically the
 20 focus of auditing standards has been very properly to
 21 provide guidance to auditors and to improve the quality of
 22 audits. But now with the passage of the Sarbanes-Oxley
 23 Act and the formation of the PCAOB, I think we have a
 24 third objective added to it and that is the regulatory
 25 enforcement process. So that auditing standards now have

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1 to consider not just the quality, not just the audit
 2 guidance, which is the foundation for regulatory
 3 enforcement, but also they must be modified and tuned to
 4 enhance the regulator's enforcement mandate.
 5 Now, in terms of what's been going on at NASBA,
 6 that really shares and supports the philosophy and the
 7 agenda of the PCAOB, the programs and activities of NASBA
 8 now currently in process are parallel to the PCAOB as it
 9 applies to both public companies as well as to non-public
 10 entities as well, which we have a particular focus on
 11 because we regulate all CPA's, not just those who are
 12 involved in public audits.
 13 So specifically to this question with that as a
 14 background, we feel that audit documentation should
 15 provide the basis or, in the words of the preamble to the
 16 question, be sufficiently specific to allow those who are
 17 not members of the audit team, including reviewers and
 18 regulators outside of the firm, that have knowledge of the
 19 industry, to evaluate the quality and the judgments made
 20 and the quality of the audit process as a whole.
 21 So that examples of that are that you have not
 22 only the accounting firm reviewers that we must satisfy
 23 with this documentation with auditing standards, but you
 24 have the PCAOB inspection teams, you have the quality
 25 assurance teams that are outside of the firm internal

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1 process, and you have state and federal regulators for
 2 enforcement purposes.
 3 So we have the third dimension of that, that all
 4 the auditing standards should consider the enforcement
 5 aspect as well as quality and guidance to the auditors.
 6 MR. RAY: Any other remarks on those questions?
 7 I guess Bruce Webb.
 8 MR. WEBB: Bruce Webb with McGladrey & Pullen.
 9 I basically agree with Keith Newton's comment
 10 that if we meet the requirements of SAS-96 by default we
 11 should enable an adequate quality control review. I think
 12 there's a couple of ways to tackle the issue of the
 13 documentation enhancing quality control reviews. One is
 14 to deal with it through the quality control standards,
 15 which I would agree could use some enhanced documentation
 16 requirements.
 17 But I think the better way to deal with it is
 18 through adding the specific documentation requirements to
 19 the other auditing standards that do not presently contain
 20 them. As we'll come to later, there are a few that do not
 21 have specific documentation requirements, and I think it's
 22 been the practice, the recent practice, of the Auditing
 23 Standards Board to include specific documentation
 24 requirements in recently promulgated standards and I
 25 believe that goes a long way towards solving the issue at

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1 hand.
 2 MR. RAY: Chuck Landes.
 3 MR. LANDES: Chuck Landes, AICPA.
 4 I'd like to mention that I agree wholeheartedly
 5 with what Bob had to say in the sense that in the day and
 6 age in which we live it certainly is necessary that we
 7 take into consideration the needs of regulators in terms
 8 of documentation. I think -- and I would just simply ask
 9 the PCAOB in their deliberations, though, to be careful in
 10 terms of trying to capture for whom it is the standard
 11 would be issued, because I could see differences of one
 12 federal agency and their need for documentation maybe at a
 13 different level, different extent to what the PCAOB might
 14 have documentation concerns.
 15 So I think it's just important if you go down
 16 the road of making an objective being to your enforcement
 17 and inspection that you keep in mind that it would be
 18 tailored for your needs, which may or may not meet the
 19 needs of other regulators.
 20 MR. RAY: Yes, Mike Sutton.
 21 MR. SUTTON: Michael Sutton.
 22 One thing that is emerging from the discussion
 23 that I noticed in reading the paper is there seems to be a
 24 sense that there are multiple audiences for these
 25 documentation standards. I would submit that

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1 documentation that satisfies the need for an effective
 2 audit also should also satisfy the need for effective
 3 supervision, review, oversight, and inspection. And vice
 4 versa, audit documentation that satisfies the needs of the
 5 regulators for effective supervision, review, and
 6 oversight would also increase, enhance the quality of the
 7 audit.
 8 So I would argue that the goal should be one
 9 goal that would satisfy the needs of all and not -- to
 10 avoid a segmentation of individual needs. Now, there
 11 certainly would be some specific items that might require
 12 attention, but at a regulatory level. But my experience
 13 is that effective documentation benefits all the
 14 participants in the process.
 15 MR. RAY: Let's turn to the next subject, which
 16 is the scope of audit documentation. Auditors are
 17 required to comply with the ten generally accepted
 18 auditing standards in discharging their duties in an audit
 19 of financial statements. However, the current standard on
 20 audit documentation, SAS No. 96, states that audit
 21 documentation should be sufficient to show that standards
 22 of fieldwork have been observed.
 23 So the question is: Should audit documentation
 24 demonstrate that the auditor has complied, not only with
 25 the standards of fieldwork, but also with all standards,

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1 including auditor independence, due professional care, and
 2 training?
 3 We'd be happy to take your comments at this
 4 point. Lynn Graham.
 5 MR. GRAHAM: Yes, Lynn Graham from BDO Siedman.
 6 Auditor independence and training are functions
 7 that are normally centrally administered in a public
 8 accounting firm. It would be -- I'm a little confused as
 9 to how I would demonstrate with respect to a specific
 10 engagement how these standards and practices are met.
 11 Training records as well as independent certifications are
 12 generally done by the firm.
 13 I think the due professional care is something
 14 that one is able to reflect on by going through the work
 15 papers and understanding the documentation that's there.
 16 But I just don't understand how one could deal with
 17 independence and training in the audit documentation.
 18 MR. RAY: Charles Drott.
 19 MR. DROTT: Yes, Charles Drott.
 20 It seems to me that over all the years that I've
 21 practiced clearly the general standards involving auditor
 22 independence, due care, and training have to be complied
 23 with to comply with the generally accepted auditing
 24 standards just as well as the standards of fieldwork. I
 25 would think it's entirely appropriate that the audit

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1 documentation address those issues specifically to
 2 demonstrate compliance with them, because to not do so
 3 somewhat leaves the reader of the work papers or the
 4 reviewer, whether it's a firm reviewer or an outside
 5 reviewer or a regulator, somewhat in the dark as to
 6 whether or not these issues have even been addressed.
 7 So I think you could and I think you should in
 8 any new audit documentation standard, I think you really
 9 should have this as part of your standard, that there
 10 should be some demonstration that those standards have
 11 been complied with.
 12 MR. RAY: Jeffrey Steinhoff.
 13 MR. STEINHOFF: Jeff Steinhoff again from GAO.
 14 I think I view this on several levels. I agree
 15 with the gentleman over here that some things are at an
 16 institutional level, for example training. I know in our
 17 office we do have an audit checklist as part of our report
 18 papers for an engagement, and in that we do have
 19 documentation on auditor independence.
 20 I think that the notion of due professional care
 21 comes down to following fieldwork standards. I agree
 22 fully with that. So I think there are a variety of places
 23 that the auditor should be able to direct a reviewer. In
 24 some cases they should say: Here are the audit team
 25 members; you can go to our central training files.

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1 But I think the reviewer should at least be able
 2 to look at a working paper or some kind of documentation
 3 that's part of an engagement to see that at least people
 4 asked the question about independence, they've asked the
 5 audit team members that question on that particular job.
 6 So I think it is broader, but there's probably a variety
 7 of ways that the auditing organization can meet that
 8 requirement.
 9 MR. RAY: Bob Gray.
 10 DR. GRAY: I think, to take the easy part first,
 11 I think that training can be evaluated through the firm
 12 inspection or quality control process and need not be
 13 documented. I think due professional care, I agree with
 14 someone here who said that it cannot be -- it should be
 15 demonstrated as an integral part, a result of the overall
 16 audit process and comprehensive documentation. I'm not
 17 sure that it can be demonstrated as a specific separate
 18 item and specifically separately documented.
 19 Now, the tough one is the independence one,
 20 which I think that independence is of such importance that
 21 it should be documented. I think there are elements of
 22 independence that are conducive to documentation. I think
 23 there are some elements of independence that are more
 24 challenging and more difficult to do. But the basic
 25 fundamental elements of it can be documented, and I'd have

<p style="text-align: right;">Page 22</p> <p>1 to -- and such documentation will really reinforce the 2 need for the firm to review its procedures for 3 independence and will provide a basis for independent and 4 outside reviewers to verify that they're independent. 5 But I also want to remind you that in fact if 6 the firm is not independent the financial statements are 7 essentially unaudited, no matter what they do. No matter 8 how much they document them, no matter how many procedures 9 they apply, if they're not independent the financial 10 statements are not audited. So I think it should be 11 demonstrated. 12 MR. RAY: Jim Lee. 13 MR. LEE: Jim Lee from PricewaterhouseCoopers. 14 Because of the importance of independence as 15 well as training, we've centralized both of those 16 functions. So we have a lot of information at a firm- 17 wide level, particularly with respect the independence 18 matters. 19 But I also would point out that there are 20 situations regarding audit committee preapproval of 21 services and things of that nature that we would have 22 documentation in the actual audit work papers as well. So 23 in our view, given the importance of independence, it's 24 there at both the firm-wide level and anything specific to 25 the individual engagement.</p>	<p style="text-align: right;">Page 24</p> <p>1 rules and regulations and training requirements. 2 MR. RAY: Mark Pearson. 3 MR. PEARSON: Mark Pearson with Ernst and Young. 4 I agree with Craig. I think most of the points 5 that I wanted to make he did make. The question should be 6 is compliance documented, both reporting standards, the 7 general standards, and the fieldwork standards. With 8 respect to independence and training, they are very well 9 documented. It's a matter of geography, where are they 10 documented. 11 The one area where I would agree that 12 documentation at the individual engagement level is 13 important is when there are specific issues to the 14 engagement that are unique and perhaps not generally 15 applicable, and Jim Lee gave a good example of pre- 16 approval requirements and those sorts of things. I would 17 also say, in training if it's, for example, a government 18 audit and the understanding of the Yellow Book 19 requirements is critical to that area, that that may well 20 be an example of training that is specific to an 21 engagement and ought to be documented there. 22 MR. RAY: Lynn Turner, you had your card up 23 earlier. 24 MR. TURNER: I would just chime in with what the 25 last three people have said. My experience was that the</p>
<p style="text-align: right;">Page 23</p> <p>1 MR. RAY: Craig Crawford. 2 MR. CRAWFORD: Craig Crawford, KPMG. 3 A couple things I'd kind of like to clarify. I 4 would -- I want to make sure that we understand. This 5 information is documented. Training, compliance with 6 training protocols, is documented. Compliance with 7 independence requirements is documented. I think the 8 question we're deliberating here is where in a firm's 9 documentation does the evidence exist, does it reside. 10 I would agree with Jim Lee from 11 PricewaterhouseCoopers that we believe compliance with 12 training requirements and compliance with the independence 13 rules and requirements is of significant importance, and 14 such importance that certain matters are managed and 15 administered at a national level. Certain information, 16 certain matters, are more appropriately managed at the 17 individual engagement level, and that documentation 18 generally speaking resides in the engagement work papers 19 files. 20 But I would hate for people to think that 21 compliance with these rules and regulations goes 22 undocumented today, because it does not. We, I believe 23 all the firms, have put in place systems and protocols 24 that are very significant, very robust, to deal with 25 managing and administering compliance with independence</p>	<p style="text-align: right;">Page 25</p> <p>1 firms did document that stuff, and it is a question as to 2 where you get it documented. 3 I think one thing you want to think about as you 4 move forward with this project is, if you look for 5 documentation you want to make sure it adds to the quality 6 and value of the audit, that you're not creating just 7 another set of checklists within the firms. At least 8 while I was there, we did a real good job of adding 9 checklists that I'm not sure it always added value to the 10 process. So I think you ought to be careful with that. 11 I think they're right, geography is probably 12 something I wouldn't get into necessarily with rules, 13 provided you knew that it was getting documented. I serve 14 on the audit committee of a large multinational company, 15 though, and like for example on independence my sense has 16 been they do a very good job of documenting their 17 independence around the world on that, and so as it 18 relates to that particular engagement you may find that in 19 the work papers there's probably some broader firm-wide 20 things that are up at a firm-wide level that you wouldn't 21 necessarily expect to see in the work papers. 22 So I think what you want to make sure is that at 23 the end of the day you get the basic documentation done 24 that adds to the quality and be careful about getting, how 25 far down you go into the geography issue. But I agree</p>

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1 with them; my experience has been the training, the
 2 auditor independence, is documented and so it shouldn't be
 3 an issue with including that in the standard.
 4 MR. RAY: John Fogarty.
 5 MR. FOGARTY: John Fogarty with Deloitte and
 6 Touche.
 7 I'd just like to agree with what Lynn Turner
 8 just said, especially with respect to creating more
 9 documentation that does not really increase the
 10 effectiveness of the audit.
 11 I'd like to also point out that the
 12 International Auditing Standards Board has deliberated a
 13 question quite similar to this over the last year as it
 14 relates to their quality control standards and they have a
 15 quality control standard that is part of the auditing
 16 standards. The question was debated as to how much you
 17 put in quality control standards versus auditing standards
 18 with careful attention to the types of issues that have
 19 been raised here, as to things that are particularly
 20 specific to an engagement versus a firm-wide view. So I
 21 recommend that the Board consider the work of the IAASB in
 22 this area.
 23 MR. RAY: Lynn Graham.
 24 MR. GRAHAM: Yes, Lynn Graham from BDO Siedman.
 25 One area where I think it might be worthwhile

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1 focusing on an engagement-specific independence
 2 documentation issue would be in the area when an
 3 engagement team brings in a specialist to become part of
 4 the engagement team. That would be a third party that's
 5 not employed by the firm, not a member of the firm. This
 6 would have to be documented at the individual engagement
 7 level because there would be no way of centrally
 8 identifying these individuals as they're brought into the
 9 engagement circumstance.
 10 Also, we know that some of the firms have
 11 alliance firms which they utilize and may borrow some
 12 staff to work on specific engagements. Again, it may be
 13 difficult to do all of that work with all of the alliance
 14 relationships that the firms have on a centralized basis,
 15 and that indeed might be something to really consider to
 16 document at the engagement level.
 17 MR. RAY: Jim Brown.
 18 MR. BROWN: Jim Brown, Crowe Chizek.
 19 Just a short comment. I think I'd like to
 20 caution the Board in looking at where things ought to be
 21 documented. The more you put things in individual audit
 22 work papers, the more you tend to lose control. Some of
 23 these things we have centralized, as many of the folks
 24 here have said, so that we can keep control on them on a
 25 better nature for the firm. Some things, training and

