

January 20, 2004

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

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

Deloitte & Touche LLP is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards, PCAOB Rulemaking Docket Matter No. 012 (the "Release," the "Proposed Standard," or the "Proposed Amendment") (November 21, 2003), to implement Sections 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act"). This letter is submitted on behalf of Deloitte & Touche LLP, the non-U.S. member firms of Deloitte Touche Tohmatsu, and Deloitte Touche Tohmatsu.

We strongly support the goals of the PCAOB to develop responsible auditing standards that will improve the quality of engagements conducted in accordance with auditing and related professional practice standards and help increase investor confidence in our capital markets. We fully support appropriate audit documentation requirements that will enhance audit effectiveness, and agree with the position of the Board that the auditor should prepare and maintain audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report.<sup>1</sup> However, we are concerned that the rules-based approach taken in the Proposed Standard, significant ambiguities in the language used, and inconsistencies between the Proposed Standard and the "Final Rule: Retention of Records Relevant to Audits and Reviews" issued by the Securities and Exchange Commission on January 28, 2003 (the "SEC Rule"), will likely have the unintended effect of diminishing audit quality by shifting the focus of auditors from performing quality audits to concentrating on documentation matters. We also believe the documentation requirements with respect to work performed by others,

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<sup>1</sup> PCAOB Release, page 2.

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including associated firms<sup>2</sup>, contained in the Proposed Standard and the Proposed Amendment are unworkable.

While we are committed to serving the public interest and will strongly support any and all workable efforts to enhance the quality of audits, we are not supportive of the Proposed Standard or the Proposed Amendment in their present form. We believe the Proposed Standard will be subject to wide variations in interpretation and that many significant issues must be addressed to enable the Proposed Standard to be implemented consistently and in a manner that meets the objectives of the Board and the Act.

We have organized our comments into three sections. First, we set forth seven issues that we believe are the most important for the Board to address. Specifically, we ask that the Board:

- Eliminate the rebuttable presumption that would attach in the absence of certain audit documentation;
- Revise the Proposed Standard to not require the consolidation of all audit documentation in one location, especially in view of conflicts with non-U.S. laws;
- Clarify what would constitute an “experienced auditor” for purposes of the general audit documentation standard;
- Coordinate with the SEC so that the standard adopted by the Board and the SEC Rule on audit documentation are the same;
- State explicitly that the various state law provisions requiring audit documentation are preempted by the Act and the Board’s rules, to the extent that the state law provisions are different;
- Clarify its rules concerning the retention of “information relating to significant findings or issues that is inconsistent with the conclusions of the audit” to focus on documenting only material considerations and materially inconsistent information; and
- Require a different implementation date for the standard so that auditors will be able to apply the new standard beginning with audit planning, as opposed to changing standards midstream during an active engagement.

Second, we discuss overall comments that concern the totality of the Proposed Standard that we believe the Board should address. Finally, we provide additional comments concerning issues that arise in specific paragraphs of the Proposed Standard and the Proposed Amendment.

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<sup>2</sup> As used herein, the term “associated firms” includes individual firms that are members of international organizations or members of international associations of firms.

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## I. MOST SIGNIFICANT COMMENTS

### 1. Rebuttable Presumption

We strongly disagree with the inclusion in the Proposed Standard of the “rebuttable presumption.”

The Proposed Standard would establish a “rebuttable presumption” that, in the absence of specified documentation, “the procedures were not applied, evidence was not obtained, and conclusions reached were not suitably supported” during an audit.<sup>3</sup> As described below, we believe that the proposed “rebuttable presumption”: (a) is not appropriately included in an auditing standard; (b) would not effectively enforce the Board’s audit documentation requirements and, indeed, would be detrimental to audit quality; (c) threatens the accuracy and fairness of the Board’s inspections and disciplinary processes by preventing the Board and its staff from fairly considering all of the available information; and (d) jeopardizes the ability of other judicial and disciplinary proceedings to produce accurate and fair judgments. Accordingly, we strongly believe that the “rebuttable presumption” should not be retained in the Board’s final standard.

#### *a. The “Rebuttable Presumption” Does Not Belong In An Auditing Standard*

For the reasons set forth below, we believe that the Board should not adopt a “rebuttable presumption” in any form. But in any event, the “rebuttable presumption” is not properly part of the Board’s auditing standards. The “rebuttable presumption” proposal does not pertain either to the procedures by which audits are conducted or to the retention of audit documentation. Instead, the presumption proposal seeks to establish evidentiary rules for use in later adjudicatory proceedings. Therefore, the presumption has no place in the Board’s “auditing standards” and should be removed from the Proposed Standard.

At most, the Board could argue it has authority to establish a “rebuttable presumption” for its own disciplinary proceedings.<sup>4</sup> If the Board were to determine that some form of a

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<sup>3</sup> Release at A1-4-5. According to the Release, the “rebuttable presumption” is based on Section 5097(c) of the California Business and Professions Code. The California statute became effective on January 1, 2003, and California courts have not yet interpreted the statute.

<sup>4</sup> Although the Release is not clear that the proposed presumption would be restricted to the Board’s own disciplinary proceedings, that is the only result consistent with the limits on the Board’s authority, and any “rebuttable presumption” must be clarified to make that limitation clear. In contrast, establishing evidentiary standards for judicial and administrative proceedings in other jurisdictions is far outside the Act’s mandate for the Board’s authority. Although we recognize that the Board may have authority to preempt differing state *auditing* standards, that preemption carries out the Board’s authority to

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“rebuttable presumption” is appropriate for its own proceedings, the Board should undertake to implement the presumption through a separate rulemaking proceeding. The Board has proposed other rules that will establish the rules for the conduct of various Board disciplinary proceedings, and this type of evidentiary rule should be included, if anywhere, only with those other procedural rules.

This point is of considerable significance; it is not simply a technical concern. By proposing the “rebuttable presumption” as part of an auditing standard, the Board appears to be suggesting that a violation of its rules, predicated solely on the application of the presumption, is a violation of auditing standards. Such a result would be unfair and unjust in a Board proceeding, and may well have litigation consequences far beyond Board proceedings, as the private plaintiffs’ bar may seek to establish a violation of the securities laws or other legal liability based on a failure to satisfy a Board auditing standard.

***b. The “Rebuttable Presumption” Would Not Effectively Enforce The Board’s Audit Documentation Requirement And Would Be Detrimental To Audit Quality***

As a practical matter, the presumption would not be effective to enforce the Board’s audit documentation standards. Auditors will have all the incentive necessary to document issues that they believe to be relevant at the time of the audit by their need to comply with the Board’s enhanced documentation requirements and the direct consequences of failing to do so. Because the presumption would be imposed in proceedings only after the fact -- and, as discussed below, is tied to a retention obligation arguably broader than the proposed general “experienced auditor” standard -- the presumption would demand that the auditor attempt to foresee, and to document, any issue that could possibly be relevant in any future dispute, however immaterial during the course of the audit. Accordingly, while the presumption may punish the failure to document properly any issue that turns out to be relevant in future proceedings, the presumption will do little to ensure that material issues are documented properly at the time of the audit and before any proceedings are initiated.

