

January 19, 2004

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

By E-Mail: comments@pcaobus.org

Dear Sir(s):

Re: PCAOB Rulemaking Docket No. 012

IDW Comments on the PCAOB Proposed Auditing Standard “Audit Documentation” and the Proposed Amendment to Interim Auditing Standards “Part of Audit Performed by Other Independent Auditors”

We would like to thank you for the opportunity to comment on the PCAOB Proposed Auditing Standard “Audit Documentation” (hereinafter referred to as the “proposed Standard”) and the Proposed Amendment to Interim Auditing Standards “Part of Audit Performed by Other Independent Auditors” (hereinafter referred to as the “proposed Amendment”). The Institut der Wirtschaftsprüfer represents approximately 85% of the German Wirtschaftsprüfer (German Public Auditor) profession. The German Wirtschaftsprüfer profession seeks to comment on the proposals by the PCAOB noted above because we believe that this proposed PCAOB Standard and Amendment will affect not only audit documentation in the United States, but also the further development of auditing standards relating to audit documentation on a worldwide basis. Furthermore, a significant number of German Wirtschaftsprüfer will be subject to PCAOB auditing standards due to their involvement in the audits of financial statements of SEC registrants. We have divided our comments into general matters applicable to both the proposed Standard and Amendment, and general comments

on the proposed Standard, specific comments on the proposed Standard, and general comments on the proposed Amendment.

General matters

1. Access to Working Papers

We are extremely concerned that the PCAOB together with EU authorities have not yet resolved the problems resulting from data protection and privacy laws, etc. in Germany. A number of our members are currently placed in an extremely difficult and uncertain position until these issues are clarified. The PCAOB has recognized the existence of this problem and has permitted certain exemptions as far as registration of non-U.S. public accounting firms is concerned, in cases where the submission of information would contravene local country law. The Board has further extended the registration period in respect of non-U.S. public accounting firms, such that the deadline is currently set at July 19, 2004.

Hence, in connection with the registration of foreign audit firms, it has become apparent that there are legal problems severely limiting the ability of local audit firms in some foreign jurisdictions to agree to the requirements associated with registration – in particular in relation to requirements for the production of working papers under the Sarbanes-Oxley Act. Audit firms in Germany are subject to local data protection, privacy, confidentiality, secrecy and national security obligations under German law. Based upon drafts of legal opinions to which we have become privy, it appears that certain requirements in both the proposed Standard and the proposed Amendment with respect to the use of other auditors by U.S. audit firms appear to require German auditors to violate these German laws just like the production of working papers would violate these laws. Legal counsel appears to have strong grounds for believing that attempts to circumvent the law by having U.S. audit firms obtain the documentation either directly or indirectly will suffer from the same legal impediments as having German audit firms produce audit working papers to the PCAOB. However, if the PCAOB were to issue the proposed Standard and Amendment, with which all registered auditors must comply, while at the same time, German auditors are subject to laws that will prevent them from complying therewith, the position forced upon German auditors will be intolerable.

On this basis, the portions of the proposed Standard and Amendment ought to be revised so that they do not conflict with local law. In any case, we expect that a more thorough legal analysis of these problems will be submitted to you.

However, the logistical problems associated with the provision of the relevant information by redacting the material to eliminate anything that could constitute a breach

of local law would constitute a significant administrative burden that should not be underestimated.

We would like to point out that these problems need to be resolved **before** the proposed Standard and Amendment are issued in final form.

2. The international context and convergence

Since SEC registrants as a whole have operations around the globe, auditing standards issued by the PCAOB will affect the conduct of audits of financial statements of SEC registrants' operations throughout the world and hence affect the international auditing community in a far-reaching manner. We accept that the PCAOB may regard itself as primarily concerned with the U.S. capital market, but would respectfully suggest that this is a rather narrow contention fraught with oversimplification. It is entirely inconsistent for the PCAOB to insist, on the one hand, that its rules, regulations and standards must be applied to SEC registrants and those involved with them throughout the world, but on the other hand to take a predominantly U.S.-based view of the environment within which SEC registrants and the auditors of their financial statements operate. In this sense the PCAOB must accept that it has assumed the role of a leading authority on the conduct of audits of financial statements used in global financial markets and therefore recognize that the auditing standards it issues must be capable of functioning in different jurisdictions across the globe.