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1 some independence matters, it's better to centralize it
 2 rather than having individual engagement teams making
 3 those decisions.
 4 Possibly even the use of specialists. We have a
 5 specialist we use on more than one engagement, so we've
 6 documented that in a central fashion, just to make certain
 7 that we're handling it well.
 8 So I would simply caution you to see if you can
 9 maybe make this a principle-based standard and give us the
 10 general objective and not get into too many rules on the
 11 details, because there are different reasons, valid
 12 reasons, why we would want to do things on a central basis
 13 rather than in an individual audit engagement.
 14 MR. RAY: Colleen Sayther.
 15 MS. SAYTHER: Colleen Sayther, Financial
 16 Executives International.
 17 I think I just want to add my voice to the
 18 chorus, that basically repeating the documentation for
 19 certain things that are handled on a central basis seems
 20 duplicative, redundant, and costly.
 21 MR. RAY: Any other comments on that before we
 22 move to the next subject?
 23 (No response.)
 24 MR. RAY: Let's go ahead and move on then to
 25 form and content of audit documentation. As many of you

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1 are aware, the Panel on Audit Effectiveness recommended
 2 that sufficient guidance about audit documentation be
 3 provided to enable accounting firms, internal inspection
 4 teams, as well as others, including reviewers outside of
 5 the audit firms, to assess the quality of engagement
 6 performance. This might require, for example, that the
 7 considerations made by the senior members of the audit
 8 team be more thoroughly documented than what might be
 9 required by existing standards, and this leads to our next
 10 question:
 11 Should audit documentation contain sufficient
 12 information to enable an experienced auditor, with no
 13 previous connection with the engagement, to understand the
 14 nature, timing, extent, and results of the procedures
 15 performed, evidence obtained, and conclusions reached?
 16 I open it up to your comments. Lynn Graham.
 17 MR. GRAHAM: Yes, Lynn Graham from BDO Siedman.
 18 I think I'm troubled a little bit by the meaning
 19 of the word "experienced auditor." It means a lot of
 20 things to a lot of different people. Would a person that
 21 had spent a great deal of time in public accounting
 22 auditing in the health care field be an experienced
 23 auditor with respect to a brokerage firm? I don't think
 24 so. I think you need industry orientation, you need an
 25 understanding of the current business environment and,

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1 frankly, client orientation in order to understand the
 2 audit documentation.
 3 I think this is kind of the focus of the
 4 existing audit documentation standard, that you need that
 5 kind of a background. I have difficulty seeing what falls
 6 between the chairs between a person serving in the
 7 concurring reviewer role and someone in this experienced
 8 auditor role. What difference does that make? And right
 9 now the concurring reviewer needs to be able to understand
 10 those work papers.
 11 MR. RAY: Chuck Bowsher.
 12 MR. BOWSHER: I'd like to just give a little
 13 history here and then kind of propose that you give a lot
 14 of consideration to adopting what's in the most recent
 15 revision of the government auditing standards. When we
 16 started on the Yellow Book in the early seventies, we
 17 stayed very close to what the AICPA auditing standards
 18 were for a very good reason, because we were starting in a
 19 new area, trying to get the government auditors up to
 20 speed.
 21 As years went on and starting with the '88
 22 revision, there was a couple areas where we really wanted
 23 to move beyond that for various reasons. One was in the
 24 area of internal controls, and we were requiring more
 25 review of the internal controls, more documentation, and

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1 we were really even pushing, if you remember, some kind of
 2 review by the auditor at the end. Much of this has come
 3 to pass now in section 404 of the Sarbanes Act.
 4 Another area was in documentation. In other
 5 words, because in the government arena we have many more
 6 people or many more units looking at the same audit -- if
 7 you remember, we passed the single audit legislation in I
 8 think 1984 and one of the reasons why we did that was to
 9 try to get rid of a lot of the duplicate auditing that we
 10 were doing in the government sector, and to rely upon the
 11 audit that was basically done, whether it be done by
 12 somebody in the private sector or somebody in the
 13 government sector.
 14 I think today we have evolved here to a very
 15 good standard in documentation here in the Yellow Book
 16 which has been done after I've left the GAO. But I think
 17 it really does a very good job of requiring what is needed
 18 to be done and therefore to have people that come in later
 19 to look at it. When you think about it, it's already been
 20 described. You not only have in the private sector, you
 21 have the inspections within the firms, you have the PCAOB
 22 coming in later on. In other words, you have a lot of
 23 oversight being built into the system here in the private
 24 sector.
 25 You also have a lot of different government.

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1 Like I'm on the board of a big educational group and the
 2 Department of Education finances 70 percent of our
 3 revenues. So they have their people in looking at our
 4 material and audits and everything like that. Anybody
 5 that's in the defense industry, anybody that's in the
 6 health care industry, you have a lot of oversight.
 7 So I think getting a well-documented audit and
 8 not getting too much afraid that we're going to overdo it
 9 -- and I go with Sutton, Mike there: Let's get one basis
 10 of doing this. I think we lost a lot over the years when
 11 we would be going through the AICPA process because people
 12 would always remind us of the small firms and the problems
 13 there. But I really think, I worked on a lot of small
 14 audits when I was young in the business and I still think
 15 a well-documented audit is a well-documented audit, and
 16 it's not that hard to do.
 17 So I think the big thing we ran into is the
 18 lawyers started explaining: Don't document so much, let's
 19 keep these work papers as thin as possible. We've got to
 20 get away from that. In other words, I think if the PCAOB
 21 would accept something close to what the Yellow Book
 22 standard is I think the profession would gain a lot of
 23 credibility, I think the review process would be much
 24 enhanced.
 25 So I just would like to put the forward as an

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1 overall position.
 2 MR. RAY: Charles Drott.
 3 MR. DROTT: Yes, Charles Drott, California Board
 4 of Accountancy.
 5 I certainly agree with what Mr. Bowsher just
 6 said. I would like to let you know that the California
 7 Board of Accountancy effective the first of this year has
 8 in fact adopted this very language into law, as a matter
 9 of law. And we did it because we consider this to be a
 10 high level public protection policy issue. It really
 11 would serve to enhance the review capabilities, to my way
 12 of thinking, not only for federal and state regulators,
 13 but for that matter peer reviewers or perhaps even others
 14 within a firm itself.
 15 I just don't see any down side to this at all
 16 and I highly recommend that the Board give great
 17 consideration to adopting this.
 18 MR. RAY: Chuck Landes.
 19 MR. LANDES: Chuck Landes, AICPA.
 20 I just wanted to reiterate a point that was made
 21 earlier with respect to relevant knowledge and experience.
 22 I think that's very key as well. I think the GAO makes an
 23 excellent point, and in fact I think you can look at that
 24 and say an experienced auditor in that field may or may
 25 not be an experienced auditor with respect to SEC matters.

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1 So I think when you look at documentation it is important
 2 to not only look to what is an experienced auditor, and
 3 maybe it's implicit in that, but I believe the Board
 4 could, assuming you choose to go with this, could even
 5 strengthen that and make it more clear that it could be
 6 somebody with the relevant knowledge and experience.
 7 MR. RAY: Bob Gray.
 8 DR. GRAY: Yes, Bob Gray, NASBA.
 9 SAS 96 properly focuses on audit quality and the
 10 audit process, which is certainly compatible with the
 11 regulatory goals of NASBA and the state boards. But
 12 frequently it's not sufficient for enforcement
 13 responsibilities, particularly for reviewers outside of
 14 the firm, which regulators are, as well as now we have
 15 people from outside, people who are not part of the
 16 engagement team. Now we must have documentation
 17 sufficient for those, which includes the regulators as
 18 well as the PCAOB inspection teams and so forth.
 19 So we feel that adopting standards similar to
 20 government auditing standards is very appropriate, maybe
 21 not identical but very parallel, very similar to it.
 22 I think that I just want to comment for a minute
 23 on Chuck Bowsher talking about the lawyers pressuring not
 24 to document. It's been an often repeated comment by many
 25 participant observers in the standard-setting process that

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1 there has been -- perhaps that standards have been
 2 tempered somewhat over the years with a concern for
 3 liability exposure, which may have hampered the
 4 documentation issues that we're focusing on now.
 5 To the extent that may or may not be true, I
 6 think that now is no longer the case, because in my
 7 earlier remarks I pointed out with the PCAOB now we have
 8 put together the historical focus on quality and auditor
 9 guidance with new regulatory enforcement goals in the
 10 documentation. So that I think, as Chuck Bowsher pointed
 11 out, it's been discussed for many years by people close to
 12 the process, but it may be a moot question.
 13 MR. RAY: John Fogarty.
 14 MR. FOGARTY: John Fogarty with Deloitte and
 15 Touche.
 16 I'd like to echo what Lynn and Chuck said about
 17 the need to be clear about what an experienced auditor
 18 means. But I'd also like to express concern about the use
 19 of the word "understand" in the question, because what an
 20 understanding is to one person may be vastly different in
 21 depth and significance to another.
 22 Here I think the devil really is in the details
 23 of what's meant by an understanding. Understanding can
 24 range from a detailed understanding of all of the
 25 accounting business issues or, on the other end of the

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1 spectrum, a very general and reasonable understanding of
 2 how audits work and accounting standards are applied.
 3 So in order to give a level playing field, I
 4 think any standard that would adopt this needs to be clear
 5 about what the depth of the understanding will be.
 6 MR. RAY: Chuck Bowsher, I have your name next
 7 on the list. Did you want to add a comment?
 8 MR. BOWSHER: No, I'll wait for the others. Why
 9 don't I talk at the end.
 10 MR. RAY: Let's move on to Ann Yerger.
 11 MS. YERGER: Hi. Ann Yerger with the Council of
 12 Institutional Investors, and I'm also a non-accountant,
 13 non-lawyer here trying to share the end user's perspective
 14 on this.
 15 I'll just stress that from the investors'
 16 standpoint the most important thing is that we want a high
 17 quality audit and we want high quality oversight. It
 18 strikes me that the language being proposed is
 19 appropriate. I don't know how oversight can be meaningful
 20 unless you switch it to adopt a standard to permit an
 21 experienced auditor. I don't want to split hairs over
 22 words here. I'm sure they're important, but the spirit of
 23 this change I think is critical.
 24 MR. RAY: Lynn Turner.
 25 MR. TURNER: Lynn Turner, Colorado State

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1 University.
 2 I do think that the knowledgeable auditor third
 3 party type look at this is the proper way to go. I think
 4 if you're going to stay with the principle type approach
 5 you're going to have to be careful not to try to get down
 6 and define each word like "experienced," or you'll get
 7 caught in a quagmire. Maybe a better words would be
 8 someone who knows what they're doing on the audit.
 9 But I think if you want to really state, if
 10 people really want to state a principle approach, you want
 11 to be careful that you don't try to overdefine this. I
 12 think most people know what they're thinking about when
 13 they say from a commonsense perspective we want it
 14 documented at a level that an experienced person who knows
 15 what they're doing can come in and tell what was done,
 16 that the conclusions reached were reasonable to provide
 17 the quality to the audit.
 18 I know that the Auditing Standards Board itself
 19 back a couple of years ago came close to that with
 20 something similar to what GAO has. The GAO's got a
 21 standard out there that has worked well in their sector.
 22 I've had to work underneath that as an audit partner and
 23 it's worked very well, and I think that it's raised the
 24 discipline in the auditing in the governmental arena to a
 25 higher level. And to think that we might have a higher

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1 level standard there than what we have for public
 2 companies is, quite frankly, somewhat disconcerting.
 3 So I think changing the standard, moving up the
 4 documentation requirements, again to try to get back to
 5 our objectives of ensuring there's discipline in the
 6 process, we've got adequate review and supervision. I
 7 don't know how I as an audit partner could have gone in
 8 and adequately reviewed and supervised the work and made
 9 sure that the junior people, who quite frankly are doing
 10 80 percent of the work on these audits, how I can tell if
 11 they've done the right work unless it's documented and
 12 then turn around and provide a basis for reasonable
 13 inspection.
 14 When I was at the Commission we constantly, as
 15 we reviewed the peer reviews and the work that had been
 16 done on inspection -- documentation was a common recurring
 17 theme, and when the documentation wasn't there we couldn't
 18 determine whether or not the audit had been done other
 19 than by going and asking those people, did you do a good
 20 job?
 21 So I think you're headed in the right direction
 22 with this type of standard.
 23 MR. RAY: Craig Crawford.
 24 MR. CRAWFORD: Craig Crawford, KPMG.
 25 Just to reiterate -- and maybe this is a little

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1 redundant, but I'll go through it anyway -- with regard to
 2 the overarching objectives here, everyone wants to enhance
 3 the quality of audits. Everyone's overarching objective
 4 is to exercise, produce high quality audits and to ensure
 5 high quality oversight. I would agree with Ed that
 6 keeping those two overarching objectives in mind and
 7 reflecting upon this question and the word "experienced,"
 8 it would seem to me that "experienced" would infer, in
 9 order to ensure high quality oversight, "experienced"
 10 would infer that that individual would have relevant
 11 knowledge, relevant understanding, relevant skill set,
 12 because the quality of the oversight exercised is diffused
 13 or diluted significantly if that individual does not have
 14 relevant knowledge and skills.
 15 So I would suggest that the understanding -- or
 16 the Board consider in whether or not to define the word
 17 "experienced" any further is a matter of wrapping, I would
 18 suggest. But I think it's important to understand that
 19 "experienced" does infer in my mind, it does infer
 20 relevant skills and knowledge.
 21 MR. RAY: Bruce Webb.
 22 MR. WEBB: Bruce Webb.
 23 I would simply observe that the spirit of what's
 24 in SAS 96 right now, "to enable members of the engagement
 25 team with supervision and review responsibilities," as

