

Public Company Accounting Oversight Board
(PCAOB)

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

USA

By E-Mail: comments@pcaobus.org

Düsseldorf, May 12, 2003

Dear Sir(s):

Re: PCAOB Rulemaking Docket Matter No. 004

IDW Comments on the PCAOB Proposals on the Establishment of Auditing and Other Professional Standards and of Interim Professional Auditing Standards

We would like to thank you for the opportunity to comment on the PCAOB Statement Regarding the Establishment of Auditing and Other Professional Standards and the PCAOB Statement on the Establishment of Interim Professional Auditing Standards. The Institut der Wirtschaftsprüfer represents approximately 85 % of the German Wirtschaftsprüfer (German Public Auditor) profession. The German profession seeks to comment on the proposals by the PCAOB noted above because we believe that these PCAOB proposals will affect not only the development of auditing standards in the United States, but also the development of auditing standards on a worldwide basis. Furthermore, increasing numbers of German Wirtschaftsprüfer will be subject to the requirements of the Sarbanes-Oxley Act. Consequently, we will limit our comments on those issues that we believe will affect either the development of auditing

and related standards on a global basis or the German profession. We will begin our comments with our general views on auditing and related standard setting.

In the past two years, the credibility of financial reporting in capital markets has been seriously called into question. Those involved in the financial reporting process (accounting standard setters, preparers, auditors, auditing standard setters, professional bodies, governments and regulators) in different jurisdictions have attempted to reestablish the credibility of that process by various means. All have recognized the interrelationship among the various parts of that process. Auditing (including attestation and quality control) and ethics (including independence) standards represent only one part of that process.

While the improvement of accounting standards, the preparation of financial statements by management, compliance with professional ethics requirements by both preparers and auditors, and enforcement of professional standards have been regarded as particularly critical areas, serious questions have also been asked about the performance of audits by auditors. However, we suspect that these questions relate primarily to compliance with existing auditing and ethical standards. In our opinion, there is little evidence to suggest that something has been fundamentally remiss with current auditing or ethical standards – whether in the U.S. or internationally. This is not to say that there is no room for considerable improvement in auditing or ethical standards.

Subject to Section 107, under Section 103(a)(1) of the Sarbanes-Oxley Act (SOX), the PCAOB is required to establish by rule and amend or otherwise modify or alter auditing and related standards used by registered public accounting firms in the preparation and issuance of audit reports as required by the SOX or the rules of the SEC, or as may be necessary or appropriate in the public interest or for the protection of investors. It is clear that the intention of the legislator is to provide the PCAOB with primary responsibility for the establishment of auditing and ethics standards for audits of SEC registrants. However, Section 103(a)(3)(A)(i) of the SOX also authorizes the PCAOB to adopt as its rules any portion of any statement of auditing standards or other professional standards that the PCAOB determines satisfy the requirements of Section 103(a)(1) that were proposed by one or more professional groups of accountants that shall be designated or recognized by the PCAOB, by rule, for such purpose. From our point of view, it is also clear that the legislator recognized the professional nature of such standards, and consequently incorporated an adoption mechanism into the SOX. We will define what we mean by “professional nature” below.

Based upon the Statement Regarding the Establishment of Auditing and Other Professional Standards, the PCAOB makes clear that it has chosen not to exercise its

authority to designate a group of accountants or an advisory group as a source of auditing standards. We would have preferred the PCAOB to have chosen to exercise its authority to adopt auditing standards (including any related quality control standards) because of 1. the professional nature of such standards, 2. the current efforts in the profession and among regulators to harmonize these standards on an international basis, and 3. the uniformity of auditing standards for both audits of financial statements of publicly listed entities and such standards for privately owned entities.