With respect to auditing standards, this role is, de facto, to some extent shared with the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). Nevertheless, there are significant differences between the roles and remits of the PCAOB and the IAASB. In particular, the PCAOB agenda operates under, and is driven by, the pressures of its legislative mandate in the U.S., whereas the IAASB has achieved some general recognition on a global basis as *the* international standards setter for auditing standards. In addition, the agreement reached with regulators on the oversight structure for IFAC public interest activities will serve to strengthen the IAASB's acceptance as *the* global standards setter. However, the fact remains that both institutions develop and issue auditing standards that are applied at an international level.

In our opinion, convergence of auditing standards and their requirements to the maximum extent possible is highly desirable, such that comparability of, and underlying trust in, the audit function can be enhanced on an international level. We understand that the IAASB recognizes the need to minimize substantive differences for convergence purposes. We hope that this objective is shared by the PCAOB in substance, which would mean that the PCAOB regards convergence as a two-way street

in which both standards setters try to move towards one another, rather than as an exercise designed to have the IAASB move towards the PCAOB, regardless of the strength of the IAASB's case.

Recent events in both the U.S. and Europe have demonstrably re-enforced the need for a set of global auditing standards upon which the public can rely. Currently, because standards differ from jurisdiction to jurisdiction there is considerable room for uncertainty within the global financial community. As we have stated in previous correspondence, we support the overall objective of the PCAOB to improve the current position of audits in relation to financial statements for SEC registrants, but would also like to underline the desirability of ensuring international agreement as to precisely what an audit can and should achieve. It follows that there is urgent need for convergence between leading regulators and standards setters if this is to be achieved both successfully and satisfactorily.

3. Consultative Procedures

Following on from our above comments, we are concerned that the consultative procedures relating to development of this PCAOB Auditing Standard does not adequately address their international impact. For instance, participants invited by the Board to the roundtable discussion concerning the proposed Standard were not geographically representative of the international financial community. This contrasts greatly with the geographical spread of comments generally provided in response to PCAOB Rulemaking Dockets. The state of California, in particular, is referred to in the Briefing Paper issued prior to the Roundtable discussion, was represented at that discussion and is referred to in subsequent release papers. We suspect that such honors have not been accorded to representatives from the financial community of major industrial countries where major or a large number of SEC registrants – including so-called “global players” – are based.

We urge the PCAOB to consider the impact of its Rules and Standards from both an international and national standpoint. We would welcome increased participation of other international standards setters and representatives of the financial community (including auditors, preparers and users) and more intensive discussions with such parties as the IAASB, FEE, etc.

4. Deadlines

We have previously noted our disappointment that exposure periods are exceedingly short in respect of PCAOB Docket Matters. This equally applies to this Docket Mat-

ter. While we note that the exposure period for this Docket Matter concerning auditing standards exceeds the 45 days of the previous Docket Matter, inclusion of the Christmas and New Year holiday season (in which many often take longer vacations) within that period negated the longer time period. Furthermore, in an international environment, those submitting comment letters may require more time to consult their constituents. As we have stated previously, normally 60 to 90 days is an appropriate exposure period for new standards unless there are unusual circumstances (such as a holiday period). However, for standards of a fundamental nature (such as those covering documentation or other fundamentals of audits) or of unusual complexity (e.g., audit of internal control or audit risk) 120 to 180 day periods may be more appropriate.

5. Overprescription

By including a rebuttable presumption that audit procedures not documented have not been performed, together with other documentation requirements (see 7 (a)), the proposed Auditing Standard appears to suggest that audit documentation should allow reperformance of virtually the entire audit. This would lead to a significant increase in the nature and extent of audit documentation required. In our view, it is questionable whether such stringent audit documentation requirements are necessary, and in fact, we believe that they may be counterproductive.