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1 opposed to an "experienced auditor with no previous
 2 connection," that there's really no difference in the
 3 spirit of what SAS 96 was trying to accomplish. So I
 4 think we're sort of quibbling about words and I think
 5 those of us in the profession would not object to a
 6 properly worded standard of this nature.
 7 MR. RAY: Jim Brown.
 8 MR. BROWN: Jim Brown, Crowe Chizek.
 9 First I want to assure the Board that I think
 10 we're all for documentation, so I think we're all in favor
 11 of that. We do want to make certain, though, I think,
 12 that we recognize that some of this can be carried to an
 13 extreme, and I mentioned weak performance. When we talk
 14 about an experienced auditor having enough information to
 15 determine the procedures done, the evidence obtained, do
 16 you expect that experienced auditor to be able to re-
 17 perform the audit?
 18 I'll give you an example. Assuming the test is
 19 relating payroll records to time cards, do you want to
 20 have copies of the time cards and the payroll register in
 21 the work papers so that somebody else can look at it and
 22 see that that agrees? Or do you want a schedule put
 23 together that excerpts some basic data and says, I
 24 compared it?
 25 So how far do you want to go? Again, I think

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1 we're all in favor of documentation. We're trying to say,
 2 how far do you want to go in having something where an
 3 inspector -- and this is going to be inspector-driven --
 4 can take a look at everything you did and reconstruct it?
 5 I'll just mention that on an audit, take a
 6 2,000-hour audit, which might be a decent sized one.
 7 That's 8 hours a day, 5 days a week, 50 hours -- 50 weeks
 8 a year. Think of your own schedule. If there's that much
 9 work in there, documenting in effect -- that's 2,000
 10 hours, that's everything you did for the last year on your
 11 job, every hour of the job, everything you did, everyone
 12 you talked to. The volume of documentation can be
 13 significant.
 14 So recognize also that a lot of audit
 15 documentation is a summary, is an excerpt, is that stuff
 16 being boiled down, excerpted, compacted, so that somebody
 17 can look at it and get the detail, but not necessarily re-
 18 perform everything that was done, not necessarily, to use
 19 your words, every bit of evidence obtained. Sometimes
 20 it's a more summary level, and we just want to make
 21 certain it sort of stays at that approach, rather than
 22 getting too detailed so that somebody else can redo the
 23 audit.
 24 MR. RAY: Jeff Steinhoff.
 25 MR. STEINHOFF: Jeff Steinhoff from GAO.

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1 The nuances might be a small sum, but in the
 2 Yellow Book the language is a bit different. It really
 3 states, and I'll quote: "The audit documentation should
 4 enable an experienced auditor" -- and that means someone
 5 with the ability to look at that audit in a reasoned
 6 manner -- "to go through and ascertain from the
 7 documentation what evidence was used to support
 8 significant, substantial judgments and conclusions."
 9 It's not everything someone may have done, but
 10 to the extent you have a significant judgment and
 11 conclusion what is your basis for that? What is the work
 12 you performed to lead up to that?
 13 As someone who must rely on use of other auditors'
 14 work -- for example, we do the consolidated financial
 15 statement audit of the federal government. We must use
 16 the work of other auditors. There are times that we look
 17 at working papers, and this is not infrequently, that we
 18 cannot tell what the auditor has done to look at very
 19 material accounts. We don't see anything in the work
 20 papers at all that show any evidence at all that they've
 21 looked at certain things.
 22 We aren't going back to re-perform the audit.
 23 We're trying to ascertain from the documentation they have
 24 what evidence they have to support the conclusions and
 25 judgments they made. That's a little different twist on

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1 it. That's a little different wording than in the
 2 proposed standard.
 3 MR. RAY: Bob Burns.
 4 MR. BURNS: I'm Rob Burns with the Securities
 5 and Exchange Commission, and I'm a lawyer. I hope that
 6 doesn't discredit too much what I have to say.
 7 But I have been involved in the Office of the
 8 Chief Accountant in reviewing drafts of SAS 96 as it was
 9 going through and various other things that I've been
 10 involved in. Our office has evaluated auditing standards
 11 for quite a while. I do remember back when SAS 96 was
 12 going through there was a lot of discussion about the re-
 13 performance test, should it be enough to re-perform or
 14 should it just be enough for the engagement team to go
 15 through and figure out what they did in their inspection
 16 process, was that sufficient?
 17 As I recall -- and maybe Lynn or Mike or someone
 18 else can talk a little bit about this some more -- we
 19 always wanted to make sure that there was enough there
 20 that somebody from the outside coming in and looking at
 21 that would be able to figure out what was done, what
 22 accounts were looked at, what tests were done, and how it
 23 all worked.
 24 I think especially now with the Sarbanes-Oxley
 25 Act it's especially important from an investor confidence

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1 point of view, when you're going to do an inspection
 2 you're going to be able to know what type of accounts were
 3 looked at and how they performed the work.
 4 SAS 96 right now is pretty much limited to the
 5 engagement team type of concept, that engagement team can
 6 go in and look at it. And I would encourage you to think
 7 about, to try and make sure there's enough there that when
 8 you go in to do something you'll be able to do a competent
 9 job in reviewing it, find out exactly what was done, when
 10 they did it, where they did it, how they did it, and be
 11 able to come to some solid conclusions about that, because
 12 that's what the investor confidence really needs at this
 13 point, for you to be able to stand up and say
 14 independently, yes, you think a good job or a bad job was
 15 done.
 16 MR. RAY: I noticed earlier that Lynn Graham had
 17 his tent card up, and I'd like to just move to a related
 18 question to this, and I don't want to preclude you from
 19 adding your remark and we can come back to that in a
 20 second. But we have a slightly more detailed question on
 21 the same subject matter that I'd like to at least get up
 22 on the screen so you can consider it and provide your
 23 comments on that as well. But if you have additional
 24 comments on question 4, please feel free to let us know
 25 what they are.

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1 The fifth question is: Should audit
 2 documentation contain sufficient information to determine
 3 who performed the work and the date such work was
 4 completed, as well as the person who reviewed the work and
 5 the date of such review?
 6 So let me go to Lynn Graham. Would you like to
 7 comment?
 8 MR. GRAHAM: Yes. Specifically, I think it's
 9 been standard practice for a very long time for the work
 10 papers to be documented with initials and the date of the
 11 preparer. I've been looking at work papers that are,
 12 frankly, older than I am in conjunction with a matter that
 13 I'm involved with and they all are dated and signed.
 14 There is a variety of views with respect to how
 15 reviewers go about their work. Within BDO we have what we
 16 call a detail reviewer who examines and initials every
 17 page. We have a partner-level review, which requires a
 18 partner level individual to examine certain documents,
 19 certain key pieces of documentation, as well as any other
 20 matters that that individual feels that they should look
 21 at in the work papers, and those things are documented as
 22 to what the partner looks at.
 23 The same thing holds true for the concurring
 24 partner. The second partner also has to look at his key
 25 points: for example, scheduled adjustments; for example,

<p style="text-align: right;">Page 46</p> <p>1 any issues that relate to accounting and auditing matters 2 that involve consultation or a disagreement within the 3 engagement team. And the concurring partner needs to 4 initial those work papers and those documents which the 5 concurring partner reviews. I think some people have 6 gotten away from that, but we have retained that practice. 7 So I think that is a good practice and I think 8 it helps the reviewer understand what all levels of 9 supervision did in ensuring the quality of the work that 10 was performed. 11 MR. RAY: Bruce Webb. 12 MR. WEBB: SAS 96 currently requires that the 13 audit documentation indicate who performed and reviewed 14 the work. So I think the only thing that is perhaps new 15 here is the proposal that it indicate the date such work 16 was completed and the date of the review. I don't think 17 any of us would object to that, at least in theory. And I 18 think once again we get into the manner in which that may 19 be done. 20 An audit standard that would require that each 21 individual work paper contain all of that information I 22 think is difficult in practice to implement, in part 23 because you may initial the work paper at the time you 24 prepare it, later come back and do some more work, so what 25 is the date that you put on the work paper? The reviewer</p>	<p style="text-align: right;">Page 48</p> <p>1 is important what particular point in the month that work 2 was done as well. So that's something that perhaps the 3 Board could consider, too: when you indicate date, just 4 how specific should that date be? 5 MR. RAY: Charles Drott. 6 MR. DROTT: Yes, Charles Drott, California Board 7 of Accountancy. 8 Not to sound like a broken record, but this is 9 also part of the new California law. As a matter of law 10 we have adopted something that says, and I quote: "Audit 11 documentation shall provide the date of the document, if 12 the work papers was completed by the preparer and any 13 reviewer, and shall include the identity of the preparer 14 and the reviewers." 15 We did this because our enforcement group has 16 continuing and significant problems with missing dates and 17 identification of personnel that performed the work. So 18 again, we look at this as a public protection policy 19 issue, and it's critical for firms and outside reviewers 20 to know the identities of the professionals that did the 21 work and are responsible for the work and the timing in 22 order to properly evaluate the standard of care that was 23 exercised during the engagement. 24 So again, I would certainly support this and 25 urge the Board to consider adopting this as part of their</p>
<p style="text-align: right;">Page 47</p> <p>1 may review it preliminarily, write a review note, come 2 back, clear the note after some more work has been 3 performed and documentation added, and what is the date? 4 I think in most cases most firms adequately 5 document who performed each work paper section, who 6 reviewed each work paper section, who reviewed the overall 7 engagement performance and approved the overall engagement 8 performance, and they do that in a variety of means, 9 frequently by signing off on audit programs and review 10 checklists. 11 So I would just discourage the Board from 12 becoming too prescriptive in how this would be 13 accomplished. 14 MR. RAY: Susan Markel. 15 MS. MARKEL: Susan Markel, the Securities and 16 Exchange Commission. 17 I view this question as having a simple answer 18 and the answer is yes, basically that all levels of 19 persons associated with the engagement team should be 20 willing to stand behind their work and indicate what in 21 specific was done and when. 22 I guess one comment I would add to that is 23 sometimes what we see is perhaps lower level people sign 24 the date and the month and the year, and then as you move 25 up it just becomes the month and the year. Sometimes it</p>	<p style="text-align: right;">Page 49</p> <p>1 new standard. 2 MR. RAY: Lynn Turner. 3 MR. TURNER: Lynn Turner. 4 I actually don't think this is far off from 5 where the firms already are, but I would reiterate 6 something that Bruce said earlier. When you go and do an 7 audit and you're working in a particular area, like 8 reserves or even something, testing and controls, that 9 work is not at a point in time where all of a sudden you 10 can just go in and do something and you're done 11 necessarily. There are parts of audits, and even more so 12 today as we get into more of a mode of continuous type 13 auditing, where the work goes for some period of time. 14 While someone may for convenience put their 15 initial on the work and put a date up there, the work 16 doesn't just get done on Tuesday of this week. It goes on 17 for some period of time. 18 So when you turn around and say "day completed," 19 you know, is it the piece of it that I completed back in 20 June? Is it the piece that I completed in November or 21 December? Is it the piece I completed when I did my final 22 inquiries in January? Those are all very relevant points 23 that I think come out of the point that Bruce was trying 24 to make. 25 So when you say "date completed," I want to make</p>

<p style="text-align: right;">Page 50</p> <p>1 sure the Board doesn't think we just go out during an 2 audit and plop down for a week and we're necessarily done 3 and in fact a lot of this stuff isn't followed up. The 4 one thing that has been concerning to me in this area of 5 late with some of the cases, though, is the need to make 6 sure that the work was all dated and completed before we 7 issued the audit report. The one problem that does seem 8 to be coming out of this in some cases are some of the 9 work seems to be getting done post-audit report date, 10 which would be concerning.</p> <p>11 MR. RAY: Chuck Bowsher, I noticed you put up 12 your card a little earlier. Did you want to make a 13 remark?</p> <p>14 MR. BOWSHER: Well, the only thing I'd like to 15 add is I'd like to have the staff get a hold of the 16 various Yellow Books dating back to the early seventies 17 and to look at the board of advisers that we've had over 18 the years, because we've had some of the best auditors out 19 of the private sector serve on the advisory board in 20 putting this together. So it was always a joint effort 21 between the government and the private sector auditing 22 group, and I just thought for some on the Board that would 23 be interesting for them to see how we evolved, what the 24 talent that we used to get these standards updated.</p> <p>25 MR. RAY: I'm going to take Craig Crawford's</p>	<p style="text-align: right;">Page 52</p> <p>1 reviewing the audit documentation would have only the 2 auditor's oral explanations to determine what was done and 3 whether the audit was in compliance with professional 4 standards. That leads to our next question: 5 Should the failure to document the procedures 6 applied, the evidence obtained, and the conclusions 7 reached create a rebuttable presumption that the work was 8 not done? And if so, a related question is: How does the 9 auditor overcome this rebuttable presumption? 10 We'd be happy to take your remarks. Charles 11 Drott.</p> <p>12 MR. DROTT: Yes, Charlie Drott, California Board 13 of Accountancy. 14 I'd like to say on this rebuttable issue 15 proposed standard, in my view it's one of the most 16 important things this Board is taking up today, 17 considering. Again, we did make this a matter of law in 18 California effective the first of this year and we did in 19 fact have a rebuttable presumption standard effective in 20 California as a matter of law. The wording is very close 21 to what you have in your briefing paper. 22 What this issue really comes down to has to do 23 with the burden of proof, and that is who is in a better 24 position to explain or to offer evidence of audit work 25 that was prepared if there's no documentation to accompany</p>
<p style="text-align: right;">Page 51</p> <p>1 comment on the subject and then we're going to move 2 forward. Craig.</p> <p>3 MR. CRAWFORD: Craig Crawford, KPMG. 4 I'll keep this very short. I think that it's 5 entirely appropriate to expect that the work paper or 6 files evidence who performed the work, who reviewed the 7 work, and the date of such performance and review. But I 8 would encourage the Board to consider allowing for some 9 flexibility in enabling engagement teams and firms to 10 document that, the dating and the performance, and by that 11 meaning reflecting on some of the comments that have been 12 made previously by Bruce and Lynn.</p> <p>13 Audits are not necessarily a linear exercise. 14 They are continuous, they are ongoing. By enabling some 15 flexibility in evidencing the date of a review within a 16 working paper file, it doesn't necessarily dilute the fact 17 that the review was done, the review was done timely. 18 It's more a matter of a clerical exercise.</p> <p>19 So I would encourage that the Board consider 20 some flexibility in evidencing compliance with the dating 21 of the review requirement.</p> <p>22 MR. RAY: Okay, let's move on to the next 23 subject area. If the work papers or the audit 24 documentation completely omits work that is performed or 25 significant work that is performed by the auditor, anyone</p>	<p style="text-align: right;">Page 53</p> <p>1 the work? The answer can only be the auditor that 2 performed the work.</p> <p>3 This really is a very large problem. Our chief 4 of enforcement in California testified not long ago that 5 the vast majority of audit failure cases that he 6 investigates missing audit documentation is present and is 7 a significant problem, and it causes our enforcement 8 people a lot of headaches and problems to try and resolve 9 it.</p> <p>10 I think that if you do not incorporate this 11 rebuttable presumption standard what we do is perpetuate 12 the problem, because if work is not documented and oral 13 explanations are the only way that an auditor can say the 14 work was done, I think you have a continuing problem 15 because that's a very poor source of evidence, oral 16 explanations.</p> <p>17 So I think if you don't adopt this standard, and 18 I certainly encourage you to do so, I think you do open 19 the door to further abuse to short-cut documentation and 20 to use oral explanations as an excuse when in fact there's 21 no way to really prove that the work was done if that's 22 the only source of evidence, meaning oral explanation. So 23 I would highly encourage this Board to incorporate the 24 rebuttable presumption standard.</p> <p>25 MR. RAY: Bob Gray.</p>