The “professional nature” of standards and the involvement of the audit profession

By “professional nature”, we mean that auditing standards do not represent theoretical documents, nor do they regulate a theoretical activity: such standards are applied by practitioners in the field and hence their development must consider the experience of practicing auditors with several years’ experience. We recognize that stakeholders have a legitimate interest in the definition of the subject matter of an audit, in the contents of any report issued based upon the audit, and in the proper performance of such an audit. However, to the extent that stakeholders are not themselves experienced auditors, without the expert guidance of experienced auditors, stakeholders are generally not in a position to judge the auditability of proposed subject matter, the appropriateness of the contents of an audit report to convey the nature of the work actually done, or the proper performance of an audit. In other words, just as a patient has a proper interest in the proper performance of an operation by a surgeon or a legal client a proper interest in the receipt of appropriate legal counsel from his or her lawyer, neither a patient nor a legal client is generally necessarily in a position to judge the appropriate standard for the performance of an operation by a surgeon or appropriateness of legal advice provided by his or her legal counsel, respectively.

We are deeply concerned about the development of auditing standards without substantial audit practitioner input and their issuance without the general agreement of audit practitioners because, in the absence of such input or agreement, there is a danger that auditing standards may represent unreasonable wishes and expectations of stakeholders that do not properly reflect the underlying limitations of auditing procedures and of the audit evidence obtained through the performance of those procedures. In the end, auditing standards developed without substantial audit practitioner input or without the general agreement of audit practitioners may serve only to increase the expectation gap for audits of financial statements, and thereby further undermine the credibility of financial reporting.

For these reasons, we view the current proposal, in which the role of audit practitioners in the development of auditing standards compared to other stakeholders is un-

clear and in which the PCAOB chooses to issue those standards without adoption and without having clearly defined the role of audit practitioners in the development and issuance of those standards, as having the potential to increase the risk of the issuance of dysfunctional auditing standards. Consequently, we consider the nature of the process (and in particular, the nature of the due process) used to develop and issue auditing standards to be crucial to the effectiveness of auditing standards. We will comment on specific matters in the proposed process for setting auditing standards in an Appendix attached to this letter.

International Harmonization of Auditing Standards

Another main reason for us preferring that the PCAOB would have chosen to exercise its authority to adopt auditing standards, rather than developing and issuing such standards itself, is the current efforts in the profession and among regulators to harmonize these standards on an international basis. Under the Constitution of the International Federation of Accountants, member bodies have made commitments to incorporate the principles of the International Standards on Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB) within their auditing standards. Together with member bodies and standard setters from other major industrialized countries, the AICPA has been a leader in the development of the ISA and has been instrumental in the convergence process between the ISA and US GAAS. To this effect, a number of joint projects between the AICPA and the IAASB of international importance for auditing standards (audit risk standards, audit of fair value measurements, etc.) have been undertaken. It would be unfortunate if these efforts were no longer to bear fruit.

Furthermore, the European Commission regards the ISA as the basis for the harmonization of statutory audits within Europe and there is an expectation that the ISA or standards that incorporate the ISA will be applicable for all statutory audits in Europe as of 2005. In addition, the International Organization of Securities Commissions (IOSCO) has begun an endorsement process, whereby the ISA are being reviewed and revised so that they can be an acceptable basis for the audit of financial statements of entities with cross-border offerings of securities. In our view, the importance of international harmonization of auditing standards is bound to the recognition that in today's global capital markets, investors and creditors can and do purchase securities from abroad outside the regulatory reach of their home jurisdictions.

Consequently, as part of its mandate to establish (whether directly or through adoption) auditing and related standards as may be necessary or appropriate in the public interest or for the protection of U.S. investors, we believe that the PCAOB has a responsibility to assist and promote international harmonization and convergence of

auditing standards. In our view, it would have been more convenient for the PCAOB to assist and promote harmonization and convergence through the American profession, which invests considerable time and resources (financial and technical) in these processes. The decision by the PCAOB to not exercise its authority to adopt auditing standards by developing and issuing such standards itself means that continued international harmonization and convergence is predicated upon the PCAOB investing this time and these resources into international standard setting processes and that the PCAOB make a commitment to convergence. It would be rather unfortunate – and, in our view, counterproductive to the PCAOB’s mandate in the long run – if the development and issuance of auditing standards by the PCAOB would lead to a divergence between the ISA and auditing standards worldwide on the one hand and auditing standards applicable to the audit of the financial statements of SEC registrants on the other hand.