Beyond failing to enforce the audit documentation requirement, the presumption would also diminish audit quality by shifting the primary focus of the audit team from the conduct of the audit to the preparation of documentation. An audit is a process consisting of a myriad of steps and judgments. The proposed presumption, however, is not limited to those issues that were material at the time of the audit. As such, the presumption attaches a sanction to any matter that is not documented and strips the auditor of any degree of judgment about the nature and extent of the audit documentation to be obtained, created and retained. An unqualified requirement to document procedures performed, evidence obtained, and conclusions reached without permitting auditor judgment about what is important to record,

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establish rules governing the conduct of *audits* pursuant to Section 103 of the Act. Thus, when the Board’s audit standards are approved by the SEC and become part of federal regulation, those standards will preempt conflicting or inconsistent state standards. But the Board has no comparable authority to set evidentiary rules for other adjudicatory bodies (e.g., state regulatory authorities or the United States District Courts).

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together with a presumption that if it is not recorded it did not happen, will increase the volume of documentation, but not audit quality. If anything, by requiring excessive detail on matters not yet determined to be of significance from an audit perspective, the presumption will most likely cause the inefficient expenditure of resources on over-documentation and divert those resources from ensuring the accuracy and comprehensiveness of the actual audit.

In fact, the presumption makes the Board's audit documentation standard itself less clear and, thus, less effective and harder for the Board to administer fairly. The Release's general "experienced auditor" standard for required audit documentation is that an auditor must retain "sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the work that was performed, who performed it, when it was completed, and the conclusions reached."<sup>5</sup> The special standard triggering the presumption, however, is broader: where the general standard for audit documentation requires only the retention of such material as will enable an experienced auditor to determine what occurred in an audit, the "rebuttable presumption" contains no such limitations. The "rebuttable presumption" requires instead that "auditors, including any specialists, should document the procedures performed, evidence obtained, and conclusions reached," whether or not documenting a certain procedure, for example, would be necessary for the "experienced auditor" standard.<sup>6</sup> The presumption introduces disabling ambiguity into the Board's audit documentation standards and, for this reason as well, should not be retained.

***c. The "Rebuttable Presumption" Would Threaten The Accuracy And Fairness Of The Board's Inspections And Disciplinary Proceedings***

The presumption would threaten the accuracy and fairness of Board disciplinary proceedings in which the presumption would be applied by requiring that the Board and its staff ignore the best available evidence for determining what occurred during an audit.

For example, the Release states "the Board contemplates that oral explanation alone would not constitute persuasive other evidence" to rebut the presumption and invites comment on a requirement to *bar* expressly any consideration of oral testimony.<sup>7</sup> By barring oral testimony from the accountants who performed the audit, or from employees of the audit company which participated in the audit process, that certain evidence was gathered or that certain procedures were performed, the Board would be unfairly rejecting, in advance, without consideration, the available information crucial to an understanding of the audit work performed. Because of the presumption, the Board may also not be able to weigh fairly circumstantial evidence—such as events contemporaneous to procedures or conclusions that the auditor claims were performed or reached—that would indicate that certain audit

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<sup>5</sup> Release at 4 (emphasis omitted).

<sup>6</sup> Release at A1-4 ¶6.

<sup>7</sup> See Release at 5.

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procedures had been undertaken. Nor would the Board necessarily consider and weigh appropriately documentation found in, for example, the issuer's files that reflects or memorializes that procedures were, in fact, performed.

The "rebuttable presumption" would also unfairly shift the burden of proof in Board proceedings. As fairness demands, the Board's enforcement staff must generally prove that a respondent firm violated a Board rule or professional standard in order to impose a sanction in a disciplinary proceeding.<sup>8</sup> Even without adopting the presumption, the Board is authorized to demand any audit documentation from a registered accounting firm and to use that documentation to prove that a professional standard has been violated.<sup>9</sup> If the proposed presumption is adopted, however, the Board may assert that a crucial procedure or conclusion lacks documentation and shift the burden from itself to the auditor, requiring the auditor to prove that the crucial event occurred. By minimizing the need for the Board initially to prove, rather than merely to assert, any flaw in the audit, the presumption reduces the enforcement staff's burden of proof and undermines this fundamental safeguard against arbitrary disciplinary action.<sup>10</sup>

***d. The "Rebuttable Presumption" Would Also Threaten Other Judicial And Administrative Proceedings***

The proposed presumption could also threaten the fairness of proceedings far beyond the Board's own disciplinary actions. Even if the Board clarifies that the application of the proposed presumption is explicitly limited to the Board's disciplinary proceedings, the presumption may still affect, and unfairly shift the burden of proof in, other judicial and administrative proceedings. To the extent a violation of the Board's rules is deemed a violation of the securities laws,<sup>11</sup> civil plaintiffs, government regulators, and prosecuting authorities may seek to use the presumption to establish the intermediate fact that the Board's rules have been violated, without the plaintiff otherwise meeting its burden of proof. Those parties could then use the *presumed*, but not proven, violation of the Board's rules to show that the auditor violated the securities laws. Similarly, if the Board's rules were invoked to establish the standard of care in a negligence action against the auditor, the application of the presumption could resolve the case against the auditor, by presuming from a lack of documentation that a procedure was not followed and, therefore, that a Board rule was violated. In such circumstances, parties attempting to impose liability on an auditor may never be required to prove any fact at all before obtaining judgment in their favor. Although courts have employed "rebuttable presumptions" in other contexts, triggering a presumption

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<sup>8</sup> Proposed Rule 5204(a).

<sup>9</sup> Proposed Rule 5103.

<sup>10</sup> The Board is statutorily required to have "fair procedures." Act § 105(a).

<sup>11</sup> Act § 3(b)(1).

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from so slight an initial showing by the party bearing the ultimate burden of proof is unfair and punitive and reinforces that the presumption would be arbitrary in practice.

Moreover, adverse findings by the Board, based on the presumption, may collaterally estop auditors from arguing that they complied with the Board's rules or the securities laws in civil proceedings, or may be used as evidence against the auditor in civil or criminal proceedings. The Board cannot reasonably view the presumption as only a means to facilitate its own adjudicatory process—the operation of the presumption, even if notionally limited to Board disciplinary proceedings, may have a legal significance that could distort or truncate proceedings in other jurisdictions as well. Because of the threat to the accuracy and fairness of these proceedings, the Board should not adopt the presumption in any form.

## **2. Multi-location Audits - Location of Audit Documentation**

We strongly disagree with the requirement of paragraph 16 of the Proposed Standard to retain all audit documentation in the office issuing the auditor's report. This requirement is legally impossible in some countries, will not result in the intended improvement in audit quality, and will be detrimental to the quality control and inspection processes.

### ***a. Legal Impediments***

First and foremost, granting access to working papers within, and/or delivering working papers out of, the country is illegal in some jurisdictions, would subject foreign firms to criminal penalties including fines and imprisonment, is strictly regulated in other countries, and will place the auditor in the untenable position of choosing between (i) knowingly preparing audit working papers that will not meet required standards as to audit documentation and (ii) trying to convince others to break the laws of their home country.

As discussed in more detail in the comment letter on the Proposed Standard submitted by Linklaters, dated January 20, 2004, the principal legal impediments in non-U.S. jurisdictions that inhibit access to audit documentation involve issues relating to (i) data privacy laws; (ii) professional obligations under non-U.S. laws and professional standards, particularly relating to confidentiality; and (iii) laws specific to a particular client's business.<sup>12</sup> For example, with respect to data privacy, processing of personal data in member countries of the European Union is often governed by national laws implementing European Directive 95/46/EC of October 24, 1995. These national laws impose certain prohibitions on the person processing personal data. Processing includes the collection, retrieval, distribution and transfer to other countries of personal data. Personal data can be any information relating to an identified or identifiable natural person. Personal data to be found in audit documentation

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<sup>12</sup> These legal impediment issues have previously been highlighted in our March 31, 2003 comment letter to the Board regarding the Board's proposed registration system and in numerous Rule 2105 opinions submitted in connection with the registration application of Deloitte & Touche LLP.