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1 DR. GRAY: Many state regulators have frequently
 2 encountered problems with lack of documentation of the
 3 conclusions reached in an audit. It has been a
 4 particularly difficult thing, and we've found that oral
 5 explanations are insufficient to provide us with the
 6 enforcement actions that take place often long after the
 7 audit has been.
 8 By that time, memories have faded. Sometimes
 9 some of the audit staff have left the employ of the firm
 10 or are otherwise unavailable. So audit judgments are
 11 really too critical to the audit process and to the audit
 12 firm, as well as to the regulators and everyone else, to be
 13 left to oral standards only.
 14 I think the rebuttable presumption thing has to
 15 be very carefully drawn because you can draw -- you could
 16 get some of the wrong conclusions. Just take a simple
 17 example. If you didn't audit petty cash and you don't put
 18 a documentation there because we did not audit petty cash
 19 because we thought it was immaterial, it would be wrong to
 20 conclude that that was a flawed audit. So I think it has
 21 to be very carefully drawn in order to avoid some
 22 unintended results here.
 23 I'll comment later -- I'm spilling over to
 24 number 7 if I'm not careful. So I'll stop.
 25 MR. RAY: Keith Newton.

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1 MR. NEWTON: I guess the short answer would be
 2 we feel no, that it should not be a rebuttable presumption
 3 that the work was not performed. Certainly it could very
 4 well indicate a lack of sufficient evidence. We also
 5 would say that -- we don't say this saying that we
 6 shouldn't document. We feel that better documentation is
 7 indicative of a better audit, just like we don't think
 8 there ought to be a rebuttable presumption that just
 9 because you signed the audit report that you did the work.
 10 So I think there has to be some care in what the
 11 final words are, because even in an enforcement situation
 12 I suspect you can talk to auditors and ascertain very
 13 quickly their level of knowledge and whether their work,
 14 whether their knowledge indicates that they did the work.
 15 Again, not to say that we feel that there should not be
 16 audit documentation and this should be used as an excuse
 17 not to have audit documentation. It's just that there's
 18 no way an auditor can always get all the information
 19 inside their head into the audit papers to where you can
 20 look at this evidence. So maybe some qualifiers or
 21 something on this, but we believe in good documentation.
 22 I just don't think there should be a rebuttable
 23 presumption that the work wasn't done if it's not in the
 24 documentation.
 25 MR. RAY: Lynn Graham.

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1 MR. GRAHAM: Yes. On this issue, I think that
 2 existing standards would have a difficulty with knowing
 3 it's being apparent that a procedure was being performed
 4 or a discussion was had with someone. But I think that
 5 the question is whether or not the oral evidence is in
 6 lieu of other documentation or is in support of other
 7 documentation.
 8 I think that the example we had before of what
 9 documentation it would take to document your life over the
 10 last 12 months would be an example of how much one could
 11 really try to document, but there's no way that you ever
 12 can get all of that down on paper. If an issue comes up
 13 later where you need to explain or amplify or recall some
 14 aspects of a conversation that you had, I think that's
 15 appropriate evidence. But I think that if there's no
 16 evidence in the work papers that that conversation ever
 17 took place, it becomes a little straining the credibility
 18 to use oral evidence in lieu of some documentation that it
 19 occurred.
 20 MR. RAY: Jeff Steinhoff.
 21 MR. STEINHOFF: Jeff Steinhoff from GAO.
 22 As a general proposition I would say yes, it
 23 would be a rebuttable presumption. However, there is a
 24 degree factor here, and if certainly there's no evidence
 25 at all that something was done and it's not shown I would

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1 not place stock on oral evidence. However, if there were
 2 oral evidence that helped me piece together other work
 3 that an auditor may have done so that I can tell what
 4 their train of thought was and based on that I felt
 5 somewhat comfortable that there was some reason behind
 6 what they had done, I would consider that.
 7 What we oftentimes find, though, when we have
 8 concerns is that nothing is done and there's nothing shown
 9 in the work papers that shows that there was any work at
 10 all in a given area. In that case I think the burden of
 11 proof really must be in the evidence in the working papers
 12 and I would presume the work wasn't done.
 13 But if I could link it together through it being
 14 explained to me or some rationale or reason, then I think
 15 what we have to do is really apply what I call a rule of
 16 reason to it. It's not always black and white. There's
 17 at times a degree of grey.
 18 MR. RAY: Ann Yerger.
 19 MS. YERGER: Ann Yerger with the Council of
 20 Institutional Investors.
 21 I just wanted to second what Mr. Drott said and
 22 comment that from an investor confidence standpoint I just
 23 think there's no question that this is the direction the
 24 rule should be headed. I don't think investors at this
 25 point are confident thinking that if things aren't

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1 documented, well, you can go to the auditor and they'll
 2 say: Yeah, we did it; trust us. That's just not working
 3 in this environment and I think the rules should reflect
 4 that.
 5 MR. RAY: Mark Pearson.
 6 MR. PEARSON: Mark Pearson, Ernst and Young.
 7 I read question 6 and have difficulty again with
 8 question 7, but I think if you read question 6 it says
 9 "Should the failure to document the procedures applied,
 10 evidence obtained, and conclusions reached create a
 11 rebuttable presumption." The question here should be was
 12 the work done or was it not done. If it was not done,
 13 then obviously the rule shouldn't be used as a way to
 14 avoid the consequences of not doing the work. But if the
 15 work is done, then there should be every opportunity given
 16 to documenting or to convincing the reviewer that it was
 17 done.
 18 The panel recognized that documentation will
 19 never document everything that's done in the course of an
 20 audit, but the goal should be to provide the best
 21 documentation possible, and I think that's everybody's
 22 goal.
 23 Part of the problem is that while you're in the
 24 process of doing an audit you may not necessarily have in
 25 your mind the significance of an item that you're looking

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1 at that may later become very significant. I would hate
 2 to deny the inspector or anyone else the opportunity to
 3 have the benefit of that observation or procedure or the
 4 results thereof simply because oral evidence is not
 5 permissible.
 6 MR. RAY: Bill Gradison would like to ask a
 7 question.
 8 MR. GRADISON: I'd just like to observe, Tom,
 9 that the discussion as I've heard it so far regards things
 10 that ought to be done and the question is have they been
 11 done. I'm having trouble tracking how this discussion
 12 applies to those many instances where the auditing
 13 standards say "should" something, that something should be
 14 considered or should be evaluated, but not necessarily
 15 done. The question therefore arises in my mind, to what
 16 extent should there be written evidence that the auditor
 17 has considered those should's before deciding whether to
 18 do the work or not to do the work.
 19 MR. RAY: We can consider responding to that as
 20 we continue our discussion.
 21 Bruce Webb.
 22 MR. WEBB: Bruce Webb, McGladrey & Pullen.
 23 I would simply observe that without
 24 documentation it would be difficult to suggest that you
 25 comply with the standard of fieldwork in obtaining

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1 sufficient competent evidential matter. That's not to
 2 suggest that the work was not in fact done because it very
 3 well may have been. But certainly an auditor who
 4 performs procedures that are necessary to support the
 5 opinion has an obligation to obtain evidential matter, and
 6 the evidential matter should reside in the work papers.
 7 MR. RAY: Jim Brown.
 8 MR. BROWN: Jim Brown, Crowe Chizek.
 9 I think that we ought to allow -- that the truth
 10 of what happened should be allowed to come out, however it
 11 comes out. So if we don't have something written down but
 12 you can still provide enough evidence that you did do
 13 something, I think that ought to be allowed.
 14 I was trying to give you an example of a way to
 15 think about that. Seated two to my right is Doug
 16 Carmichael. If I go through and prepare a memo that says
 17 I was at this meeting and saw Doug Carmichael and said
 18 something to him, somebody coming later, as Mr. Pearson
 19 said earlier, might wonder, what evidence do I have that
 20 in fact that is Doug Carmichael? What evidence did I
 21 obtain?
 22 Again, your standard here is driving us toward
 23 evidence obtained, not only procedures applied. If I
 24 didn't document how I happened to know it was Doug
 25 Carmichael, would I then be remiss? Maybe I know that or

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1 feel that because his name plate's in front of him. Maybe
 2 another reason is because I met him before. A third
 3 reason might be I saw his picture in the newspaper.
 4 Now, if all those things are three pieces of
 5 evidence I have in my mind and I may not bother to write
 6 one of them down, but they're still there and they're
 7 still true, if I write one of them down I maybe should be
 8 able to supplement the one I write down with another
 9 couple more.
 10 Now, that being said, I think we all acknowledge
 11 that, especially in the inspection process and doing peer
 12 reviews and litigation work and so on, that a lot of times
 13 a lack of documentation, somebody pleads that and you have
 14 a strange suspicion that it was because it wasn't done in
 15 the first place. So between these I think there's some
 16 balance to be taken. Let us document things that in fact
 17 were done, but again apply a little skepticism to somebody
 18 that hasn't documented something. Keep a balance.
 19 MR. RAY: In the interest of time, I'd like to
 20 get the next related question up on the screen. I will
 21 continue to call on you in order because this is very much
 22 related to what we have been talking about and we actually
 23 have been addressing it for a few minutes now.
 24 The question 7 is perhaps an amplification of
 25 the first question: Should the Board expressly prohibit

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1 the use of oral explanations as sufficient "other means"
 2 to support audit evidence?
 3 I'd like to call on Lynn Turner.
 4 MR. TURNER: At the end of the day, if the
 5 objective here is to make sure that the work gets done,
 6 then the question ought to be whether or not the auditor
 7 did enough, including oral inquiries. I think just
 8 because something is oral -- a fair amount of the audit is
 9 talking to people. Sitting on the audit committee, I know
 10 we go through a lot of discussions with the auditors. So
 11 eliminating people being able to talk to one another as
 12 the result of an audit, I'm not sure that's a good thing.
 13 But you talk about "other means." I mean, it has
 14 to be one piece of the puzzle. Audit by inquiry, just
 15 oral inquiries in and of itself, I don't think gets the
 16 job done, and investors today I think would struggle with
 17 an audit by inquiry. So I think it may be one piece of
 18 the puzzle, and in many cases it may be a small piece of
 19 the puzzle because, as we all know, the best evidence is
 20 evidence that comes in from the outside, that's
 21 independent of the company.
 22 So I think it has to go into the bigger picture.
 23 Going back to Member Gradison's question about should we
 24 have documentation of should you consider, quite often
 25 from my experience at the Commission and elsewhere the

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1 only way you figure out whether the auditor considered is
 2 to be able to go do a Vulcan mind meld and get into their
 3 mind and say: Hey, did you consider it or not? And I
 4 seldom see an auditor turn around and say: No, I didn't
 5 consider it.
 6 So that's the type of situation where just oral
 7 inquiry probably doesn't do it. The auditor needs to
 8 document what their considerations was. Quite frankly, if
 9 it's not there in the work papers I think the rebuttable
 10 presumption gives the auditor plenty of chance to come
 11 back and demonstrate otherwise how they got there. But if
 12 they can't demonstrate through a rebuttable presumption
 13 type thing that the work was actually done, I think it has
 14 to be without a doubt considered that the work wasn't
 15 performed.
 16 I remember one of the last peer reviews that got
 17 done after the O'Malley Panel had come out and already
 18 criticized the profession for a lack of documentation.
 19 The peer reviewer -- and this is on one of the largest
 20 firms -- noted to me that they had a difficult time on the
 21 peer review because there wasn't adequate documentation.
 22 So I said: Well, on how many of the audits? He said: Oh
 23 about half the audits.
 24 So I turned around and I said: Well then, how
 25 did you ascertain on those half the audits of this large

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1 Big Five firm that the audits were done okay? And he
 2 said: Well, I went and asked the auditor. I was just
 3 thinking in my own mind: I doubt that too many of those
 4 audit partners came back and said: Hey, we did a lousy
 5 job.
 6 Also, from a review and inspection perspective,
 7 unless you get the documentation there I don't know how
 8 the investing public is going to be able the rely upon the
 9 inspection process of this Board.
 10 MR. RAY: Charles Drott.
 11 MR. DROTT: Yes. I think Lynn has just nicely
 12 put what I was about to say. I would reiterate that in
 13 California we have the standard that the presumption that
 14 the work that was not done can be overcome by a
 15 preponderance of the evidence. We certainly anticipate
 16 taking individual cases as individual cases and allowing
 17 oral evidence to be given as to the work that was not
 18 documented.
 19 However, if all there is is oral evidence and
 20 there's really nothing else that you can get your arms
 21 around beyond that, I think it would be very difficult to
 22 overcome the presumption that the work was not done.
 23 MR. RAY: Jim Lee.
 24 MR. LEE: The importance of the oral
 25 explanations is something that we have to keep in mind