The uniformity of auditing standards for all financial statement audits

By having chosen to not exercise its authority to adopt auditing standards by developing and issuing such standards itself, the PCAOB will make efforts to maintain the uniformity of auditing standards for audits of financial statements of privately owned businesses and such standards for SEC registrants more difficult. In our view, while there may be special issues that need to be considered in setting auditing standards for financial statements of SEC registrants, these are not of such a basic nature that they warrant a whole set of separate auditing standards. In other words, an audit is an audit. We note that US GAAP requirements apply, in most cases, to all enterprises that are required or choose to use them, regardless of whether they are privately or publicly owned. Likewise, a single set of auditing standards for all financial statement audits should apply to all financial statement audits.

It should be noted that auditing standards are considered so generic that even the International Organization of Supreme Audit Institutions (INTOSAI) and the World Bank are considering whether audits of financial statements of government bodies should be undertaken in conformity with the ISA. Negotiations between INTOSAI and the IAASB to develop a means of incorporating public sector concerns into the ISA are currently under way. We would consider that a separate set of auditing standards for audits of financial statements of SEC registrants will be redundant, at best, or divergent from other auditing standards, at worst. In any case, to prevent such potential divergence, it would be incumbent upon the PCAOB to become involved in the process by which auditing standards are set generally for all enterprises. Unfortunately, this appears to be beyond the mandate of the PCAOB.

We hope that you have found our comments useful. If you have any questions about our comments, we would be pleased to be of assistance or to meet with you.

Yours very truly,

Prof. Dr. Klaus-Peter Naumann

CEO, Institut der Wirtschaftsprüfer

Enclosure: Appendix

APPENDIX

Comments on the Proposed Process for Developing and Issuing Auditing Standards

The Role and Composition of Advisory Groups and Task Forces

Appendix 1 of the proposed rule relating to professional auditing standards and advisory groups addresses the formation, composition, membership selection, etc. of such advisory groups. Section C of the Statement also discusses the role of such advisory groups and “task forces” and proposes that each member of the advisory group have expertise in at least one of public company accounting, public company auditing, public company finance, public company governance, investing in public companies and other relevant disciplines. Section C also mentions that the PCAOB expects that the advisory group will have fairly equal representation among these broad groups and that no one group will dominate the advisory group.

In our view, given our comments on the professional nature of auditing standards and the fact that, in both our experience and that of the IAASB, stakeholders generally have only limited interest in the technical details of auditing standards, we believe that a clear majority of an advisory group on auditing standards needs to be audit practitioners. This would ensure sufficient technical input from audit practitioners and that the profession’s concerns about auditability of proposed subject matter, the limitations of audit procedures and resulting evidence, and the reporting of the performance of the audit given these limitations are not “drowned out” in discussion. Since under the Proposal, the PCAOB develops and issues the auditing standards, there is no danger that a clear majority of audit practitioners on an advisory group could “hijack” the process to serve any narrow special interests.

In Section B of the Statement, the advisory group’s role appears to be limited to recommending that the PCAOB propose a new standard or amend an existing standard, commenting on an analysis and evaluation of a proposal by the PCAOB’s staff, advise the PCAOB on proposals or hold hearings, etc. In essence, as mentioned in Section C of the Statement, such expert advisory groups would assist the PCAOB in reviewing existing standards. In our view, such a role for an advisory group is not adequate to ensure that the detailed technical wording of auditing standards is appropriate. We believe that if the PCAOB develops and issues auditing standards, then it will require the assistance of experienced audit practitioners in the drafting process itself.

Given the international impact of the SOX and hence any PCAOB proposals, we suggest that consideration be given to ensuring that audit practitioners from all major industrial nations are represented. As the experience with the other PCAOB proposals shows, the international environment is very complex, and input is required early in the drafting process to ensure that problems in other jurisdictions are appropriately considered.

Exposure Periods

We consider a 21 day exposure period to be inadequate time so that firms and other bodies have the time to consult with members of their technical bodies. In our view, at least a 60 day exposure period is required for new proposals that are urgent. Given the international impact of the SOX on firms outside of the U.S., we believe that a 90 day exposure period may be more appropriate for proposals in general. In any case, we do not believe there is a case for issuing rules without any appropriate due process involving a sufficient exposure period.