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include, among other things, details about the engagement team, details about the client team, information about client personnel, signature blocks and names in agreements, salary information traceable to persons, identity card numbers, confirmation lists with third party names, and registration numbers.

In addition, duties of confidentiality under both non-U.S. laws and professional standards in many countries restrict the ability of non-U.S. firms to provide the U.S. firm or the Board access to audit documentation. While client waivers can be obtained in some countries to address these impediments, in other countries the restrictions are absolute and client waivers would not serve to eliminate the impediment. Moreover, the ability of audit firms in certain countries to allow access to audit working papers is further restricted by impediments that arise from the nature of the client's business. For example, where an audit firm serves a client involved in the banking industry or the government contracting industry, the firm's ability to provide access to working papers are severely restricted by banking secrecy laws and national security laws, respectively.

We also strongly disagree with the requirements in the second sentence of paragraph 16 regarding the work of other auditors. As discussed above, obtaining the original or a copy of the other auditor's audit documentation might be prohibited by law or restricted by regulation. In addition, this obligation could be imposed by the Board in its standards, but only upon auditors registered with the Board. However, audit firms that do not play a substantial role in the audit of an issuer are not required to be registered. As a result, in addition to the reasons described in the preceding paragraphs, the principal auditor could be in an untenable position because he or she was being required to obtain documentation that another party has no obligation to provide.

The alternative presented in the third sentence of paragraph 16 of the Proposed Standard to "prepare and retain documentation of the work performed by other auditors" as a part of the review by the principal auditor is equally unworkable.<sup>13</sup> We believe there are two different ways of interpreting this sentence, neither of which we believe to be feasible. It can be read to mean that the principal auditor's alternatives to obtaining originals or copies of the other auditor's audit documentation are to either (a) review and summarize the other auditor's work in sufficient detail to re-document each and every individual procedure performed and piece of evidence obtained (essentially reviewing and then transcribing all of the other auditor's audit documentation); or (b) reperform the work and assemble the audit documentation himself or herself. Under interpretation (a), because the result would be no different than obtaining a copy of the other auditor's audit documentation, the principal auditor would be subject to the legal and regulatory restrictions discussed in the preceding paragraph. With regard to interpretation (b), there might be legal, contractual, or business reasons why an entity engages another auditor to audit an affiliate. Even with client consent to duplicate the work and pay for the costs associated with this duplication of work, the principal auditor may not be able to do so in certain countries where he or she is not licensed or qualified to practice

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<sup>13</sup> Proposed Standard, paragraph 16, page A1-9.



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and, even if licensing or qualification is not an issue, the principal auditor would be subject to the legal and regulatory restrictions discussed in the preceding paragraphs. Additionally, the auditor would need to have knowledge of the language and local business customs and laws to perform the audit.

***b. Impact on Audit Quality***

In the Release, the Board states “This requirement would improve audit quality by enhancing the probability that *all* audit documentation will be prepared consistently with the same standards of audit quality,”<sup>14</sup> but offers no rationale or even discussion to support this assertion. Audit quality is determined throughout the audit by the appropriateness of the planning, performance, and supervision of the audit. Assembling the final audit documentation in one location for storage will not per se improve audit quality.

An audit of a large multi-national company might include performing procedures at more than fifty locations around the country and throughout the world, involving tens of thousands of hours of work performed by many participating accountants. With appropriate planning and supervision, the review of this work is currently performed by the engagement team of the participating accountants, with matters highlighted as appropriate for consideration by engagement management from the office issuing the report. And although much of the audit documentation may be in electronic form, there is still a significant volume of hard copy documentation. Requiring that audit documentation from each and every one of these locations be shipped to one physical location would subject the audit documentation to risk of loss during transmittal, especially hard copies of evidence from third parties, such as confirmations. Additionally, the original audit documentation prepared by the participating accountants is, in many instances, in a language other than English and will be meaningless to any reviewer who does not read that language.

Further, if an affiliate of an issuer is also an issuer, and the audit report on that affiliate is issued from a different office, the Proposed Standard appears to require two complete sets of the audit documentation be retained, one in each office. This duplication also would not improve audit quality and would be entirely unnecessary.

Paragraph 16 of the Proposed Standard is also inconsistent with the Proposed Amendment with respect to work performed by other auditors in circumstances when the principal auditor does decide to make reference to the audit of the other auditor. In these circumstances, the principal auditor does not take responsibility for the work of the other auditor. Paragraph 16 should be revised to expressly state that the principal auditor has no responsibility for reviewing, or retaining copies of, the work of other auditors in circumstances where the principal auditor makes reference in his or her report to the work of the other auditor. As discussed in more detail in our comments relating to the Proposed Amendment, we also believe that the Proposed Standard and the Proposed Amendment should be clarified to

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<sup>14</sup> PCAOB Release, page 5.

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explicitly state that associated firms are excluded from the definition of “others” and “other auditors.”

We also believe that the final standard requires additional clarification regarding those instances where an SEC registrant’s financial statements are audited by joint auditors. There are certain situations outside the United States where the financial statements filed with the SEC are jointly signed by two different accounting firms. In these situations, neither firm is acting as the principal auditor and, although the audit work may not be equally shared, the responsibilities are jointly shared. In these situations, the financial statements filed with the SEC either may be signed by both firms or by only one of the joint auditors.

We believe that requiring the entirety of both firms’ audit documentation to be located at one or both firms in these situations would be unnecessarily duplicative. In addition, such sharing of documents would not be acceptable from a business and competitive standpoint. We recommend that audit documentation requirements for joint auditor situations be addressed in the final standard by requiring each firm to retain only its own audit documentation.

*c. Detrimental to Quality Control and Inspections*

Moving the audit documentation from the location where the audit work was performed, especially from country to country, to a central location will be detrimental to an auditor’s quality control process, as well as the Board’s inspection process, because it removes the quality reviewer or inspector from contact with the audit personnel who performed the work. It also appears to be contrary to the Board’s stated intention to “develop an efficient and effective cooperative arrangement where reliance may be placed, to the maximum extent consistent with the independence and rigor of the home country system, on an inspection of a non-U.S. registered firm conducted by such system.”<sup>15</sup> Further, without maintaining audit documentation in the home country, inspection by the home country system cannot be effective.

In summary, due to the reasons stated above, we firmly recommend that paragraph 16 be deleted in its entirety, and replaced with a requirement that the auditor in the office issuing the report (the “referring office”) obtain documentation that (i) identifies the auditor responsible for supervising the work at each location, (ii) confirms that the audit procedures performed at each location were planned, performed, and supervised in accordance with auditing standards of the PCAOB, including the standards for audit documentation, as supplemented where appropriate by instructions from the referring office, (iii) confirms that matters have been highlighted as appropriate for consideration by engagement management from the referring office, and (iv) confirms that the location is responsible for retaining the audit documentation for the required period. We believe that this documentation could take the form of a summary memorandum, checklist, signed representation, or other form depending on the circumstances.

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<sup>15</sup> Proposed Rules Relating to the Oversight of Non-U.S. Public Accounting Firms, PCAOB Rulemaking Docket Number 13, at 8.

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We believe this recommendation would achieve the objective of understanding that appropriate work was performed and reasonable conclusions were reached and would be consistent with the PCAOB's intention of developing a cooperative arrangement with home country oversight systems.