At the roundtable discussion in September 2003 auditor representatives strongly contended that they recognize a danger, that if too much emphasis is placed on documentation, it could lead to concentration on that aspect to the detriment of other aspects, and that the PCAOB should not be overly prescriptive. Another participant made the point that it would be virtually impossible for an auditor to “get all the information inside his head into the documentation” and that therefore a rebuttable presumption that work was not done where there is a failure to document procedures applied, evidence obtained and conclusions reached would be too strong. Neither point appears to have been accorded due consideration in the drafting of the proposed Auditing Standard. In our opinion, both are valid and we strongly suggest that the rebuttable presumption and the requirement in 7 (a) are, in fact, overly prescriptive. In this respect, we believe that the currently proposed Standard does not appropriately take the process by which practitioners exercise professional judgment into account. This, in turn, may lead to dysfunctional auditor behavior.

a) *The nature of professional judgment and its relationship to documentation*

We believe that the prescriptive nature of the proposed Standard does not properly recognize the nature of professional judgment and how it is exercised by a practitio-

ner in the field. It should be recognized that documents, books of record, physical assets, etc. are not audit evidence in themselves, since audit evidence is information, as both the current IAASB auditing standard on “Audit Evidence” and the FEE Issues Paper “Principles of Assurance: Fundamental Theoretical Issues With Respect to Assurance in Assurance Engagements” (the “FEE Paper”) point out. Hence, audit evidence exists only “in the eye of the beholder”, or more precisely, in the mind of the recipient – the auditor. In relation to this, the application of professional judgment by practitioners in the field involves the eclectic use of their associative memory, created by previous experience in the conduct of audits, and takes place within an auditor’s stream of consciousness. In the end, only the main results of that process, which will include only the major conclusions reached with only an outline of the reasoning used to support these, can be documented after the fact (i.e., after the application of professional judgment has taken place). Given the extreme volumes of information that auditors receive and that they must assess as part of an audit, the process involving the application of professional judgment often involves heuristics based upon experience, commonly known as “hunches”. However, it should be noted that it is these “hunches” that usually lead good auditors to perform high quality audits – not the after-the-fact documentation justifying the reasoning behind their decisions.

On this basis, while we recognize that good audit documentation can improve the conduct of audits by ensuring a certain discipline in the performance of the work, overemphasis of documentation requirements can actually hinder the performance of high quality audits. The question is one of trying to obtain an appropriate balance of documented vs. undocumented reasoning processes to optimize the quality of audits, where “quality” is defined as a reasonable likelihood that audit risk has been reduced to an acceptably low level. In this respect, quality can be improved through internal reviews of audit work and through internal firm inspections to ensure that quality control systems are functioning. The performance of such reviews and internal inspections are predicated upon adequate audit documentation, but it should be remembered that documentation is a means – not an end in itself and that it should not hinder the appropriate application of professional judgment.

b) *The dysfunctional effects of overly prescriptive documentation requirements*

We also recognize that audit documentation is important to the performance of inspections and investigations performed by the PCAOB and forms an important basis for the work of litigation lawyers and court decisions in relation to audits of financial statements. However, the fact that audit documentation is also used as a basis for professional and regulatory sanctions and in courts of law does not imply that stringent documentation requirements will turn bad auditors into good ones. Auditing standards are supposed to drive auditor behavior. However, we believe that overly

prescriptive requirements will drive the wrong behavior: they will simply cause bad auditors to make bad audits appear to meet the formal documentation requirements, and may have the dysfunctional effect of turning good auditors into bad ones by having them overemphasize documentation, which leads to a “tick the box” and “cover your back” mentality at the expense of the application of sound professional judgment. In the end, bad auditors can always be selective about documenting what they have seen or heard. More importantly, not only bad, but good auditors may be led to perform more of the audit by sight and verbal discussions alone and then to discuss some serious issues only verbally (i.e., instead of by e-mail or other means of written communication) in the hope of channeling or limiting the resulting audit documentation to help prevent the risk of sanctions or legal liability. No law in any country can effectively force auditors to document everything they have seen or heard.

Somewhat out of context, in relation to bad audits one is reminded of the three monkeys “hear no evil, see no evil, speak no evil”, to which the proposed documentation standard would appear to add a fourth monkey: “write no evil”! Such an auditing standards setting strategy is not particularly effective in improving the quality of audits.

