

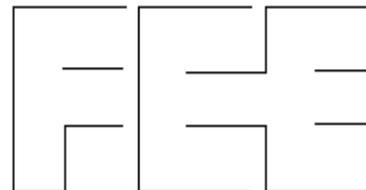
Date  
20 January 2004

Secrétariat  
Général

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Office of the Secretary  
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1666 K Street, NW  
USA - Washington D.C. 20006-2803



Dear Sirs,

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

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased, as the representative organisation of the European accountancy profession, to comment on the exposure draft released by the PCAOB on 21 November 2003 on “Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards” (referred to as “the proposed standard”).

Because of the importance of the issues raised by the proposed standard we are sending a copy of our response to the International Auditing and Assurance Standards Board (IAASB) and the European Commission.

In addition to our overall comments on matters of principle, this letter includes comments on specific paragraphs.

**Overall comments**

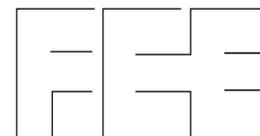
**Worldwide repercussions of proposed standard**

The proposed standard will have a very wide impact not only on US-based auditors, but also on auditors throughout the world serving:

- (1) SEC foreign registrant companies who choose to be listed in the US; and
- (2) the relevant subsidiaries of US domestic SEC registrants which fall under the same requirements as the US domestic portion of the entity.

The auditors of both types of registrants will be required to prepare and maintain audit documentation in accordance with the proposed standard and as noted below under “Multi-location audits and data protection issues” there is serious doubt about whether the proposed standard could be applied in practice.

We request the PCAOB to give due consideration to the impact its proposal will have on the IAASB’s global auditing standards. In particular, we strongly encourage the PCAOB to consider how the proposed standard fits in with International Standards on Auditing (ISAs). It is our understanding that the IAASB will consider ISA 230 ‘Documentation’ for revision in the first half of 2004. The resulting revised ISA on documentation may prompt calls for revisions to the proposed standard and should be carefully considered by the PCAOB.



### **Primary purpose of audit documentation**

The primary and most important purpose of audit documentation is to support the conclusions reached in an audit. The requirements for audit documentation included in the proposed standard are overly prescriptive and will result in unnecessary audit procedures and preparation of unnecessary audit documentation for the purposes of compliance only, resulting in a deterioration, and not an improvement, of audit quality. Although we recognise the need for the PCAOB to fulfil its mandate to inspect public accounting firms to assess the degree of compliance by firms with applicable standards, laws and regulations, the proposed standard is overly focused on the regulatory requirements supporting the PCAOB in executing such inspections and should have been more practically oriented towards prompting audit quality.

### **Reviewability standard**

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

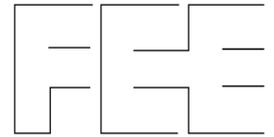
We do not believe such a requirement to be cost effective or necessary. It is normal for a reviewer to develop an understanding by discussion as well as review of the working papers. We do not support the PCAOB arguments in favour of this approach: "This has been an important requirement in the field of government auditing because government audits have long been reviewed by GAO auditors who, although experienced in auditing, do not participate in the actual audits. Public company audits will now, under the Act, be subject to review by PCAOB inspectors, and therefore a documentation standard that would enable such an inspector to understand the work that was performed in the audit seems appropriate." It is the experience of certain European Union Member States that enquiry and discussion play a major role in reviews by independent inspectors and that reviews do not require the documentation standards proposed by the PCAOB. We would encourage the PCAOB to study experience beyond the US government sector before finalising its proposed standard.

### **Rebuttable presumption**

The proposed standard creates a rebuttable presumption that the failure to document work performed indicates that the work was not performed. The proposed presumption could be rebutted by persuasive evidence that the procedures were applied, the evidence was obtained, or sufficient support was provided for the conclusions reached. Oral explanation alone would not constitute persuasive other evidence.

We agree that if there is no documentary evidence of any kind that an audit procedure was performed, this should result in a rebuttable presumption that the procedure was not performed. However, we do not agree that oral explanation does not constitute persuasive evidence. Oral explanations and communications are an integral part of the audit process and oral explanations often supplement written audit documentation. It is quite impossible to perform audit procedures, review audit files or communicate effectively with the audited entity *without* oral explanations, but it is ineffective and burdensome to document each and every detail of oral explanations.

Additionally, the rebuttable presumption that no audit procedures were performed if there is no documentary evidence may in fact place the burden of proof on the auditor which may be in contradiction with company law in a number of Member States of the European Union. We therefore disagree with this requirement as we believe it will not be effective in attaining its purpose.