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1 with regards to the documentation. As part of the process
 2 of completing the audit, the auditor goes through a number
 3 of decision points on what needs to be documented and what
 4 should be documented based on their understanding at that
 5 point in time of the significant issues that exist.
 6 After the fact there may be additional matters
 7 that develop that weren't viewed at the time the audit was
 8 being done as being significant. I think it's important
 9 that in order to get a full picture of what the audit
 10 entailed, what work was actually performed, what were all
 11 the considerations that were made as part of the audit
 12 process, that oral explanations have to be considered
 13 along with the documentation that was prepared in
 14 connection with the audit.
 15 So to get to the full picture, we think oral
 16 explanations do in fact have to be considered.
 17 MR. RAY: Craig Crawford.
 18 MR. CRAWFORD: Craig Crawford, KPMG.
 19 It seems to me that the principal goal or the
 20 principal objective of inspection is to be able to
 21 ascertain the quality of the audit engagement and the
 22 completeness of the audit engagement, and to look at
 23 whatever, any and all evidence that's available in order
 24 to reach that conclusion.
 25 By prohibiting the use of oral explanation as

<p style="text-align: right;">Page 66</p> <p>1 sufficient audit evidence, it seems to run contrary to the 2 objective of getting to the bottom of it, getting their 3 arms around all the facts that are available and making 4 decisions and drawing conclusions based on an analysis of 5 all the facts and all the evidence that's made available 6 irrespective of form. 7 So I don't see that anyone's interests are 8 furthered by ignoring the facts. 9 MR. RAY: John Fogarty. 10 MR. FOGARTY: Yes, John Fogarty with Deloitte 11 and Touche. 12 Just a couple of thoughts. First, audits 13 themselves, if we conducted them and only looked at 14 documentary evidence and we admit no evidence from an oral 15 source, I don't think the audit would be a particularly 16 effective audit. Like Craig, I think the inspection 17 similarly would not be particularly effective. 18 I'd also point out that I'm very much in favor 19 of good documentation, complete documentation. I think it 20 drives quality. I think it improves the inspection 21 process, and all the goals that we talked about here. But 22 without some balance and limitations, it can reach a point 23 where auditors in their effort to comply with the rules, 24 because they do take the rules very seriously, can drive 25 this to a point where the end product of the audit's not</p>	<p style="text-align: right;">Page 68</p> <p>1 But if you find yourself in a position where 2 you're talking about important audit judgments and the 3 reviewer cannot find anything or much of anything in your 4 working papers that shows that you have covered those 5 areas, I think you're really going to a very high bar to 6 try to overcome the presumption that you didn't do the 7 work. 8 So it would be very, very key of the Board could 9 make it clear that you do run a fairly high risk if you're 10 banking on the ability to explain away where it's not 11 apparent from your working papers that you have in fact 12 done a reasonable job. 13 MR. RAY: Mike Sutton. 14 MR. SUTTON: Mike Sutton. 15 It's hard for me to deal with 6 and 7 separately 16 because it seems to me they are intertwined. If you look 17 at the context of 6, the context is that there is no 18 documentation. So I think it's difficult to conclude that 19 a rebuttable presumption is inappropriate or unreasonable. 20 It seems quite reasonable to me. 21 But the real issue comes in question 7, is what 22 then overcomes that rebuttable presumption. It seems to 23 me again the context of question 7 is or the direction of 24 question 7 is that an oral explanation alone, in and of 25 itself, is not adequate. And that also seems very</p>
<p style="text-align: right;">Page 67</p> <p>1 the document; it becomes documentation, not the effective 2 execution of the audit. 3 So I think we do need to be cautious with very 4 prescriptive and drastic statements that could drive a 5 level of documentation that is no longer driving 6 effectiveness of auditing. 7 MR. RAY: Lynn Graham. 8 MR. GRAHAM: Lynn Graham from BDO. 9 I think the problem that we seem to be having is 10 in this question 7 it says "to support audit evidence." I 11 don't hear anybody indicating that they shouldn't listen 12 to oral explanations to support audit evidence if you take 13 it in the meaning of supplement. But I think everybody 14 has a problem with substituting evidence, and that you 15 might keep in mind with respect to the draft, that that is 16 more or less what I hear as a consensus. 17 MR. RAY: Jeff Steinhoff. 18 MR. STEINHOFF: I agree wholeheartedly with what 19 all the other folks have said on this topic. I think that 20 there should be the ability to receive oral evidence from 21 the auditor. At the same time, I think the commission, 22 the Board, can stress that the goal is to have work papers 23 that stand on their own and certainly in every case there 24 would be some need to explain something, because people 25 will read things in different ways.</p>	<p style="text-align: right;">Page 69</p> <p>1 reasonable to me. 2 MR. RAY: Okay. Well, we have reached a few 3 minutes past the appointed time for our ten-minute break. 4 We have plenty to discuss after the break, so we will keep 5 the break to ten minutes, at which point we will 6 reconvene. Thank you. 7 (Recess from 3:38 p.m. to 3:50 p.m.) 8 MR. RAY: Greg Scates is going to start the 9 remainder of the discussion here in a moment with the 10 subject of changes to audit documentation. 11 MR. SCATES: Let's go ahead and get started. As 12 Tom mentioned, our next subject has to do with the changes 13 to audit documentation. More particularly, we would like 14 to hear your views on changes to the work papers after the 15 audit report has been released. 16 Is it appropriate to change the working papers 17 after release of the audit report? And if so, under what 18 circumstances would this be appropriate, and how should 19 such changes to the working papers be documented? 20 CHAIRMAN McDONOUGH: If any Yankees need a 21 translation, you can -- 22 MR. SCATES: That's not a strong accent, is it? 23 (Laughter.) 24 Lynn, Lynn Graham. 25 MR. GRAHAM: Let me just -- Lynn Graham from BDO</p>

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1 Siedman.
 2 Let me just start the discussion. I guess it
 3 depends on what your definition of "change" happens to be.
 4 There are going to be instances where in the process of
 5 wrapping up an engagement you need to add additional
 6 material to the file. Maybe it was obtained in a remote
 7 location. You are now in the process of electronically
 8 creating audit files. Common practice is to hold off on
 9 scanning some of the documents into that electronic file
 10 until you can administratively do that more effectively
 11 back in the office.
 12 So there are going to be circumstances such as
 13 that to appear that documents were added after the report
 14 release date. I certainly don't think that that's an
 15 audit quality issue. It's an administrative issue.
 16 With respect to adding schedules and other
 17 things, I think a lot of the previous discussion was over
 18 undocumented procedures. If you recognize that you should
 19 have documented something after the report release date
 20 and there is evidentiary matter that documents the
 21 procedure that you performed, you do that. But again, I
 22 think as time creeps on the credibility of adding
 23 documentation diminishes and you shouldn't be adding
 24 documentation to files that are quite old.
 25 MR. SCATES: Jeff Steinhoff.

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1 MR. STEINHOFF: I agree with what Lynn said. I
 2 all that just basic cleanup work. You shouldn't be
 3 performing new audit work. The things that you would
 4 change or work papers add or documents added to the file
 5 that you already obtained and for some reason hadn't
 6 included them should not really affect the principal
 7 findings, conclusions, or recommendations. They should be
 8 in your working papers. So I would call this just basic
 9 cleanup -- a document that for some reason was
 10 inadvertently not placed in there.
 11 You shouldn't be doing added work and I don't
 12 think you should be deleting the working papers that are
 13 there. They should stand on their own. The job should be
 14 completed.
 15 MR. SCATES: Charles Drott.
 16 MR. DROTT: Yes. I agree with the gentleman
 17 earlier who talked about defining what "change" means. In
 18 our new laws in California we do have a definition of
 19 that, basically to include any additions, removal,
 20 deletion, substitution, or editing of audit documentation
 21 occurring after the date of issuance of the audit report.
 22 Part of our requirements also state that the identity of
 23 the person making the change, the identity of the person
 24 approving the change, the date of the change and the
 25 reason for the change must be documented if the reason is

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1 other than assembling preexisting documents.
 2 We also go on to say that the documentation
 3 which has changed should include sufficient detail to
 4 enable the reviewer with a relevant knowledge and
 5 experience, having no previous connection with the audit
 6 engagement, to understand the nature, timing, reason for,
 7 and extent of the change.
 8 I think there's another question right after
 9 this dealing with a specific date or event after which
 10 changes to the work papers will no longer be permitted. I
 11 have comments on that, but I'll reserve those for that,
 12 for that question.
 13 MR. SCATES: Jim Brown.
 14 MR. BROWN: Jim Brown, Crowe Chizek.
 15 Maybe we ought to give a few examples of how
 16 work papers can change, and I think one is the situation I
 17 mentioned a little bit earlier, where you have a lot of
 18 staff on the job and you're trying to train them. Those
 19 staff may be on ten different audits at year end, and you
 20 see something they did, especially when they give it to
 21 you late Friday, you're comfortable with what they've done
 22 because you've been supervising them, but they just can't
 23 write a memo yet. They just can't write what they've
 24 done.
 25 So you give them some direction on what to do.

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1 Now, they may not be back in the office or able to do
 2 something for you for a month and a half yet. You don't
 3 want to sit there and write up the memo for them because
 4 they don't get any training then, they don't get the
 5 learning out of the fact and how to express themselves on
 6 what they've actually done. Or maybe they've
 7 overexpressed themselves and they said they've done more
 8 than they had.
 9 Whatever it is, you have to spend some time with
 10 them to move them along. They're going to be on ten
 11 different audits, they're going to be elsewhere. You've
 12 got to have an opportunity to come back in and get things
 13 right.
 14 Another thing you might have is the last thing
 15 you're doing before releasing the audit report is meeting
 16 with the audit committee, and you have a nice meeting with
 17 the audit committee and you're going through a lot of
 18 points and it's okay, you're ready to release the audit
 19 report, but you haven't yet prepared the memo of the
 20 meeting with the audit committee.
 21 So there are a lot of things that will happen
 22 and will get just as a normal course of business, be put
 23 in there. I think we've all seen some things in the paper
 24 lately where documentation can be -- things can be
 25 manipulated, and you know there is people in the world

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1 that do bad things. I think we have to look at the vast
 2 variety of the reasons why things can be changed.
 3 If you want to have a trail later, make us leave
 4 a trail. But let us go through and update things.
 5 Again, another reason for a documentation change
 6 is the internal inspection or somebody else looking at the
 7 job. They may say: That's not clear. And the person
 8 that wrote the memo may sit down and say: Well, here's
 9 what I meant to say; I see what you mean, it's not clear,
 10 it's not complete; I'll amplify on it.
 11 So again, there's lots of valid, legitimate
 12 reasons why things can change after the fact.
 13 MR. SCATES: Bruce Webb.
 14 MR. WEBB: Well, I think an auditor should be
 15 allowed a reasonable period of time to -- a reasonable and
 16 a reasonably short period of time to assemble the
 17 information and to sort of clean up the audit files after
 18 the release of the report. And I also think there are
 19 other circumstances under which adding information to the
 20 work papers would be appropriate, such as evaluating a
 21 significant subsequent event, evaluating facts that were
 22 discovered subsequent to the issuance of the auditor's
 23 report, conflicts that might develop between the audit
 24 evidence and the procedures performed in connection with
 25 letters for underwriters, in connection with subsequent

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1 event procedures and securities filings, or in the case of
 2 review of interim financial statements.
 3 However, if changes to the work papers are
 4 warranted I would certainly agree with the idea that what
 5 was changed, when, why, who, all that sort of thing should
 6 be documented in the working papers.
 7 So I would agree with, I think, other commenters
 8 what said that generally deletions should not be permitted
 9 and additions should document the who, what, when, why.
 10 MR. SCATES: Craig Crawford.
 11 MR. CRAWFORD: Actually I just took mine down,
 12 my tent down, because I would have repeated just what
 13 Bruce has said.
 14 MR. SCATES: Bob Gray.
 15 DR. GRAY: Yes. I think all of us, we recognize
 16 -- and NASBA has studied this very carefully and is
 17 developing some proposed rules for the Uniform Accountancy
 18 Act as a guide for all state regulation. And we recognize
 19 the issues of assembling work papers, the housecleaning
 20 that has to be done, all the things that have been very
 21 appropriately pointed out here.
 22 But what we were concerned with was the
 23 additions, deletions, and changes in relevant
 24 documentation after the audit report is issued. Again, I
 25 said "relevant documentation after the report is issued."

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1 We took this up with the AICPA Auditing Standards Board
 2 staff and with Chuck Landes and we received very excellent
 3 support and cooperation from them in terms of NASBA's
 4 concern with the adequacy of SAS 46 in this regard.
 5 As a result of this, we feel that there should
 6 be enough detail in any changes that are made to enable a
 7 reviewer to understand the nature, timing, reason for, and
 8 the extent of the changes, and also the reviewer and who
 9 approves these changes should be identified and dated. So
 10 we proposed all of that. And Chuck Landes and his group
 11 is going to make some recommendations to the Auditing
 12 Standards Board to revise SAS 46. So we've worked very
 13 effectively and cooperatively with them, which we thank
 14 them for.
 15 But also, we feel that this was strong enough so
 16 that we would have developed a rule very similar to
 17 California's. But it is taken care of adequately by
 18 Auditing Standards there's no need for a rule.
 19 MR. SCATES: Let's move on to the next question.
 20 As many of you are aware, at least two states have
 21 implemented rules requiring the audit documentation to be
 22 complete at a certain point in time. Should there be a
 23 specific date or event after which changes to working
 24 papers should no longer be permitted or permitted only
 25 after proper approval?