In addition, we recommend that the PCAOB continue to develop a process to work with regulators in other countries, so that when the Board needs to get access to any audit documentation physically located in another jurisdiction, this can be facilitated through cooperation with these other regulators.

### **3. Experienced Auditor**

Paragraph 5 of the Proposed Standard contains the requirement that audit documentation must contain sufficient information to enable an "experienced auditor with no previous connection with the engagement" to understand the procedures performed, evidence obtained and conclusions reached.

We believe the standard of an "experienced auditor" is an inappropriate concept on which to base the breadth and depth of content of audit documentation. We understand that this is a concept similar to that used by the General Accounting Office (the "GAO") in relation to audits subject to the GAO requirements. GAO audits are generally reviewed by GAO auditors or other auditors who, through their direct experience, are familiar with the issues associated with these particular audits. However, this concept is inappropriate to use in the broader context of all issuers, where the variety of industries makes it impractical for an individual to have adequate knowledge across all industries. We strongly believe that an auditor who is reviewing audit documentation specific to an audit engagement should be expected to have experience and knowledge consistent with the level of experience and knowledge that the auditor performing the audit is required to possess, including knowledge of the current accounting, auditing, and financial reporting issues unique to the industry in which the client issuer operates. We strongly recommend that this be expressly stated in the Proposed Standard.

### **4. Align the Proposed Standard with the SEC Rule**

We are concerned that the Proposed Standard and the SEC Rule are inconsistent. Throughout our comments below, we point out instances where the Board's proposed standards deviate from those established by the SEC. For example, the Proposed Standard and the SEC Rule use different terminology, such as "significant findings or issues" and "significant matters," to describe what should be the same concept. In many of these instances, the Release neither expressly recognizes its departure from the SEC's existing rules nor explains the reasons for its departure. We believe that the Board and the SEC should have the same standard.

We recommend that the Board and the SEC undertake a joint effort to consider the inconsistencies between the Proposed Standard and the SEC Rule and propose revisions to one or both to bring them into alignment. If the Board believes that a complete alignment is

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not appropriate, the Board should present its reasons for that belief to the public and the SEC in the revised release.

## **5. Interaction with State Laws and Other Documentation Standards**

The Board should clarify how its audit documentation standards will co-exist with the rules and statutes governing audit documentation established by state law. The Board has recognized that the mandate of Congress for the centralized regulation of public company audits may have the effect of preempting state laws that are inconsistent with the Board's task of developing a coherent nationwide standard. For example, the Board expressly recognized in prior rule releases that state laws guaranteeing accountant-client confidentiality are preempted in certain circumstances where information is required for the Board's registration and investigatory processes.<sup>16</sup> The Board should make clear that the Proposed Standard is preemptive, and that states or other state-level regulators may not add to, subtract from, or in any way conflict with the Board's rules.

In paragraph 17, the Proposed Standard specifically contemplates that an auditor "also may be required to maintain documentation in addition to that required by this standard." We believe the Board should state clearly that the Proposed Standard displaces any differing audit documentation standards under state laws or regulations.

Paragraph 13 of the Proposed Standard sets a seven-year requirement for the retention of audit documentation, but specifically contemplates that the seven-year period may be extended if "a longer period of time is required by law." The Board should clarify that the retention period may not be extended by the requirements of state law pertaining to accountants. We certainly understand that the Board should be careful about displacing state laws governing the obstruction of investigations through the destruction of documents. But the Board's seven-year rule provides a uniform standard of conduct that should provide sufficient safeguard for state regulatory processes.

Finally, paragraph 1 states that the audit documentation standard in the Proposed Standard "does not supplant specific documentation requirements of other auditing and related professional standards." The Board should make clear that this language only relates to other documentation standards within the Board's own rules.

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<sup>16</sup> PCAOB Release No. 2003-0015, *Rules on Investigations and Adjudications*, at A2-33-34 (Sept. 29, 2003) (stating that certain state accountant-client non-disclosure laws are preempted under its rules and the Act); SEC Release No. 34-47990, *Notice of Filing of Proposed Rules Relating to Registration System*, 68 Fed. Reg. 35016-01, 35028 n.39 (June 11, 2003) (stating that any state laws that would prevent an accounting firm or associated person from giving the consents required by the Board's registration rules would be preempted by the Board's rules and the Act).

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## **6. Information Relating To Significant Findings Or Issues That Is Inconsistent With Or Contradicts The Auditor's Final Conclusions**

Paragraph 12 of the Proposed Standard requires the auditor to retain information relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions. As proposed, this requirement is overly broad, unclear about what needs to be retained, and will result in the retention of a substantial volume of irrelevant information. The Proposed Standard is also inconsistent with the SEC Rule, both in terminology used and in describing the nature of inconsistent information that needs to be retained.

Inconsistent information is an ordinary fact of business, and is usually due to situations involving preliminary thinking, before all relevant facts have been gathered and considered. Even in situations that are new or unusual, controversial, and/or result in formal consultations, the requirement to retain all information that is inconsistent with or contradicts the auditor's final conclusion is overly inclusive and would lead to the accumulation of a significant volume of documentation without improving audit quality. While it may be necessary to include a discussion of the inconsistent or contradictory information, the significant procedures performed in response, and the conclusions reached, including resolution of differences in professional judgment, we believe it is unnecessary to retain each and every document, draft, analysis, or other scrap of information that the auditor receives or creates in the process.

We recommend that this paragraph be revised to require that the auditor document the material considerations, including material inconsistent information, and the final conclusions reached on significant findings or issues (see comments above on resolving inconsistencies with the SEC Rule and detailed comments below on paragraph 9 of the Proposed Standard).

## **7. Implementation Date**

The proposed effective date of the Proposed Standard is for engagements completed on or after June 15, 2004. However, implementation of a new standard is difficult to properly manage when the effective date is dependent on the timing of completion of a process, rather than on a fixed date, such as a financial statement date. The effective date as proposed would require engagements already in progress to modify documentation practices subsequent to the initiation of an engagement (i.e., audit procedures for fiscal years ending June 30, 2004 have already begun and under the proposed effective date, documentation may need to be modified); such a construction for implementation creates several difficulties including having to anticipate what the final standard will require before it is approved. We strongly believe that the Proposed Standard should be effective based on the fiscal year being audited, rather than the completion date of the audit.

Additionally, auditors require a reasonable period after issuance of the final standard to identify how the standard changes current practice, implement the necessary changes to internal policies and procedures, and train their staff to comply with the new standard. We do

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not believe an effective date of engagements completed on or after June 15, 2004 provides sufficient time for implementation.

To allow a reasonable transition period and provide a more manageable effective date, we recommend the Proposed Standard be effective for audits of financial statements for periods beginning on or after 180 days following the SEC's approval of the final PCAOB standard. For example, if the final standard were approved by the SEC on March 31, 2004, its effective date would be "for audits of financial statements for periods beginning on or after September 30, 2004."

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## **II. OVERALL COMMENTS**

### **1. Standard's Objective**

We believe that each proposed standard issued by the PCAOB should clearly articulate and explain the objectives of the Board. However, the Board has not undertaken to do this. We believe an appropriate objective of the Proposed Standard would be to modify the existing standard to align it with the SEC's Rule; however, the Proposed Standard does not attempt to meet this objective. Therefore, it is difficult to understand what the objectives of the Proposed Standard are and why the current standard, AU 339, does not result in sufficient documentation to support the conclusions reached. In order for the public and interested parties to fully understand the basis for the Proposed Standard, the PCAOB should provide specific objectives of the Proposed Standard.