Consequently, the application of the proposed Standard (and in particular, the rebuttable presumption) may lead to dysfunctional behavior that could reduce, rather than increase, audit quality.

6. Conceptual Framework

The second paragraph on page 2 of the Release dated November 21, 2003 states “The Board’s standard on audit documentation will be one of the fundamental building blocks on which both the integrity of audits and the Board’s oversight will rest.” Whilst we accept the latter contention as valid, in our opinion, the integrity of an audit cannot be said to rest upon an auditor’s ability to follow instructions on how to document, but, as noted above, rather on the appropriate application of professional competence and judgment, of which, the ability to document forms a comparatively small, but indispensable, part. This leads us to question whether the PCAOB is relying on a conceptual framework relating to the topic of auditing. To state that the standard on audit documentation will be one of the fundamental building blocks presupposes an overview or concept. What form do the other or complementary ‘building blocks’ take? It appears to us that, given the lack of a conceptual framework for audits (such as noted in the FEE Paper), the PCAOB may not have a sound basis for its assertion about what the fundamental building blocks of audits might be.

7. Implementation Date

The proposed date does not appear to be practicable, as most large audit engagements to be completed on, or near to June 15, 2004 will be well under way by the time the standard is finalized. It is impossible to require an auditor to comply with requirements not known to him or her at the planning stage, or commencement of an audit. In any case, little time will have been allowed for any practical changes which may result from application of the standard within an audit firm – staff training and systems changes amongst others. The problem of data security and privacy, which we have outlined will require more time before it can be resolved, which has further implications for those foreign audit firms intending to register with the PCAOB.

General Comments on the Proposed Auditing Standard “Audit Documentation”

Rebuttable presumption

The Board has specifically invited comments on the addition of a rebuttable presumption that (in line with the state of California’s statute on audit document) the failure to document work performed indicates that the work was not performed and further that oral evidence alone will not constitute persuasive other evidence. We are concerned that this may place an unduly heavy burden on auditors as it will lead to attempts to document absolutely every thought, conversation, etc. which hitherto may not have been considered necessary. The danger resultant from this requirement was discussed at the roundtable meeting, as we have noted above. We have also noted the dysfunctional effects of excessive emphasis on documentation caused by overly prescriptive documentation requirements.

We would also like to mention that personal verbal testimony is considered a powerful form of evidence in courts of law (and may overturn documentary evidence), and on this basis question the contention that oral explanation alone could not constitute persuasive other evidence in appropriate circumstances.

**Specific Comments on the Proposed Auditing Standard “Audit Documentation”
by Paragraph**

3. This paragraph in connection with paragraph 5 appears to suggest that an experienced auditor, having no connection with the engagement, should essentially be in a position to reperform the audit. In our view, an auditor who has not been involved in the audit can never obtain the same degree of knowledge about the business and accounting of a particular enterprise as the auditor that had performed the audit. Furthermore, in connection with the inherent limitations on documentation that we have addressed above, an experienced auditor having no connection with the engagement will need to engage in inquiries of those who were directly involved in the audit to obtain a true and full understanding of the audit performed.
4. The second sentence appears to suggest that “all” correspondence, schedules, or other documents created or obtained in connection with the engagement would be included under the term “audit documentation”. We consider this requirement to be unduly onerous, since some correspondence or documents created or obtained in connection with the engagement may turn out not to be relevant to the performance of the engagement. In these cases, such documents need not be included in the term “audit documentation”, which is subject to retention and other requirements.
5. We suggest that the terms ‘experienced auditor’ and ‘understand’ be defined to avoid misunderstandings.
- 5(b) Some tests may require more than one day in their execution, but be documented as one audit procedure, so it will be necessary for the Board to define what is intended by the use of the term ‘date’, i.e., DD MM YY or MM YY.
6. The first sentence states that auditors should document the procedures performed. Taken on its own without qualifiers, this statement appears to suggest that everything the auditor sees and hears ought to be documented, since inspection and inquiry are both procedures. We would like to suggest that this is unreasonable. Rather, the auditor should be required to document those procedures and the results of those procedures that are material to the process by which audit conclusions are drawn. We have addressed the rebuttable presumption above.
- 7(a) We are concerned that the requirement for audit documentation to demonstrate compliance with auditing and related professional practice standards may lead to additional unnecessary ‘cover-your-back’ documentation or the