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1 Jim Lee.
 2 MR. LEE: Jim Lee from PricewaterhouseCoopers.
 3 We feel that it would be appropriate, given the
 4 various actions at the state level on establishing
 5 different time frames after the issuance of the financial
 6 statements, for there to be an established number of days
 7 after the financial statements are released after which
 8 changes should not be made to the working papers. We
 9 don't see that as impacting necessarily audit quality as
 10 much as to make it clear to the auditor what the rules
 11 are, to avoid multiple state rules that may be in effect,
 12 and to eliminate any potential confusion that might
 13 otherwise exist.
 14 I think in this area, too, when we talk about
 15 changes in working papers it's important that we be very
 16 specific about what we're discussing. Even after
 17 establishing a number of days after the issuance date of
 18 the financial statements where working papers shouldn't be
 19 changed, to the extent, as others have mentioned earlier,
 20 there's been a subsequent event that has occurred or a
 21 material matter has come to the attention of the auditor,
 22 there should be a new working paper file created and that
 23 documented in that working paper file. So it's not a
 24 matter that it shouldn't be documented; it's just a
 25 question of where it should be documented.

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1 MR. SCATES: Chuck Landes.
 2 MR. LANDES: Chuck Landes, AICPA.
 3 I just want to reiterate what some others have
 4 said, because I do think 8 and 9 somewhat go together. To
 5 me, the issue isn't so much is it appropriate to change,
 6 but rather how should those changes be documented. I
 7 think from an inspector's point of view that's what you
 8 really want to focus on. As others have already
 9 articulated, there are a number of reasons why working
 10 papers change, but I believe what's most important is that
 11 you be able to determine what changed and when it changed,
 12 and so focusing more on the date and how those changes
 13 should be documented to me is the most significant issue
 14 that the Board should focus on.
 15 MR. SCATES: Charles Drott.
 16 MR. DROTT: Yes. Following up, it was mentioned
 17 that two states have adopted this rule, and that's New
 18 York and California. I know New York has what we call a
 19 45-day rule and California adopted a 60-day rule. What
 20 I'd like to do, it's very brief, is just quote that for
 21 you. We basically passed a law that said during the 60-
 22 day period after the date of issuance of the audit report
 23 documents may be added to the file for the assemblage and
 24 documentation of work previously performed. "Nothing in
 25 this section authorizes the deferral of audit procedures

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1 required to be performed prior to the date of issuance of
 2 the report."
 3 The key thing that I will urge the PCAOB to
 4 consider with respect to this part is stressing in the new
 5 standard that under no circumstances would this, whatever
 6 the number of days you decide on, can any additional audit
 7 work be performed, that it can only be for the assemblage
 8 of preexisting documents or completing the documentation
 9 of work performed prior to the issuance of the audit
 10 report.
 11 MR. SCATES: Lynn Graham.
 12 MR. GRAHAM: Yes. I agree with Charles with
 13 respect to that. I would ask that the Board consider a
 14 couple of factors if you are going to set some sort of a
 15 date. One is that we have a very substantial and
 16 unexplored area that we're going to be dealing with this
 17 year in 404, and that's going to require a lot of
 18 discussion as well as a lot of documentation. That's
 19 going to have to be worked out from scratch. This is not
 20 business as usual. This is all new stuff.
 21 We also have SEC rules that are new. We're
 22 going to possibly have a documentation standard here
 23 that's going to be new. And if anything, I would like to
 24 urge you to start with a date that's a little further out
 25 than you'd like to wind up with, because I think that that

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1 will contribute to quality as opposed to contribute to
 2 chaos.
 3 MR. SCATES: Jim Brown.
 4 MR. BROWN: Jim Brown, Crowe Chizek.
 5 Let me give two other areas to the Board where
 6 there may be some reasons for things being changed quite a
 7 bit of the time after the release of the audit report,
 8 which I guess I just want to confirm, too. That's not the
 9 same as the audit fieldwork date, which could be, say,
 10 January 31st, but the audit release date, which is when
 11 you finally say, here, go use it.
 12 But a lot of times tax return work is done 6
 13 months after the audit report's been released, and there
 14 may be something in the tax return analysis or some
 15 question comes up, especially with the audit team looking
 16 at it trying to solve a tax-related question, that they
 17 say: Oh yeah, this is the case.
 18 Actually you have a rule now, because you
 19 adopted the AICPA rule, that if it comes to our attention
 20 that we missed some procedure on the audit, we may have to
 21 go back and figure out whether we have to do it, and
 22 there's no timing on that. So we've got a rule right now
 23 on us that says we have to look at it whenever we note it
 24 -- it could be a couple years later -- there's an omitted
 25 procedure.

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1 I'd just like to mention, it seems sort of
 2 simple to me that as long as you date and describe what it
 3 is that you did to make a change, there doesn't seem to be
 4 any reason to put a limit on when the change can be made.
 5 MR. SCATES: Ann Yerger.
 6 MS. YERGER: Ann Yerger, Council of
 7 Institutional Investors.
 8 I have to tell you as a non-practicing financial
 9 person, it's sort of shocking to read that there might be
 10 a standard that would allow auditors to change their
 11 working papers. I don't think that that's what your
 12 investors, the investors are expecting. Certainly we
 13 would not expect that there would be deletions to the
 14 working paper.
 15 My own preference -- and I understand in an
 16 ideal world we'd prefer that there be absolutely no
 17 changes after the audited numbers are released. It sounds
 18 like that's not exactly practical. But it would strike me
 19 that any changes should only be, A, additions; B, should
 20 be well documented as Charles described in the California
 21 rule; and C, should -- and I think this is an accounting
 22 term -- really be based strictly on sort of non-
 23 significant transactions, because I can't fathom how the
 24 auditor can actually sign off that the work's been done if
 25 there's things that haven't been fully documented and

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1 signed off by the person doing the audit and the
 2 supervising partner.
 3 MR. SCATES: Let's move ahead to the next
 4 subject, audit-related documentation. The SEC's final
 5 rules in implementing section 802 of Sarbanes-Oxley are
 6 effective for audits and reviews completed on or after
 7 October 31 of this year. The term "audit-related
 8 documentation" has been defined in the briefing paper. An
 9 example of audit-related documentation would be an e-mail
 10 documenting a consultation or an e-mail documenting a
 11 resolution of differences of professional judgment.
 12 Question No. 10: Should an auditing standard on
 13 audit documentation include audit-related documentation as
 14 defined by rule 2-06 of Regulation S-X?
 15 Lynn Graham.
 16 MR. GRAHAM: Lynn Graham from BDO Siedman.
 17 I guess I was a little confused by this. You
 18 mean we have a choice?
 19 (Laughter.)
 20 I think this has already been decided for us and
 21 I think that the rule is out there. I think it is
 22 important, though, that if we're going to enhance or
 23 modify the rule that we don't get into a situation where
 24 the PCAOB and the SEC are issuing different rules or are
 25 wording things slightly different that are going to

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1 confuse everyone and cause a great number of
 2 interpretations to need to be made.
 3 It's almost easier in this kind of an
 4 environment that first out maybe carry the ball on this
 5 until we see where things go. But I thought that was
 6 pretty well decided.
 7 MR. SCATES: Bruce Webb.
 8 MR. WEBB: Bruce Webb, McGladrey & Pullen.
 9 I was also a little bit confused by the two
 10 examples of audit-related documentation that you just
 11 gave, because I would have thought this were audit
 12 documentation, not audit-related documentation. It seems
 13 to me that a record of consultation, whether it exists in
 14 an e-mail or a formal document, is audit documentation;
 15 and similarly, a disagreement among engagement personnel
 16 as to a material matter. Once all the facts are known and
 17 on the table, what should be done with them is audit
 18 documentation.
 19 MR. SCATES: Mark Pearson.
 20 MR. PEARSON: Yes, Greg. Mark Pearson, Ernst
 21 and Young.
 22 I don't disagree, Greg, that we would have some
 23 avenue for interpretation or additional guidance on the
 24 meaning behind rule 2-06, but I think it's critical that
 25 that be worked out between the Board and the SEC so that

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1 we get it one time, one way.
 2 MR. SCATES: Going to the next question, the
 3 SEC's release that discusses the new rule 2-06 provides
 4 some guidance as to what constitutes what we've been
 5 referring to as audit-related documentation. If the Board
 6 goes forward with a standard that includes audit-related
 7 documentation, should the Board provide additional
 8 specific guidance on what constitutes audit-related
 9 documentation?
 10 Chuck Landes.
 11 MR. LANDES: Chuck Landes, AICPA.
 12 The short answer is yes, Greg, and in a hurry.
 13 I can tell you from the AICPA's perspective in terms of
 14 the number of inquiries that we receive from our members
 15 there is a great deal of confusion. And I'm sure the SEC
 16 did their very best in issuing the rule, but it still
 17 leaves a lot to be interpreted. Therefore I would
 18 encourage the PCAOB and-or the SEC -- as was stated
 19 earlier, I think there's some confusion over who should
 20 interpret, since it is the SEC's rule. So the sooner that
 21 the PCAOB and-or the SEC can get out in front and issue
 22 this interpretative guidance, it certainly will be well
 23 appreciated by the CPA community.
 24 MR. SCATES: Bob, Bob Burns.
 25 MR. BURNS: I'm Bob Burns with the SEC.

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1 I think that there's maybe two different goals
 2 here from what the SEC did and what you're going to be
 3 doing. 802 was really, as everyone here knows, was
 4 written really for an enforcement standpoint. It was
 5 basically Congress was disturbed with situations where
 6 they didn't have the evidence that they thought people
 7 should have to enforce the securities laws. That was
 8 written really to make sure that enough documents would be
 9 there, enough information would be there, that when people
 10 went ahead to enforce the securities laws everything would
 11 be retained and it would be somewhere that was accessible
 12 to those people who needed it.
 13 I think when they did 103 and specifically
 14 directed the PCAOB to look at this area, I'm not so sure
 15 they had the same goal in mind. I think that perhaps they
 16 were thinking of more along what you needed to do your job
 17 and what investors would think you would be looking at
 18 when you issued your reports and issued your findings
 19 after having looked at audits.
 20 So I understand that there is confusion in the
 21 profession. I understand that when you go out to really
 22 implement these things and then to make procedures or
 23 policies for the firms that it can be terribly confusing.
 24 But I think that the analysis is a little bit different
 25 from what we did and what the PCAOB is going to be doing.

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1 I don't think there's an easy answer. I think
 2 part of this stems from the fact that probably some people
 3 in Congress wrote 802 and other people in Congress wrote
 4 103. I'm not sure exactly how to do it, but I do agree
 5 that it's an area that we ought to think more about and
 6 talk more about, even between agencies. I think this is
 7 very helpful today to find out what some of the real
 8 problems are out there with this.

9 MR. SCATES: Let's move forward then to question
 10 number 12: Should a standard on audit documentation,
 11 including audit-related documentation, apply to
 12 engagements other than audits and reviews?
 13 Mark Pearson.

14 MR. PEARSON: Mark Pearson, Ernst and Young.
 15 I don't see why a standard on audit
 16 documentation wouldn't deal with any document or report
 17 that we would issue that would be included in an SEC
 18 filing. I mean, it would seem within your purview and
 19 clearly something to which your guidance should apply.

20 MR. SCATES: Bruce Webb.
 21 MR. WEBB: Bruce Webb with McGladrey & Pullen.
 22 I certainly support the idea that all audit-
 23 related engagements should have a similar documentation
 24 standard to the audit documentation standard. However,
 25 it's my belief that if you were to look at those audit-

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1 related engagements, for example an interim review,
 2 subsequent events review under the federal securities
 3 statutes, a letter for underwriters, you will find that
 4 they're different enough that it's hard to write one
 5 generic standard, and that it might be better approached
 6 by writing the documentation standards specifically to
 7 those separate standards, as the ASB did for example on
 8 SAS 100.

9 I don't disagree about the overall concept or
 10 need for a level playing field on audit documentation, but
 11 would simply suggest that the individual standards might
 12 be the better home for it.

13 MR. SCATES: Craig Crawford.
 14 MR. CRAWFORD: Craig Crawford, KPMG.
 15 Just real briefly, I have presumed, maybe
 16 appropriately or inappropriately, but I have presumed that
 17 the scope of an audit documentation standard would in fact
 18 apply to all engagements underlying a report that was
 19 rendered that ended up in a public filing.

20 MR. SCATES: Let's go ahead and turn to the next
 21 question, the one on retention of the work papers.
 22 Sarbanes-Oxley also directs the Board to adopt a standard
 23 that would require the auditor to retain audit and audit-
 24 related documentation for a period not less than seven
 25 years. Should this retention requirement of seven years

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1 be required of all engagements performed in accordance
 2 with auditing and related professional practice standards?
 3 (Pause.)
 4 We have a consensus.
 5 (Laughter.)
 6 I'm sorry. Lynn Graham.
 7 MR. GRAHAM: I just wanted to repeat, I didn't
 8 think I had a choice here.
 9 MR. SCATES: Lynn Graham.
 10 MR. GRAHAM: That was my comment, I didn't know
 11 I had a choice. It's already done.
 12 MR. SCATES: Okay. Jim Brown.
 13 MR. BROWN: Jim Brown, Crowe Chizek.
 14 I'll just mention as we're talking about this,
 15 letters for underwriters are not public documents. They
 16 only go to the underwriters, so there's no public that's
 17 really looking at them. There's no representation in
 18 there that generally accepted auditing standards were
 19 followed. So it's possible that you could come up with a
 20 different reason because there's no user of these, so to
 21 speak, except that one entity that's asking for you to do
 22 certain procedures. So maybe a letter for underwriters is
 23 a bit different. Again, it's not included in any SEC
 24 filings at all.
 25 MR. SCATES: Lynn Turner.

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1 MR. TURNER: Let me counter Jim on that. The
 2 letter for underwriters is used for a public purpose.
 3 It's given to the underwriters so that they can do their
 4 own due diligence under the SEC statute to provide some
 5 protection to investors. So it is -- it does have very
 6 significant public purpose, a very significant investor
 7 protection purpose. And I think just because it does not
 8 see the light of day at the end of the day, although who
 9 knows where some of those do end up, the purpose isn't
 10 different than what the public report is and to try to
 11 make a different cut for that I think would not be a good
 12 thing.

13 I think if it takes seven years to save it to
 14 give investors confidence in protections necessary under
 15 the law for an audit report, then I think the same thing
 16 would apply to underwriter letters as well.

17 MR. SCATES: Jim Brown.
 18 MR. BROWN: Jim Brown, Crowe Chizek.
 19 Then maybe we ought to consider whether letters
 20 for underwriters ought to be made public, and I don't know
 21 if you'd want to make that statement. If they're for
 22 investor confidence, the investors never see them.