### **2. Clear Communication of New Requirements**

We believe issuing proposed standards that specifically and effectively highlight changes from the current standards is essential to the understanding and application of all auditing standards. The most effective means of identifying changes is by using the current text of interim standards, striking through text to be deleted and underlining text to be added. An alternative would be to provide a summary of how proposed standards modify the interim standards.

### **3. Ownership and Confidentiality of Audit Documentation**

The Proposed Standard fails to address the issues of ownership and confidentiality of audit documentation. The current standard expressly recognizes that audit documentation is the property of the auditor and that the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information. We believe the language currently in AU 339 continues to be applicable and we recommend that a section on "Ownership and Confidentiality of Audit Documentation" be integrated into the Proposed Standard.

Additionally, while the Proposed Standard indicates certain guidance is superceded, this indication of superceded guidance does not refer to AU sec. 9339, *Audit Documentation: Auditing Interpretations of Section 339*, which contains information on "providing access to or copies of audit documentation to a regulator." We believe that information contained in AU sec. 9339 continues to be applicable and that this guidance should be included within the text of the Proposed Standard.

### **4. Incremental Time and Cost**

Implementing the Proposed Standard would increase the costs of audits. Also, the additional documentation requirements under the Proposed Standard will further aggravate the time constraints under which audits are executed. For the many reasons stated throughout this

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comment letter, we believe the incremental cost would not yield the requisite benefit in terms of improving audit quality.

## **5. Implementation Guidance**

Because of the complexity and importance of properly implementing the Proposed Standard, we believe that a substantial number of questions will arise and that interpretation will be necessary as implementation of the final standard occurs. Therefore, we strongly recommend that the Board establish a formal process for responding to implementation questions from auditors.



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### **III. COMMENTS RELATED TO SPECIFIC PARAGRAPHS**

#### **Paragraph 1—Applicability of Proposed Standard**

The Proposed Standard extends to “any engagement conducted in accordance with auditing and related professional practice standards.” This could be interpreted as extending beyond audits and reviews of interim financial information, and may be read to include uncompleted (terminated) engagements, comfort letters, or agreed upon procedure engagements. We understand the Proposed Standard only applies to completed audits and reviews of interim financial information and, therefore, we suggest including an explicit statement that clarifies that the Proposed Standard applies only to “completed audits and reviews of interim financial information of issuers (as defined in PCAOB Rule 1001(i)(iii)).” While this may be described in an over-arching document by the PCAOB, the inclusion of a simple reference may avoid confusion by both the general public and auditing firms.

#### **Paragraph 2—Objectives of Audit Documentation**

Paragraph 2 uses the terms, “auditor’s conclusions,” “auditor’s significant conclusions,” and “conclusions reached by the auditor.” These and similar terms are used throughout the remainder of the Proposed Standard. It is unclear whether the use of different phrases has no significance or whether the Proposed Standard is referring to different levels of some unknown hierarchy. We suggest that the Board be consistent in the use of its terminology and use the phrase “the auditor’s final significant conclusions” throughout the entire Proposed Standard or define each term in a manner that more clearly articulates the hierarchy to facilitate compliance with the Proposed Standard.

#### **Paragraph 3—Audit Documentation is Reviewed by the Engagement Team and Others**

Throughout paragraph 3, the use of the present tense (i.e., “review,” “reviews,” or “is reviewed” instead of “must/should/may” as described in PCAOB Proposed Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards* (“Proposed Rule 3101”)) leaves the requirements or expectations of the Proposed Standard unclear. For example, subparagraph 3a states “auditors who are new to an engagement review the prior year’s documentation...” However, under current auditing standards, auditors who are new to an engagement are not required to review prior year’s documentation.

We recommend that the Proposed Standard be revised to replace the “is reviewed” and “reviewed” or “reviews” with “may be reviewed” and “may review,” as grammatically appropriate within each phrase of paragraph 3. We believe the consistent application and appropriate use of PCAOB terminology as defined in Proposed Rule 3101 is required and would provide clarity to the requirements of the Proposed Standard.

Subparagraph 3d of the Proposed Standard states “A successor auditor reviews a predecessor auditor’s audit documentation,” although successor auditors are not always permitted to

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review a predecessor's audit documentation. It is unclear whether this statement is intended in the context as something that might occur or whether a new requirement is subtly being established. Such a review is not the general practice outside of the United States and, in some countries, successor auditor review of predecessor audit documentation is not permitted due to confidentiality laws. Even in the United States, a review of the predecessor auditor's audit documentation is not always feasible or permitted. Additionally, even if such a review is performed, the review may be limited to only certain working papers. Accordingly, we recommend that the Board acknowledge that interim auditing standards exist that apply to the review of predecessor auditor working papers, and that such a review is not a required step which supersedes existing standards.

Additionally, subparagraph 3f indicates that "others might review audit documentation" but does not indicate any purpose for such review. This might be interpreted to mean that the audit documentation is expected to be sufficient for the purposes of any such review, which would require compliance with an unknowable standard. We recommend that subparagraph 3f be deleted.

#### **Paragraph 4—Content of Audit Documentation**

The first sentence of paragraph 4 states that the auditor must prepare audit documentation in connection with "each engagement." Similar to our comments on paragraph 1, we believe that the use of the term "each engagement" should be clarified to include only completed engagements (not terminated or uncompleted engagements) for audits and reviews of interim financial information, and not other services.

The second sentence of this paragraph states that "audit documentation ordinarily consists of memoranda, correspondence, *schedules*, and other documents created or obtained in connection with the engagement." This is slightly different from the terminology used in the SEC Rule, which states that records relevant to the audit or review that should be retained include "workpapers and other documents that form the basis of the audit or review, and memoranda, correspondence, *communications*, other documents, and records, which (1) are created, sent or received in connection with the audit or review, and (2) *contain conclusions, opinions, analyses, or financial data related to the audit or review.*" The Proposed Standard uses the term "schedules" instead of "communications", and does not limit audit documentation to items which "contain conclusions, opinions, analyses, or financial data related to the audit or review".

We are very concerned about the lack of consistency between the two sets of definitions. Having multiple definitions of the content of audit documentation will make implementation of the Proposed Standard confusing and the application inconsistent. We firmly believe it is not effective, efficient or practical to have two different standards and recommend aligning the definitions.

We also note that "audit programs" are not included among the list of items ordinarily included in audit documentation. Because "written audit programs" are currently required by

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AU sec. 311, *Planning and Supervision*, paragraph 5, and because we believe that audit programs are an important means of documenting audit procedures and conclusions, we recommend that they be explicitly referred to in paragraph 4 of the Proposed Standard.

Additionally, the phrase “other documents created or obtained in connection with the engagement” is extremely broad and could lead to wide variations in interpretation. Some practitioners may interpret this phrase as requiring that all items received from an issuer client should be retained (for example, the general ledger, accounts receivable detail, support for management’s assertion on the effectiveness of internal control used by the auditor in conjunction with the audit of internal control), which could be very voluminous but unnecessary. Furthermore, others could interpret it to mean that it would also require retention of items representing preliminary thinking, incomplete information, drafts or superseded versions, because all such items would have been “created in connection with the engagement,” even though the retention of this information would not be consistent with the SEC Rule. We strongly recommend that the nature of documentation required to be retained be more clearly described, that the requirements of the Proposed Standard and the SEC Rule be the same, and that the standard explicitly recognize that the content of audit documentation is a matter of the auditor’s judgment about what is necessary to support the auditor’s report.