### **Assembly of audit documentation**

The proposed standard will require that audit documentation must be assembled for retention within a reasonable period of time, ordinarily not exceeding 45 days, after the auditor's report is released.

We agree that audit documentation should be assembled within a reasonable period of time. However, we do not believe that a period of 45 days is reasonable, particularly in the light of the proposed requirements related to the retention of all audit documentation at the office of the principal auditor. Such a short period might also have adverse consequences for audit quality where the finalisation of the audit work and its related documentation is performed under undue time pressure.

We are in favour of principle-based standards that allow the auditor to use professional judgement to determine a reasonable period of time to assemble audit documentation as long as the auditor documents the justification of the chosen period.

### **Multi-location audits and data protection issues**

The auditor issuing the report is expected to retain the original audit documentation or copies of such documentation with respect to the audit documentation related to the work performed by others. He may also prepare and retain audit documentation of the work performed by others as a part of the review of such work. In our understanding, these two alternatives effectively require the same level of documentation.

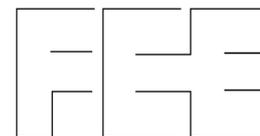
It is indicated that this requirement will improve audit quality by enhancing the probability that all audit documentation will be prepared consistently with the same standards of audit quality. We do not agree with this assumption. The mere retention of audit documentation prepared by other auditors by the office issuing the report will do little to enhance the quality of work that has already been performed. Standards of audit quality must be enforced long before audit documentation of the audit procedures performed is prepared. This is achieved during the early stages of the audit planning by means of a proper assessment by the principal auditor of the independence, competencies and standards of other auditors before decisions are taken to use their work, and by clear instructions to, and communications with, the other auditors whilst they perform their audit work.

This requirement also does not recognize that the vast majority of the audits of components of a group of undertakings are performed by audit firms of the same network. The whole point of network firms is to adhere to the same high quality standard to avoid such burdensome and costly retention of working papers or review of audit work. In the case of network firms, the principal auditor is commonly provided with a detailed questionnaire demonstrating the audit work performed by the other auditor and an interoffice audit report provided by the other auditor for the purposes of the group audit. It should also be noted that the logistical difficulties and cost implications involved in obtaining audit documentation on a timely basis for multi-national audits should not be underestimated.

Additionally, confidentiality requirements and data protection legislation are likely to conflict directly with the proposed requirements. The impossibility of obtaining the relevant consents to share information casts serious doubt on the ability of *any* audit firm to comply with the proposed standard on *any* multinational audit. This could have a severe impact on investor confidence, the credibility of audited financial statements and the standing of the PCAOB. The risk that working papers prepared by other auditors could be used without their consent in legal proceedings and for other purposes could further deter other auditors from cooperating fully with the principal auditor. This is not conducive to enhanced audit quality and investor protection.

### **Using the work of other auditors**

The proposed standard indicates that if a firm decides to serve as the principal auditor, then the firm must decide whether to make reference in the auditor's report to the audit performed by the other



auditor. This implies that the proposed standard allows for divided responsibility (as distinct from joint responsibility) for auditors in the case of a group audit of consolidated financial statements. While FEE recognises that there are often good reasons to appoint different audit firms to perform the audits of a group of entities, FEE believes that this should not result in divided responsibility for the group auditor. FEE is a long standing opponent of divided responsibility for financial statement audits and strongly favours the auditor of the consolidated financial statements having sole responsibility for his report on the group accounts. Investors have a right to understand who is ultimately responsible for the audit of group financial statements.

### **Implementation date of the proposed standard and related amendment**

The proposed standard and related proposed amendment will apply to engagements completed on or after 15 June 2004.

This means that it is expected to be retrospective for a significant number of March 2004 year-end audits. We object in principle to a requirement that is retrospectively applicable. As a practical point, we also encourage the PCAOB when finalising the implementation date of the proposed standard to have appropriate transitional measures so that completed audit planning documentation will not require to be reperformed in order to be compliant with the proposed standard.

### **Problems with definitions**

For our comments on the use of certain terms in the PCAOB standards as stated in the statement of authority included in the proposed standard, we refer to our comment letter on the exposure draft released by the PCAOB on 12 November 2003 on "Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board" attached to the current comment letter.

### **Comments on specific paragraphs**

#### **Objectives of Audit Documentation, Page A1 – 4, Paragraph 3.**

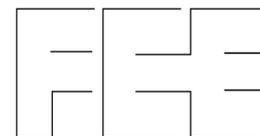
It is indicated that "audit documentation is reviewed by members of the engagement team performing the work ...". We suggest to include further clarification of this statement as it might be understood that an auditor can review his own work.