23 MR. SCATES: Any more comments?
 24 (No response.)
 25 Before we proceed to the next question, I'd like

<p style="text-align: right;">Page 90</p> <p>1 to remind the audience to, if you have a question, please 2 be sure to fill out one of the index cards that's been 3 provided and return it to one of the staff. We'll try to 4 address those questions at the end. 5 Let's turn to the next section, on specific 6 guidance with respect to audit documentation. As 7 previously discussed, the principal purpose of audit 8 documentation is to provide support for the auditor's 9 report. The work papers should be sufficient to show that 10 the audit complied with professional standards. 11 Should all significant audit findings or issues 12 be required to be summarized in an engagement completion 13 memorandum? Jeff Steinhoff. 14 MR. STEINHOFF: I think all should be summarized 15 someplace in a manner which can be readily looked at by 16 someone and is placed in a logical order. But whether 17 it's in one given memorandum or not -- I think there 18 should be more flexibility. 19 MR. SCATES: Charles Drott. 20 MR. DROTT: Yes. I think the short answer from 21 my standpoint would be yes, but I also agree with what you 22 just said, that there could be some flexibility. However, 23 I think the emphasis here is on the word "all" in the 24 briefing paper. It seems to me that as a matter of 25 practice all of the major firms as long as I can remember,</p>	<p style="text-align: right;">Page 92</p> <p>1 difference. 2 I think the question should be really more the 3 accessibility of access or whatever may be the 4 accessibility to the documentation of those significant 5 audit findings, and whether it be through an electronic 6 summarization or critical matter sheets or whether it be 7 through a single memorandum shouldn't matter. 8 I guess one of the practical issues that I think 9 we deal with in the execution of our methodology -- and to 10 my mind this is really a methodology issue as opposed to a 11 standard -- one of the difficult things that we deal with 12 is in some areas auditors differ on what is a 13 "significant," quote unquote, matter. I would hate to see 14 a well-documented item that wasn't brought forward to the 15 summary memorandum result in a GAAS violation simply 16 because it wasn't brought forward. 17 I think conceptually we don't have an issue. 18 It's the details that create the issue. 19 MR. SCATES: Bruce Webb. 20 MR. WEBB: I believe there are really two issues 21 here. One, as Mark has very succinctly pointed out, is a 22 geography issue. And the second is a redundancy issue. I 23 think it would be a mistake to create a redundant central 24 documentation. Our firm, for example, does have a central 25 location for significant audit findings or issues, which</p>
<p style="text-align: right;">Page 91</p> <p>1 which is quite a while back, do use a summary audit 2 memorandum. It may come by a different name, but 3 essentially it's been in use for decades that I know of. 4 I think they have pretty well in the past done a 5 pretty credible job of addressing all of the significant 6 and major issues. I certainly think that this would be a 7 good part of an audit documentation standard. I think the 8 question that has to be answered is do you want to, as you 9 just pointed out, use the word "all". 10 But I think that it would certainly help any 11 reviewer, whether it be a firm reviewer or a regulator or 12 the PCAOB inspection staff or whatever. It would be 13 certainly helpful to have as many or all, if you will, of 14 the significant issues to be addressed in a centrally 15 located place. 16 MR. SCATES: Mark Pearson. 17 MR. PEARSON: I'm Mark Pearson, Ernst and Young. 18 I don't think anybody would quibble, certainly 19 we would not quibble, with the idea that all significant 20 audit findings need to be documented. We have had a 21 requirement for something similar to this for some time. 22 I guess the difficulty is, the real issue should be 23 whether or not the significant items are properly 24 addressed, and whether they're addressed in individual 25 memoranda or a single memorandum shouldn't really make a</p>	<p style="text-align: right;">Page 93</p> <p>1 essentially provides a roadmap to the other -- to where 2 those matters are more fully documented and addressed. So 3 they identify the nature of the matter, the conclusion, 4 and where the audit effort can be found. 5 Once again, I would certainly agree with Mark 6 that I would hate for the oversight of including one item 7 or two items on that checklist to result in a 8 noncompliance with auditing standards. 9 MR. SCATES: Craig Crawford. 10 MR. CRAWFORD: Craig Crawford, KPMG. 11 To reiterate a little bit and maybe emphasize 12 the points that both Mark and Bruce just surfaced, this is 13 in my mind more a matter of making sure that the 14 significant matters that have been identified by the 15 engagement team are in fact documented, keeping in mind 16 that significance is determined based on the eyes of the 17 beholder, for lack of better terminology. 18 But the geography -- and I'll use the same word 19 that Bruce used -- the geography of that documentation in 20 the working paper files should not be a determining factor 21 as to whether or not the auditor complied with generally 22 accepted auditing standards. The question that really -- 23 the issue that really is pertinent, I believe, is was the 24 work performed and is the documentation sufficient. The 25 location within the working paper files is not in my mind</p>

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1 of consequence.
 2 MR. SCATES: Keith Newton.
 3 MR. NEWTON: Keith Newton, Grant and Thornton.
 4 I agree with what they've said. The significant
 5 matters, it's important that they be documented somewhere
 6 in the work papers. Our firm does prepare a summary of
 7 those matters for reviewers, to assist them in going to
 8 the matters. They're not documented again. It's just
 9 kind of a roadmap.
 10 But I like what Mark pointed out, that if
 11 someone outside the audit engagement team considered some
 12 other matter significant that may have been well
 13 documented in the work papers but just didn't happen to
 14 get on that summary, that should not be a violation of
 15 auditing standards. So that's the reason I would urge not
 16 to make this a requirement.
 17 MR. SCATES: Chuck Bowsher.
 18 MR. BOWSHER: Chuck Bowsher.
 19 I'd like to speak as a corporate director and a
 20 member of audit committees, which I've been for the last
 21 seven years. And we're representing the investors. I
 22 think one of the things that's important to recognize in
 23 an audit is at the end of an audit you generally come down
 24 to two or three or maybe a half dozen major issues.
 25 Sometimes you don't have any, but lots of times you do

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1 have two or three or maybe a half dozen.
 2 It really depends to a great extent what you
 3 decide on those three to six issues as to whether you end
 4 up in court some years later or whether you have a
 5 successful audit and everybody recognizes you made the
 6 right decisions.
 7 Now, when I first went on boards and audit
 8 committees in 1997, which is not too long ago, I don't
 9 think the big issues were getting surfaced to the audit
 10 committees, one reason being the audit committees
 11 generally didn't have the right people on them. But it
 12 really was a relationship between the auditing firm and
 13 the CFO or the controller, whoever the top financial
 14 person was.
 15 I went on one board which is a New York Stock
 16 Exchange company and the audit committees would be over in
 17 30 minutes, and I don't think that the big issues were --
 18 and we never saw this -- you know, everybody says here
 19 we've always had this memorandum summarizing. Maybe that
 20 was in the work papers, but it wasn't getting to the audit
 21 committee, it wasn't getting to the board.
 22 Okay. We evolved after the blue ribbon panel
 23 report in 1999 and at that point we started to get them
 24 surfaced. But it was generally verbal, to be very honest
 25 with you. In other words, here is the problem, let's talk

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1 it over, and things like that, but very little
 2 documentation.
 3 This same company, I was just at their audit
 4 committee meeting in July -- in August, because we're a 6-
 5 30 fiscal year. We had a six-hour audit committee meeting
 6 and one of the reasons is we had about five or six issues
 7 -- we had an acquisition this year -- we had five or six
 8 issues that our auditing firm, and this is the same
 9 auditing firm all seven years, a major firm, gave us a two
 10 to three-page memo on each of these major issues.
 11 For the first time, I really felt that we were
 12 into the issues, had the expert advice of our auditing
 13 firm. The CFO had to get in on the discussion. We had
 14 outside consultants because they were the type of issues,
 15 like, you know, the intangibles and that, where now you
 16 have to bring in an outside firm to give you the opinion
 17 there.
 18 So I think we are evolving really to a situation
 19 where that's going to be the future. And if that's the
 20 future, then that should be part of the documentation in
 21 the audit. In other words, I certainly wouldn't think you
 22 would come up with a two-page memorandum on the tax
 23 accrual and then not put it in the work papers or in the
 24 final documentation.
 25 I think once we get to this stage -- I think

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1 it's been quite a fine evolution here -- why, I think then
 2 a lot of the answers to 14 through 18 which you're going
 3 to be raising are going to be answered pretty
 4 straightforward. That is, one, you need documentation and
 5 you need documentation where somebody maybe disagrees with
 6 what the firm is going to recommend. But by getting that
 7 kind of dialogue going at the management level, with the
 8 internal auditors, the external auditors, and outside
 9 experts and the audit committee representing the board, I
 10 think generally you'll come to the right decision. And
 11 I'm not sure we did in years past.
 12 MR. SCATES: Jim Lee.
 13 MR. LEE: I would agree with the comments that
 14 were just made regarding the importance of communications
 15 with the audit committee, and I think they have evolved in
 16 recent years to be much more robust, direct, and frank in
 17 covering important matters that need to be discussed with
 18 the audit committee.
 19 I think in terms of documenting significant
 20 accounting matters, that's critical that it happen. The
 21 format that it takes place, particularly in the day and
 22 age of electronic work papers, where you can tag a
 23 critical matter so that you can sort that later on and it
 24 ends up having multiple documents, but it's very clear to
 25 the reviewer of the working papers what are the critical

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1 matters, is something that should be considered. Having
 2 one separate memorandum that is supposed to summarize each
 3 and every thing isn't the only way in our mind to go, but
 4 it is important that all those significant and critical
 5 matters be documented and communicated directly to the
 6 audit committee.
 7 MR. SCATES: Jim Brown.
 8 MR. BROWN: Jim Brown, Crowe Chizek.
 9 I think it's great that audit committees are
 10 getting more interested in what's going on. I think
 11 that's good.
 12 I would just urge the Board to again stay with
 13 the principles: make certain we have something
 14 documented. I think to have it documented twice in the
 15 work papers may be overkill, and if there's a memo to the
 16 audit committee then it's probably being documented a
 17 third time. So we probably want to say at some point, how
 18 many is enough? I think your guidance might just be
 19 enough to say if it's in there once that ought to be
 20 enough. I recognize sometimes it's not in there now, but
 21 get it in there once; that should be enough.
 22 Second, I'd like you to focus a little bit on
 23 just what a significant finding can be, because I think
 24 many of us jump to the conclusion that it's a problem,
 25 that it's an issue. But sometimes the finding is a very

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1 positive thing: The finding is that the account does
 2 balance, that something does agree, that evidence was
 3 obtained.
 4 As we start -- we have to spend extra time on
 5 documenting the findings; do we have to include the
 6 positive, the good things also? Then I submit this is not
 7 going to be a short memorandum and you'll lose the
 8 problems with the good things, the findings, because again
 9 we do have many good findings on an audit: The financials
 10 are fairly presented.
 11 MR. SCATES: Lynn Turner.
 12 MR. TURNER: On the significant findings, I
 13 think most of the major firms do it all up front in a
 14 completion memo. So going that route I don't think would
 15 result in a lot of duplicity, given the way it's done
 16 today. But if people want to do it a different way and
 17 skin the cow another way, I think that'd be fine, too.
 18 The one thing I think that -- two things I think
 19 are important. One is all significant findings do need to
 20 be identified as such, for two reasons: one, we're
 21 supposed to be getting communication on the audit
 22 committee, as Chuck said, of all significant findings. So
 23 I want to make sure all those are coming to me on the
 24 board where I'm sitting. So the auditor it seems to me
 25 has got to identify them to make sure that they get to me.

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1 The second thing is one of the key controls in
 2 this whole process is the fact that we have for many years
 3 now had a second partner reviewer, concurring, review
 4 partner, whatever you want to call them. Those
 5 significant findings need to make sure that they're
 6 identified as such so that we make sure we've got that
 7 second partner looking at those findings if they're not
 8 identified on the work papers.
 9 My concern is that if it's not on that index up
 10 front as a significant finding, then quite frankly it's
 11 gotten overlooked. And I get no comfort then that in fact
 12 the concurring partner is going back and looking at it and
 13 focusing on it as a significant finding, and all of a
 14 sudden a control that is very key and critical to the
 15 quality of these audits is lost.
 16 So even if we don't do it in a single memo up
 17 front, which would be fine with me, then I think you've
 18 still got to have someplace where the significant findings
 19 are identified in black and white so we know where they
 20 were and we make sure that they get communicated to the
 21 audit committee so that they can do their job and get
 22 communicated to the concurring review partner so that
 23 person can do their job.
 24 MR. SCATES: Lynn Graham.
 25 MR. GRAHAM: Yes, Lynn Graham from BDO Siedman.