#### **Paragraph 5—Date Such Work Was Completed**

Subparagraph 5b contains the phrase “date such work was completed”. For increased consistency in practice, we recommend that the Board explicitly define “completed,” in order to provide clarity (perhaps in the form of some examples) as to what should be done in order to conclude that “work has been completed” (e.g., “substantially complete,” “procedures performed but not reviewed,” or “reviewed and review notes cleared”). See similar comments related to paragraphs 13, 14 and 15.

#### **Paragraph 6 – Specialists**

The first sentence of paragraph 6 states that in addition to auditors, “specialists should document the procedures performed, evidence obtained, and conclusions reached.” It is not clear how the Proposed Standard could be applied to a specialist who is not registered with the PCAOB, such as a third party actuary engaged by the auditor. We recommend that the reference to specialists be eliminated from this sentence, if the paragraph is retained at all (see our comments above under “Rebuttable Presumption”).

#### **Paragraph 7—Audit Documentation Provides Principal Support**

The requirements of paragraph 7 are unclear, which will cause significant difficulties in implementation. Our comments are as follows:

We believe that the requirement in subparagraph 7a that audit documentation should demonstrate how the audit complied with not only auditing, but also related professional practice standards, is vague and too far-reaching. The purpose of audit documentation is to

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support the audit and the conclusions reached, not to prove compliance with other professional practice standards. Firms often support compliance with other professional practice standards primarily at the office-wide or firm-wide level, outside of engagement-specific audit documentation. Accordingly, we recommend that the phrase “and related professional practice” be deleted from this subparagraph. We also recommend the word “how” be changed to “that.” Documenting “how” the audit complied with auditing standards is simply not practicable because the level of detail necessary to describe the process by which certain audit procedures and other audit-related tasks were performed would be extensive and is unnecessary. As a result, this subparagraph would read as follows: “Demonstrate that the audit complied with auditing standards.”

The requirement in subparagraph 7b that audit documentation should support the basis for the auditor’s conclusions concerning “every material financial statement assertion” implies a one-to-one relationship of assertion to conclusion, which is inconsistent with AU sec. 326, *Evidential Matter*. While the auditor considers the assertions embodied in the financial statement components in developing audit objectives and designing tests, the purpose of the audit is to form a basis for an opinion regarding the financial statements taken as a whole. We disagree with the requirement that audit documentation should be oriented toward a conclusion regarding each financial statement assertion for each individual account balance, class of transaction, or disclosure. For example, the Proposed Standard appears to require five conclusions as to whether fixed assets (1) exist, (2) are complete, (3) are the rights of the entity, (4) are valued appropriately, and (5) are presented and disclosed appropriately. Auditors should not be required to document five separate conclusions for each individual account balance, class of transaction and disclosure. We believe this subparagraph should be revised to state, “Support the basis for the auditor’s conclusions regarding the financial statements taken as a whole.”

We agree with the requirement in subparagraph 7c which states that the auditor should demonstrate that the underlying accounting records agreed or reconciled with the financial statements.

### **Paragraph 8 —Documentation of Certain Matters in a Central Repository**

We agree with the statement in paragraph 8 that matters such as auditor independence and staff training and proficiency may be more efficiently managed, and therefore documented, on an office-wide or firm-wide basis rather than at the engagement level. It is not clear, however, what form of “reference to the central repository” is called for by paragraph 8, what would be considered sufficient cross-referencing, or why such a reference is necessary at all. Separate requirements exist in other professional standards with respect to appropriate documentation of compliance with independence rules and training requirements.

Requiring audit documentation for each engagement to include information relating to auditor independence or staff training for individuals participating on the engagement is duplicative and we do not agree that this is useful or necessary.

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Because paragraph 8 refers to documentation of information outside audit documentation, we recommend that it be deleted all together.

### **Paragraph 9—Significant Findings or Issues**

The overall construction of paragraph 9 on “significant findings or issues” is too complex, is difficult to understand, and contains numerous vague or undefined terms (see further discussion below). As stated in the overall comments, we strongly believe that the documentation requirements and the terminology used to describe significant findings or issues should be aligned with the SEC Rule. The term “significant findings or issues” is not defined in this paragraph, but is illustrated by examples that are inconsistent with the SEC Rule. However, we believe that the terminology should be clearly and unambiguously defined, so that the requirements can be clearly understood and correctly implemented. We recommend that the standard define “significant findings or issues” as matters that the auditor is required to, or determines that he or she should, report to the audit committee pursuant to AU sec. 380, *Communication with Audit Committees*. We believe that the illustrative subparagraphs could then be deleted.

As currently written, we have the following significant concerns with paragraph 9 and subparagraphs 9a through 9h in the Proposed Standard. If the Board does not adopt the recommendation in the preceding paragraph, the following comments should be addressed.

The first sentence of this paragraph establishes an unconditional responsibility (“must”) to document every action taken with respect to a significant finding or issue. The auditor may take a number of actions in reaching a conclusion with respect to a significant finding or issue (e.g., thinking, discussions, research, obtaining or preparing documents); however, documenting each action, particularly less critical actions, would be impracticable. Failure to document even the slightest action on a significant finding or issue could place the auditor in violation of the Proposed Standard even though the auditor has documented the most significant actions that resulted in the auditor’s final conclusion. We firmly believe that the auditor should be permitted to exercise judgment in determining the critical actions that should be documented, and recommend that the concept of professional judgment be included in the Proposed Standard.

#### **Subparagraph 9a**

In subparagraph 9a, we suggest the Board clarify whether it intends to include “all” accounting estimates or only “significant” accounting estimates. Because this section is referring to “significant findings or issues,” we recommend revising this phrase to “significant accounting estimates,” because some accounting estimates are less important than others and some might be clearly inconsequential.

#### **Subparagraph 9c**

The definition of “audit adjustment” in this paragraph is inconsistent with the definition in AU sec. 380, *Communication with Audit Committees*, and seems to combine the definitions of “audit adjustment” with “uncorrected misstatements” as described in AU sec. 380. The use of

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inconsistent definitions within the Board's standards creates uncertainty and the potential for inadvertent noncompliance. If the Board intends to make conforming changes to AU sec. 380 or other sections of the interim standards, these changes should be clearly set forth in the Proposed Standard.

However, there are two concepts that do not seem to be contemplated within the Proposed Standard's definition of audit adjustment – whether or not the audit adjustments have been recorded by management, and whether or not the adjustments are material, either individually or in the aggregate. If the Board intends to revise the definition of audit adjustment and uncorrected misstatements within all sections of the interim standards, we strongly recommend that the definitions clearly distinguish between these concepts in order to achieve a common understanding, by both the public and auditors, and consistency in application. However, we do not believe redefining the terms audit adjustment or uncorrected misstatement would be appropriate or prudent. We believe audit adjustment should be defined in the Proposed Standard as a proposed correction of the financial statements, whether or not recorded by management, which, in the auditor's judgment, may not have been detected except through the auditing procedures performed.<sup>17</sup> A modifier (e.g., “material audit adjustments”) could then be used when the population to which a particular requirement is intended to apply is less than the entire population of the defined term. Using this structure, we would recommend the use of the term “material audit adjustment” in subparagraph 9c.