#### **Objectives of Audit Documentation, Page A1 – 5, Paragraph 3. d.**

It should be noted that the review of a predecessor auditor's audit documentation by a successor auditor is not always practical. In certain European Union Member States predecessor auditors have no legal or ethical obligation to provide information to the successor auditor and in practice do not normally allow them access to their working papers. In such cases, documentation might be limited to the alternative procedures the successor auditor was able to perform.

#### **Objectives of Audit Documentation, Page A1 – 5, Paragraph 3. f.**

It should be noted again that in certain European Union Member States, there is no legal or ethical obligation to provide information or access to working papers and audit documentation to "others, including advisors engaged by the audit committee ...". Confidentiality requirements and data protection legislation across Europe are likely to conflict directly with this proposed requirement.



**Content of Audit Documentation, Page A1 – 5, Paragraph 4.**

Correspondence of the auditors in connection with the audit engagement is considered to be an integral part of the audit documentation. The proposed standard does not indicate that it requires the retention as audit documentation of all of the vast amount of correspondence and communications which the audit of an entity entails. This would be very burdensome and not practical or cost effective. However, further clarification of what is meant would be helpful. We suggest having a principle supporting the documentation of correspondence and communication of material importance to the audit engagement and of correspondence and communication between the auditor and those charged with governance.

**Content of Audit Documentation, Page A1 – 5, Paragraph 6.**

The proposed standard requires auditors, *including specialists*, to document the procedures performed, evidence obtained, and conclusions reached. The specialists on whom an auditor relies for the performance of an audit engagement vary considerably and may include third party specialists like actuaries, real estate appraisers, surveyors, banks, financial institutions, insurance companies, etc. To our knowledge, the PCAOB is not empowered to impose the provisions of its standards on persons who are not members of the accounting profession and therefore, improved clarification on the practical application of this requirements would be useful. We do not believe that the auditor can be expected to be able to impose on such specialists the documentation requirements as required by the proposed standard.

**Content of Audit Documentation, Page A1 – 6, Paragraph 9.**

The term ‘significant’ is frequently used whereas the term ‘material’ is only used occasionally. Further guidance in respect of the term ‘materiality’ is included in a footnote to SEC Staff Accounting Bulletin No. 99. However, there is no guidance or reference on how ‘significant’ is to be understood and how it is related to ‘material’. We believe that further clarification of these terms would enhance the relevance and readability of the proposed standard.

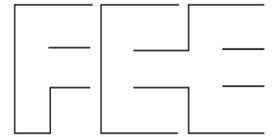
Paragraph 9. d. states that disagreements among members of the engagement team or with others consulted on the engagement about conclusions reached on significant accounting or auditing matters are expected to be part of the audit documentation. We consider it also to be necessary to document how the disagreement was resolved.

**Content of Audit Documentation, Page A1 – 7, Paragraph 10.**

The proposed standard requires that all significant findings or issues are to be identified in an engagement completion memorandum, which needs to be specific enough for a reviewer to gain a thorough understanding of the significant findings or issues including cross-references to other supporting audit documentation. We believe such requirements to be too specific by dealing with the location of audit evidence rather than its substance. Also, in an effort to avoid duplication of work, some global audit firms have modified their audit methodologies and no longer prepare such a memorandum which is a mere repetition of the conclusions already included in the more detailed audit documentation.

**Content of Audit Documentation, Page A1 – 8, Paragraph 12.**

The proposed standard requires that information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor’s final conclusions must also be included in the audit documentation. If such information is expected to be part of the audit documentation, we consider it also to be necessary to document how the inconsistencies and contradictions were resolved.



It is common audit practice to remove initial findings from the audit file that are subsequently found to be incorrect. The dividing line between what is incorrect, and what is inconsistent or contradictory is not clear. Keeping such incorrect information included in the working papers will confuse both internal and external reviewers of the audit file. Such information is not conducive to audit quality and does not support audit conclusions.

**Retention of and Subsequent Changes to Audit Documentation, Page A1 – 9, Paragraph 15.**

The proposed standard requires that subsequent changes can be made to the working papers after completion of the engagement but need to be documented without deleting or discarding the original documents.

We agree with the possibility to make subsequent changes to the working papers but we object to keeping all original documentation included in the working papers. In the light of the previous comment, we believe that initial findings that are subsequently found to be incorrect should be removed from the audit file to avoid confusion and facilitate the audit file review.

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If you have any further questions about our views on these matters, do not hesitate to contact us.