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1 I'm just suggesting that if you'd like I think
 2 it would be practical to look at some examples of these
 3 memoranda and maybe identify two or three or four major
 4 characteristics from them that they share in common. For
 5 example, I think most of them would require the inclusion
 6 of the schedule of adjustments, they would include the
 7 consultations that occurred on any technical accounting or
 8 SEC matters.
 9 I think that short list might give you a
 10 starting point if you were to create such a requirement,
 11 and then perhaps other issues would need to be decided on
 12 a fact and a case by case basis.
 13 MR. SCATES: Bruce Webb.
 14 MR. WEBB: Bruce Webb, McGladrey & Pullen.
 15 Most major firms may require an engagement
 16 completion memorandum. Our firm does not per se.
 17 However, we have a section in the file that is reviewed by
 18 the partner with final responsibility for the audit as
 19 well as the concurring and any other second partner
 20 reviewers. That would contain, I believe, all the
 21 elements included in those, though not necessarily in one
 22 document.
 23 So I just think to require one document is
 24 infringing on a methodology issue, as opposed to a
 25 standards issue. Secondly, I thought Lynn made some very

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1 good points, and as I look at the definition of
 2 "significant audit findings or issues" included in SAS 96,
 3 it just seems to me that you can't have one of those that
 4 don't meet the criteria for communication to the audit
 5 committee under SAS 61 or at least SAS 61 as the ASB would
 6 recommend the Board amend that.
 7 So I think Jim Brown has a valid point as well,
 8 that if you document it you could end up documenting it
 9 more or less three times. Let's make sure that these
 10 things are called to the attention of the reviewers.
 11 Let's just not create a terrible degree of redundancy
 12 while we do it.
 13 MR. SCATES: Jeff Steinhoff.
 14 MR. STEINHOFF: Jeff Steinhoff from GAO.
 15 I responded I guess first to this question about
 16 15 minutes ago. After listening to Chuck, it really
 17 strikes me you might want to reconsider what you're
 18 calling for here in a call for the auditor to document
 19 what they have conveyed to the audit committee involving
 20 the significant audit findings. I think that's really
 21 what you're trying to get to here, because people have
 22 various forms -- the word "geography" or cross-walks or
 23 linkages -- they have various ways in which they
 24 mechanically do this. And having one form, there probably
 25 wasn't a whole lot of support for having just one single

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1 form. But I think if you want to get to really the bottom
 2 line, it's have the auditors pulled together what are the
 3 significant issues that the audit committee should be
 4 aware of and is there documentation that they have
 5 properly communicated and fully communicated those matters
 6 to the audit committee members who should in fact know.
 7 MR. SCATES: Charles Drott.
 8 MR. DROTT: Yes, one other issue that I'd like
 9 to have everyone respond. I think there's a danger here
 10 that I'd like the Board to consider in its deliberations
 11 on this, and I guess it's a good reason to have things
 12 brought forward to a summary type memorandum. That is,
 13 oftentimes a significant issue, whatever that definition
 14 is -- and you should consider what that definition is.
 15 But oftentimes a significant issue could be in a certain
 16 section of the work papers that may not get brought
 17 forward to what I would call a top file or a summary memo.
 18 The danger then is that a reviewer looking at this top
 19 file or summary memo will not be aware of that issue.
 20 So I think that is a very good reason for having
 21 some summarization take place, so that a reviewer that
 22 perhaps is not familiar with the engagement would be sure
 23 to be aware of that issue.
 24 MR. SCATES: Mike Sutton.
 25 MR. SUTTON: Mike Sutton.

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1 I think some of the discussion about the
 2 objective of the engagement memorandum or the completion
 3 memorandum is a little misdirected. I don't see it as a
 4 duplication of anything in the audit documentation
 5 process. The role of that memorandum has been and should
 6 be to set up at a reasonably high level, for the
 7 concurring reviewer, for an audit, for a partner, for an
 8 inspector, for whoever is going to be examining that
 9 engagement, this is what this engagement is all about,
 10 here's the key issues that you should be concerned about,
 11 and guidance as to where to go to learn more about those
 12 issues.
 13 I can see that it would be a very effective tool
 14 for the engagement team in deciding, okay, what are we
 15 going to take to the audit committee, and would actually
 16 provide a background paper probably for doing that.
 17 correct
 18 MR. SCATES: Okay, let's move forward. I'd like
 19 to -- for purposes of our discussion, I'd like to combine
 20 questions 15 and 16. Specific guidance on audit
 21 documentation is included in existing pronouncements. For
 22 example, the auditor is required to obtain written
 23 representations from management. Other examples where
 24 audit documentation is included in existing pronouncements
 25 is in appendix A of the current standard on audit

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1 documentation, which is of course Statement of Auditing
 2 Standards No. 96.
 3 Question 15: Should specific guidance
 4 addressing certain subject matters be provided in a
 5 standard on audit documentation? Or is it more
 6 appropriate to include specific documentation requirements
 7 in other standards that address the specific subject
 8 matter?
 9 Mark Pearson.
 10 MR. PEARSON: Mark Pearson, Ernst and Young.
 11 I don't mean to be facetious here, but the
 12 answer is yes. I think that question 15, should specific
 13 guidance addressing certain subject matters be provided:
 14 Yes, if it's generally applicable. I don't think there's
 15 any question, that should be really the driving force
 16 behind an audit documentation standard, principles-based.
 17 But I can also see situations where, for
 18 example, comfort letters, where specific guidance on
 19 documentation that may be unique to a comfort letter,
 20 because it really derives back from work already done on
 21 an audit that's been done previously, you know, it might
 22 make more sense to be there as opposed to in the broader
 23 standard.
 24 So as I said, I don't think we have a problem
 25 either way, given those parameters that I stated.

<p style="text-align: right;">Page 106</p> <p>1 MR. SCATES: Charles Drott. 2 MR. DROTT: It seems to me that if a specific 3 standard has documentation requirements it's essential 4 that they remain there, because the danger I see is 5 someone researching, an audit person, part of an audit 6 team, researching that issue needs to know what the 7 documentation requirements are when he looks at that 8 specific standard. 9 However, having said that, I think the global or 10 general documentation standard could have an index which 11 reflects at least the other standards that contain 12 documentation requirements, so that you have the best of 13 both worlds. If I'm not mistaken, I believe SAS 96 does 14 that, and I think that would be a good way of doing it. 15 MR. SCATES: Bruce Webb. 16 MR. WEBB: Bruce Webb, McGladrey & Pullen. 17 Charles, you're correct. SAS 96 was developed 18 to be the overarching standard, as Mark suggested, and 19 provide the basic principles for documentation. I think 20 the Board has found or the Auditing Standards Board found 21 in its recent standards, anything clearly subsequent to 22 '96, that there was also a need for specific documentation 23 standards within each of those standards. And I would 24 suggest that that's the best approach. 25 MR. SCATES: Any more comments? Sorry. Craig</p>	<p style="text-align: right;">Page 108</p> <p>1 evidence was incorrect or incomplete and therefore not of 2 much value. 3 But as I read it again, it said that "evidential 4 matter that contradicts the assertions in the financial 5 statements," as opposed to internally contradictory 6 evidence, then I really focused on this as being the 7 essence of auditing. I mean, the entire purpose of doing 8 the audit procedures is to determine if there are in fact 9 items of evidence that contradict the assertions in the 10 financial statement. 11 So I think this is a description of what is in 12 working papers. So I would agree, it should be. 13 MR. SCATES: Lynn Graham. 14 MR. GRAHAM: Yes, Lynn Graham from BDO Siedman. 15 I think current SAS 96 would require the 16 documentation of this matter, looking at paragraph 9, the 17 second bullet there. So I'm just wondering if there was 18 something else that someone was thinking of that would not 19 have been covered by the existing standard. 20 MR. SCATES: Jeff Steinhoff. 21 MR. STEINHOFF: I agree that it should be, be 22 kept. I guess I was reading this that in this case the 23 auditor decided to opine anyway and there was some 24 information in the working papers that contradicted that, 25 and should they be required to keep that. So in reading</p>
<p style="text-align: right;">Page 107</p> <p>1 Crawford. 2 MR. CRAWFORD: Craig Crawford, KPMG. 3 I would just like to I guess echo what's been 4 said already. I think it's probably not feasible to 5 expect a documentation standard at an umbrella level to be 6 able to anticipate all the permutations of documentation 7 that might be required or might exist, and that when a 8 specific subject matter is dealt with in a standard that 9 documentation matters be addressed at that level. 10 MR. SCATES: I'd now like to go to the last two 11 questions, that were introduced at the beginning of our 12 roundtable by Tom Ray. The first question, number 17: 13 Our previous discussions have been based on the premise 14 that the work papers should contain the evidential matter 15 obtained by the auditor that supports management's 16 assertions in the financial statements. Should evidential 17 matter that contradicts the assertions in the financial 18 statements also be retained as a part of the working 19 papers? 20 Mark Pearson. 21 MR. PEARSON: Mark Pearson, Ernst and Young. 22 When I first read this question I think my 23 answer was a little different, because you can have 24 contradictory evidence as opposed to something that 25 contradicts an assertion and find out that in fact the</p>	<p style="text-align: right;">Page 109</p> <p>1 it in that manner, I believe, yes, it should be retained 2 in the working papers and the auditor should then explain 3 why, despite having this information that contradicts the 4 assertions, they have concluded otherwise, they concluded 5 that this is all right. 6 MR. SCATES: Bruce Webb. 7 MR. WEBB: Bruce Webb with McGladrey & Pullen. 8 I think the objective of audit evidence is to 9 support the auditor's report, not necessarily support the 10 assertions in the financial statements. The report, while 11 hopefully in all cases would be a clean opinion, it might 12 be qualified or adverse. As a result, of course you have 13 to look at evidence that might contradict assertions in 14 the financial statements and you should retain it. In 15 fact, paragraph 25 of SAS 31 already requires that. 16 I think we feel that SAS 31 and SAS 96 would 17 require auditors to retain conflict evidence. If you have 18 conflicting evidence, your audit's not done and you have 19 to continue to perform the procedures until you've 20 resolved the matter. 21 MR. SCATES: Charles Drott. 22 MR. DROTT: Yes. I would just add one last time 23 that we addressed this in California and we did adopt as 24 part of our new laws basically something that says audit 25 documentation has to be retained whether or not that</p>

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1 documentation supports the auditor's final conclusions,
 2 and any documentation regarding any significant matter
 3 related to the audit has to be retained whether or not it
 4 contains information inconsistent at the auditor's final
 5 conclusions.
 6 MR. SCATES: Jim Brown.
 7 MR. BROWN: Jim Brown, Crowe Chizek.
 8 I generally agree with everything. I do want to
 9 suggest that this be worded in a way that doesn't drive us
 10 so that we have to get on a search engine and find any
 11 derogatory information that we can get on the company,
 12 that this doesn't become a requirement where we go out and
 13 search for ever rumor and article and web posting that
 14 says something bad and then have to deal with each such
 15 item. So if you can avoid that, please do.
 16 MR. SCATES: Let's now turn to our last
 17 question, that has to do with disagreements on accounting
 18 or auditing matters, number 18: If a member of the audit
 19 engagement team disagrees with the conclusions reached on
 20 a particular accounting or auditing matter, should this be
 21 documented in the working papers and should this
 22 disagreement also be noted in the engagement completion
 23 memorandum?
 24 Bruce Webb.
 25 MR. WEBB: Bruce Webb, McGladrey & Pullen.

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1 I'm not trying to hog the mike, but the Code of
 2 Professional Conduct of the AICPA prohibits an auditor
 3 from subordinating his judgment to anyone else's judgment.
 4 As a result, if an auditor disagrees with the final
 5 conclusion once all the facts are on the table, he is
 6 obligated under his professional code of conduct to write
 7 a disagreement and to take exception to the conclusion
 8 reached. And of course that should be documented in the
 9 file and it should be documented where it will come to the
 10 attention of all the reviewers, including the partner with
 11 final responsibility for the engagement.
 12 MR. SCATES: Bob Gray.
 13 DR. GRAY: This is an issue that we very
 14 seriously and extensively discovered -- I mean discussed -
 15 - in terms of developing rules for the Uniform Accountancy
 16 Act. It's one that we strongly feel that engagement team
 17 disagreements and the conclusions reached about those
 18 disagreements should be documented, particularly for how
 19 they're resolved.
 20 Now, in addition to that we, instead of going
 21 ahead and proposing a rule at this time, the Auditing
 22 Standards Board has an exposure draft out that would give
 23 some guidance on that. It's an exposure draft on planning
 24 and supervision, which at some point in the next few
 25 months will be considered for some form of modification or

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1 adoption. In that they have a series of guidelines in
 2 there at paragraphs 17 through 21. And recently -- so we
 3 have deferred recommending a rule on that yet until we see
 4 what the outcome of that exposure draft is.
 5 But in that exposure draft it states that if
 6 there's a disagreement that if, after appropriate
 7 consultation, he or she believes it's necessary to
 8 disassociate himself or herself from the resolution of the
 9 matter, it should be documented. Now, at this point we're
 10 having some after-discussions here that are just in the
 11 beginning stages as to the term "disassociate" themselves
 12 from the conclusion or the resolution of the matter, which
 13 our question now, is that too high a threshold to meet, to
 14 disassociate oneself from the conclusions reached.
 15 But at any rate, it's in the process at this
 16 point, so this for us is a moving target. But the bottom
 17 line is yes, it should be documented and how it's resolved
 18 should be documented. But the specifics are yet to be
 19 worked out.
 20 MR. SCATES: Any more comments?
 21 (No response.)
 22 Tom, do we have some questions?
 23 MR. RAY: Yes, we have a few minutes left. I
 24 think we have time for a question from the audience I've
 25 got here. It's a two-part question: What role do

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1 concerns about litigation liability play in current
 2 documentation practice, and how should that affect any new
 3 rules in this area?
 4 DR. GRAY: Can you read that one again?
 5 MR. RAY: Sure. What role do concerns about
 6 litigation liability play in current documentation
 7 practice, and how should that affect any new rules in this
 8 area?
 9 MR. SCATES: Bob Burns.
 10 MR. RAY: Bob Burns.
 11 MR. BURNS: You know, this is one of the very
 12 few areas Congress actually asked you to take up, was
 13 documentation. There's a few others, but this is one of
 14 the few ones. I think that this question might have
 15 something to do with why Congress was so interested in
 16 having you think about this issue and come up with
 17 standards in this area.
 18 I don't know that anybody can give you an
 19 accurate answer as to what role it's played in the past.
 20 I think to say that it hasn't had any role would be
 21 incorrect and to say that it's been totally driven by
 22 litigation is probably incorrect as well. But there's
 23 probably been some thought about it.
 24 But I think that the purpose of you looking at
 25 this was just to make sure that that's not really the

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1 consideration behind this any more if it ever was, and
2 that from here on out it'll be to make sure that audits
3 are done appropriately and documented appropriately and
4 the work's actually done.

5 MR. RAY: Charles Drott.

6 MR. DROTT: I would agree with what he just
7 said. I don't see that litigation concerns should be
8 directly involved in the Board's deliberation about the
9 auditing standard and audit documentation. However, it
10 seems to me that the better the standard is that you come
11 up with, the less likely if a firm follows that standard,
12 the less likely that firm is going to have a problem with
13 litigation.

14 MR. RAY: Any other comments on that question?

15 (No response.)

16 Okay. Well, we're getting close here to 5:00
17 o'clock. I'd like to thank everybody for their
18 participation. You've provided us with a great deal of
19 information, which we will be considering. We appreciate
20 your willingness to travel to be here with us and please
21 have safe travels back to your home.

22 Thank you.

23 (Whereupon, at 4:55 p.m., the meeting was
24 adjourned.)
25

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