#### Subparagraph 9d

The meaning of “disagreement” is unclear and may be inconsistent with the SEC Rule. Because the Proposed Standard does not differentiate between preliminary thinking and final conclusions, some may interpret this subparagraph to mean that temporary differences of opinion because of incomplete information or preliminary conclusions by less experienced staff might be required to be documented under this subparagraph as written, but not under the SEC Rule. We believe documentation of disagreements should only be required if a disagreement continues after the relevant information has been gathered and considered by the engagement team, including any consultation with “national office” or others, and a final conclusion is reached that is not acceptable to a member of the engagement team or other individual consulted. Accordingly, we recommend that the phrase “about conclusions reached” be changed to “about final conclusions reached.”

#### Subparagraph 9e

Because of the lead-in sentence to the subparagraphs, this subparagraph is a circular definition. We recommend that this subparagraph be deleted and the concept be added to the lead-in sentence to the subparagraphs, to clarify that documentation is required for matters identified during the review of interim financial information as well during the annual audit, as illustrated below.

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<sup>17</sup> This definition is consistent with AU 380.09.

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Subparagraph 9f

“Circumstances that cause significant difficulty in applying auditing procedures” seems overly broad to serve as an example of a significant finding or issue. Many events (such as management or staff turnover, lack of management preparedness, or storms or other natural events) could cause difficulties, while having no ultimate impact on the audit conclusions reached. We recommend that this example remain as it is described in AU sec. 339.09, *Audit Documentation*, “Circumstances that cause significant difficulty in applying auditing procedures the auditor considered necessary,” which enables the auditor to exercise his or her professional judgment in such circumstances (for example, to perform alternative audit procedures to achieve the audit objective).

Subparagraph 9h

The phrase “any other matters” in this subparagraph implies that all of the matters in the preceding subparagraphs would result in modification of the auditor’s report, when this would not be true. Additionally, “modification” of the auditor’s report could result from adding an emphasis of matter paragraph, which may not necessarily be a significant finding or issue. Accordingly, we recommend that this paragraph be revised to read “Matters that could result in a qualified or adverse opinion in the auditor’s report.”

Although our recommendation is to revise paragraph 9 as described in the first paragraph of this section and delete the subparagraphs, the following illustrates the implementation of the comments on individual subparagraphs above, should our recommendation not be adopted (additions are shown in “bold underline” and deletions are shown in “strikethrough”):

*9. The auditor ~~must~~**should** document significant findings or issues, actions taken to address them, (including additional evidence obtained) and the basis for the conclusions reached. Significant findings or issues **may** include, ~~but are not limited to,~~ the following **(and relate to matters identified either during the annual audit or review of interim financial information)**:*

*9a. Significant matters involving **Disagreements between the auditor and management regarding** the selection, application, and consistency of accounting principles, including related disclosures.*

*9b. ~~Such significant matters include a~~ Accounting for complex or unusual transactions.<sub>2</sub>*

*9c. **Significant** accounting estimates, ~~and uncertainties as well as related management assumptions.~~*

*9d. ~~Results of auditing procedures that indicate a need for~~ **9d.** ~~s~~Significant modification of planned auditing procedures.<sub>2</sub>*

*9e. ~~or the existence of m~~ **Material misstatements or omissions in the financial statements (proposed by the auditor, but not recorded by management).***

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**9f. Material audit adjustments (proposed by the auditor and recorded by management).**

~~9g. or the existence of s~~**Significant deficiencies in internal control over financial reporting.**

~~9c. Audit adjustments and the ultimate resolution of these items. For purposes of this standard, and audit adjustment is a proposed correction of a misstatement of the financial statements that could, in the auditor's judgement, either individually or in the aggregate, have a material effect on the company's financial reporting process. Audit adjustments include corrections of misstatements, of which the auditor is aware, that were or should have been proposed based on the known audit evidence.~~

~~9d~~**9h. Disagreements among members of the engagement team or with others consulted on the engagement about the auditor's final significant conclusions reached on significant accounting or auditing matters.**

~~9e. Significant findings or issues identified during the review of quarterly financial information.~~

~~9f~~**9i. Circumstances that cause difficulty in applying auditing procedures the auditor considers necessary.**

~~9g~~**9i. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.**

~~9h~~**9j. Any other m~~M~~**atters that could result in modification of a qualified or adverse opinion in the auditor's report.****

**Paragraph 10—Engagement Completion Memorandum**

We believe paragraph 10 calls for an unnecessary duplication of effort by requiring the re-documentation of all significant findings or issues in an engagement completion memorandum, especially if the scope of “significant findings or issues” is not narrowed as recommended above. While a summary of key issues is often useful for supervision, review, and consultation purposes, the matters to be covered and the extent to which they need to be described will vary depending on circumstances and should be a matter of the auditor's judgment. The requirement that the completion memorandum be “as specific as necessary for a reviewer to gain a thorough understanding” will require repeating in the engagement completion memorandum a substantial portion of the audit documentation included in other working papers. Duplication to this extent is unnecessary and will dilute the usefulness of the engagement completion memorandum.



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This requirement also creates an unwarranted compliance trap for the auditor. The unconditional obligation to include “all significant findings or issues” means that an audit will be substandard as to audit documentation if the auditor overlooks even one “significant finding or issue” in compiling the engagement completion memorandum, even if the matter is fully documented elsewhere in the audit documentation.

We recommend that this paragraph be revised to provide that “An audit summary memorandum should be prepared for each audit engagement to document the auditor’s major findings and conclusions on matters, which in the auditor’s judgment, are considered to be important auditing, accounting, and reporting issues.” The Proposed Standard could also describe certain minimum elements of the completion memorandum, such as the auditor’s overall conclusion about uncorrected errors, matters that resulted in substantial changes to the audit plan, and identified material weaknesses in internal controls over financial reporting.

#### **Paragraph 11—Identification of Items Tested**

The second and third bullet items in footnote 2 to paragraph 11, which would permit the auditor to simply describe the scope and population of a sample or the starting point and the sampling interval, are inconsistent with the requirement within paragraph 11 that “documentation...should include identification of the items tested.” If either the auditor, in applying a sample, or a reviewer, in reproducing a sample, misapplied the parameters of the selection criteria (e.g., inadvertently skipped an item), the auditor's and the reviewer's samples would be different. Identifying items examined solely by documenting sampling parameters is also problematic in a computer database environment where a static record, such as a physical sales journal, does not exist. We believe the only way to include "identification of the items tested" would be to list the items. Accordingly, we recommend that the text of the first bullet in footnote 2, which requires that the documentation include identifying characteristics, be inserted in paragraph 11 in place of the footnote reference, and that the footnote be deleted.

#### **Paragraph 12 – Information Relating to Significant Findings or Issues That is Inconsistent with or Contradicts the Auditor’s Final Conclusions**

See comments in the following sections of this comment letter:

- I. Most Significant Comments, 6. Information Relating To Significant Findings Or Issues That Is Inconsistent With Or Contradicts The Auditor’s Final Conclusions;
- I. Most Significant Comments, 4. Align the Proposed Standard With The SEC Rule; and
- III. Comments Related to Specific Paragraphs, paragraphs 4 and 9.

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### **Paragraph 13, 14 and 15—Dates**

Paragraphs 13, 14 and 15 use similar terms to describe different dates in the audit process (i.e., completion of the engagement, date of auditor's report, time the auditor grants permission, reasonable period of time), and such inconsistency makes it unclear as to what activities should occur before certain dates or should not occur after certain dates. We recommend that the following three key dates be defined with respect to the activities discussed in these paragraphs and used consistently throughout the Proposed Standard:

- “Report date,” which is defined in AU sec. 530, *Dating of the Independent Auditor's Report*, as “the date of the completion of the field work.”
- “Issuance date,” which we recommend to be defined as the date of delivery of the auditor's report to the client. We believe this would ordinarily be the earlier of (i) the date on which the auditor clears the final printer's proof of a client-printed document including the auditor's report or (ii) the date on which the entity files a document with the SEC including the auditor's report.
- “Documentation completion date,” which we recommend be defined as the date, ordinarily not more than 45 days after the issuance date, on which the auditor has completed the assembly of a complete and final set of audit documentation for retention.