Yours sincerely,

David Devlin  
President

Enclosure: FEE comment letter on the exposure draft released by the PCAOB on 12 November 2003 on "Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board"

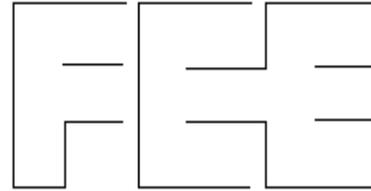
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Dear Sirs,

**Re: PCAOB Rulemaking Docket Matter No. 010 – “Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board”**

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased, as the representative organisation of the European accountancy profession, to comment on the exposure draft released by the PCAOB on 12 November 2003 on “Proposed Auditing Standard – References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board” (referred to as “the proposed standard”).

We are commenting on the use of certain terms in the PCAOB standards as stated in the statement of authority included in the proposed standard. We are not commenting on the references in auditors' reports to the standards of the PCAOB.

Because of the importance of the issues raised by the proposed standard we are sending a copy of our response to the International Auditing and Assurance Standards Board (IAASB) and the European Commission.

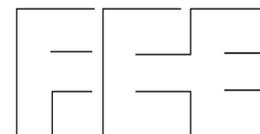
We are delighted that both the PCAOB and the IAASB are working hard towards achieving clarity in terms and definitions used in their standard setting. In the light of the considerations below, we believe that the PCAOB's rulemaking on this subject would be greatly enhanced by coordinating its efforts with the IAASB. The projects currently undertaken by both standard setters should be finalised within a similar timeframe. In particular, we note that a 90 day consultation period would be expected under the IAASB's normal due process in respect of any exposure draft issued following the IAASB meeting later this month.

**Worldwide repercussions of proposed standard**

The statement of authority in the proposed standard will have a very wide impact not only on US-based auditors, but also on auditors throughout the world serving:

- (3) SEC foreign registrant companies who choose to be listed in the US; and
- (4) the relevant subsidiaries of US domestic SEC registrants which fall under the same requirements as the US domestic portion of the entity.

We request the PCAOB to give due consideration to the impact its proposal will have on the IAASB's global auditing standards. In particular, we strongly encourage the PCAOB to consider how the proposed standard fits in with International Standards on Auditing (ISAs). There are inconsistencies with definitions contained in current ISAs and it is also our understanding that the IAASB is currently considering wording issues crucial to the development of future standards. New definitions to be



applied in future ISAs should be carefully taken into account and integrated in the proposed standard of the PCAOB.

### Problems with definitions

The use or definition of certain terms in PCAOB standards should be in line with the ISAs which will be adopted by firms in the European Union in 2005. Inconsistencies will have considerable practical consequences for the adoption of global standards, not least for the translation of English language standards into multiple European languages.

A proposed exposure draft of a proposed IAASB Policy Statement in respect of "Authority of, and Conventions Used in, International Standards and Practice Statements Issued by the IAASB" is included in the agenda of the IAASB board meeting to be held on 8 to 12 December 2003. It includes the terminology used to describe professional requirements.

The definition of "should" indicates under the proposals of both the PCAOB and the IAASB, requirements or obligations that are presumptively mandatory. However the more detailed interpretation of the definitions is substantially different. The proposed IAASB definition states that if a standard provides "... that an action or procedure is one that the professional accountant "should consider," the consideration of the action or procedures is presumptively mandatory, while the action or procedure is not" thus allowing for the exercise of professional judgement in the context of a principle based framework.

The proposed PCAOB definition indicates that the "...auditor must comply with the requirements of this nature specified in the Board's standards unless the auditor can demonstrate, by verifiable objective and documented evidence, that alternative actions that he or she followed in the circumstances were sufficient to achieve the objectives of the standard and serve adequately to protect the interests of investors and further the preparation of informative, fair, and independent audit reports." This definition effectively makes "should" into an imperative and will foster a rules-based approach. The call for "verifiable objective and documented evidence" will discourage the use of professional judgement or the consideration of any alternative options.

FEE is firmly in favour of principle-based auditing standard setting which allows and encourages the auditor to use professional judgement. We believe that it also serves the public interest and would be in the long term interest of the PCAOB in discharging its responsibilities.

The PCAOB uses the words "may", "might" and "could" or other terms and phrases to describe actions and procedures that a professional accountant might consider performing in certain circumstances. Such actions and procedures, also called explanatory material, are characterized as a separate category of professional responsibility by the PCAOB. Under the IAASB proposal, such explanatory material only provides *guidance* or *explanatory material* on other possible procedures and actions. The professional accountant has a responsibility to read and consider such guidance, but there is no general obligation to carry out other procedures and actions that are specifically intended to act as guidance. We do not believe that the description proposed by the PCAOB is consistent with the nature and intended use of explanatory material, and may inadvertently result in confusion over the responsibilities of the professional accountant.

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If you have any further questions about our views on these matters, do not hesitate to contact us.

Yours sincerely,

David Devlin  
President