In addition to defining the dates, we strongly recommend including examples in the Proposed Standard of what auditing procedures should, or should not, occur before or after the above dates. For example: a) prior to the report date, substantially all audit procedures should have been performed, including auditing procedures on the disclosures to the financial statements; b) prior to the issuance date, all review notes should be cleared and all conclusions supported; c) prior to the document completion date, all final documentation should be assembled; and d) no *final* audit documentation should be deleted or discarded after the documentation completion date.

### **Paragraph 13—Seven Years After the Report Date**

Paragraph 13 requires that audit documentation be retained for seven years “from the date of the auditor's report”. We believe that the issuance date is a more relevant date than the report date for purposes of the seven-year retention requirement because that is the date the report is available for distribution to the public. We recommend that the paragraph be revised to read “seven years from the issuance date of the auditor's report”.

We also recommend that footnote 3 to this paragraph be revised to clarify that it relates to completed engagements for which no report is issued (e.g., quarterly reviews), and state clearly that the Proposed Standard does not apply in situations where the engagement is terminated before completion of the audit or review.

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**Paragraph 14—Assembly of Final Audit Documentation**

The phrase “first time the auditor grants permission to use the auditor’s report in connection with the issuance of the company’s financial statements” has not previously been used in auditing standards and is vague. We recommend replacing the phrase with a more recognized term, such as “issuance date of the auditor’s report” and defining the term as recommended above.

Certain activities, such as cross-referencing the final version of the financial statements as issued to specific working papers, cannot take place until after the date of issuance of the auditor’s report. In addition, documentation relating to procedures performed and evidence obtained prior to the report date might be finalized after the issuance date for inclusion in the final audit documentation. For example, documentation of a discussion between the auditor and management that took place prior to the report date may be summarized in a memorandum after the issuance date for inclusion in the audit documentation. Accordingly, we recommend that guidance be added to this paragraph to clarify that “assembly” of audit documentation during the period after issuance of the report might include inserting final documents in place of drafts (including removal of the drafts) as well as the addition of documents. However, consistent with the views of the Board, we do believe that all changes (editorial changes, additions, or removals) made after the issuance date should indicate the nature of the change, the date of the change, by whom the change was made, and the reason for the change.

**Paragraph 15—Subsequent Changes to Audit Documentation**

The first sentence of paragraph 15 acknowledges that circumstances may require subsequent additions to the audit documentation, but this sentence does not specify the timing contemplated for making such additions.

Additionally, the third sentence of this paragraph states that audit documentation must not be deleted or discarded, but does not specify from which date this would apply. We believe it should be revised to clarify that *final* audit documentation must not be deleted or discarded subsequent to the “documentation completion date”. In accordance with our previous comments above, we recommend that this sentence be revised to read “Final audit documentation must not be deleted or discarded after the documentation completion date.”

**Paragraph 16 – Multi-location Audits – Location of Audit Documentation**

See comments in “I. Most Significant Comments, 2. Multi-location Audits – Location of Audit Documentation” and in “III. Comments Related to Specific Paragraphs, Proposed Amendment to Interim Standards: Part of Audit Performed by Other Independent Auditor.”

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### **Paragraph 17—Additional Audit Documentation Requirements**

This paragraph is less clear than the second sentence of the existing AU sec. 339.02 “Specific documentation requirements may be included in other standards (for example, government auditing standards), laws and regulations applicable to the engagement.” We recommend that this paragraph be revised to adopt the existing language. As recommended in the overall comments, the Board should coordinate with the SEC so that the standard adopted by the Board and the SEC Rule on audit documentation are the same. We strongly recommend that the footnote to this paragraph be deleted.

### **Proposed Amendment to Interim Standards: Part of Audit Performed by Other Independent Auditors**

We believe there is some confusion about the definition of the term “other auditor” in the Proposed Amendment because of the first sentence of paragraph 16 of the Proposed Standard, which states “(including documentation of work performed by others, such as affiliated firms)”. In practice, we have not considered AU sec. 543, *Part of the Audit Performed by Other Independent Auditors*, to include associated firms within the definition of “other auditors.” There has been a concerted effort by the global firms to align methodologies and quality control processes to enable a uniform approach to all audits. Considering associated firms as “other auditors” for purposes of applying AU sec. 543 contradicts the efforts of these firms to achieve some form of international convergence. Accordingly, we strongly recommend that the Board explicitly define “other auditors” in the Proposed Amendment as excluding associated firms.

In the first sentence of this Proposed Amendment to interim auditing standards, the phrase “to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed” might be interpreted to mean that all documentation should be reviewed to exactly the same extent. We believe the extent of review should depend on the level of staff experience and the subject matter being reviewed. The purpose of the review of the other auditor’s audit documentation is for the principal auditor to reach a conclusion about whether the other auditor’s work is sufficient for the principal auditor to use the other auditor’s report as a basis, in part, for the principal auditor’s report. We recommend that the sentence be revised to provide that the principal auditor’s review should be sufficient to reach such a conclusion and allow for auditor judgment in determining this sufficiency.

We believe that the documentation requirements in the second sentence of the Proposed Amendment are unworkable. The second sentence states, “Sufficient audit documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor to meet all the requirements of PCAOB Auditing and Related Professional Practice Standards No. X, as if the principal auditor had performed the work himself or herself.”

As discussed above in “I. Most Significant Comments, 2. Multi-location Audits – Location of Audit Documentation”, obtaining the original or a copy of the other auditor’s audit

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documentation might be prohibited by law or restricted by regulation. The alternatives to obtaining a copy of the other auditor's audit documentation, (a) review and summarize the other auditor's work in sufficient detail to re-document each and every individual procedure performed and piece of evidence obtained (essentially reviewing and then transcribing all of the other auditor's audit documentation), or (b) reperform the work and assemble the audit documentation himself or herself, are also not feasible because of the same prohibitions and restrictions.

Accordingly, we recommend that the second sentence of the Proposed Amendment be deleted and the following be substituted: "The principal auditor should document the review of the other auditor's documentation in a memorandum. The memorandum should include the principal auditor's conclusion that the other auditor's work is sufficient for the principal auditor to use the other auditor's report as a basis, in part, for the principal auditor's report, and should include a summary of the other auditor's major findings and conclusions on important auditing, accounting, and reporting issues."

The third sentence of the Proposed Amendment, in merging the considerations set forth in AU sec. 543.12, *Part of the Audit Performed by Other Independent Auditors*, subparagraphs b and c, has lost the timing distinction between the two concepts presented in the current literature. The review by the principal auditor of the other auditor's audit programs and the issuance of instructions to the other auditor as to the scope of work, if considered necessary, should take place during the planning of the audit and not in connection with the review of the audit documentation, which ordinarily would take place near the end of the engagement. We suggest that this sentence be revised to restore this distinction in timing.

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We appreciate the opportunity to comment, and would be pleased to discuss these issues with you further. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579 or John A. Fogarty at (203) 761-3227.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: William J. McDonough, Chairman of the PCAOB  
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