excessive use of lengthy checklists resulting in time and cost wastage. Furthermore, it is not clear as to what extent documentation on an individual engagement can include matters which are generally of a firm-wide nature, e.g., staff training, centralized independence registers etc. Does the PCAOB intend, for example, that each and every engagement working papers file contain a statement to the fact that the firms staff are adequately trained, plus a cross reference to the documentation held by a central training department or similar? This would result in considerable duplication and inefficient use of staff resources on each audit engagement. Consequently, we believe that 7(a) should read "Form a basis for demonstrating how..."

- 7(c) While we accept that the auditor should either ensure that the reconciliation of the underlying accounting records with the financial statements performed by the management of an entity is accurate, or perform such a reconciliation him/herself and document this audit procedure, it is not the purpose of audit working papers to demonstrate such reconciliation. This responsibility rests with management, as they alone are responsible for the preparation of financial statements and for the correctness, accuracy and propriety of the underlying bookkeeping. In the event that a reconciliation or agreement cannot be achieved, the auditor would be required to consider the matter on the merits of the individual circumstances, document accordingly and draw his or her conclusions for the audit opinion.
8. We believe that auditors should be in a position to rely on the quality control systems that their firms have established and should not be made responsible for deficiencies in these unless they are part of the firm's management body. Consequently, references to central repositories are redundant.
10. In our opinion, the requirement is too exacting. It may be extremely difficult and impractical from an administrative point of view for an auditor to set out all such matters in one memorandum. In our opinion the PCAOB is correct in requiring that these matters be documented, but not in stipulating where. Compliance with this requirement will lead to duplication of documentation and inefficient use of staff resources.
16. The requirements of this paragraph pose significant logistical problems for those firms who audit large global entities – especially that documentation (original or copies) must be retained by the office issuing the auditor's report. The legal issues relating to data security and privacy, etc. raised above must be satisfactorily resolved before audit firms in Germany will be in a position to comply. We again emphasize this issue, which ought to be recognized as constituting an issue of immediate priority for the PCAOB.

**General Comments on the Proposed Amendment to Interim Auditing Standards
“Part of Audit Performed by Other Independent Auditors”**

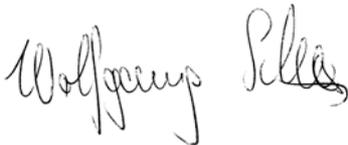
We refer to our general point concerning data protection and privacy legislation, etc. within Germany and the logistical and administrative problems we have noted.

The proposed Amendment suggests that the principal auditor should review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed. In our view, this is an ambiguous requirement because it does not define the level of review. For example, in the audit of a large one-location audit, the lead engagement partner does not and should not review every single working paper. Rather, the lead engagement partner might review key working papers containing critical issues, and other partners on the team will have reviewed some of the other important working papers. Furthermore, the remaining working papers of lesser importance may only have been reviewed at audit manager or supervisor level.

When using the work of another auditor, the question is what level of review needs to be undertaken by the principal auditor – particularly when the working papers of the other auditor will have already been reviewed at partner level within the other audit firm. In our view, there is no need for the principal auditor to review every single working paper and other documentation – regardless of relative importance. Rather, the working papers of another auditor that have already been subject to partner review in the other audit firm (and also an engagement quality control review by an “independent” internal engagement quality control reviewer as currently proposed by the draft ISQC1 by the IAASB) should be subject to review at a higher level of authority (i.e., at partner or audit manager level, as necessary). This is consistent with a risk-driven audit approach. Only if the review at a senior level indicates that important issues may not have been resolved to the satisfaction of the reviewer, need the principal auditor’s review be undertaken in greater depth and detail. The notes made about the review at this senior level need not be of greater detail or extent nor at a lower level of authority than those that a partner or audit manager might make for the review of an audit performed in their own firm. The proposed Amendment should therefore clarify that the review of another auditor’s work should take place at a senior level (audit partner or manager) depending upon the level and nature of review that has already been performed by the other auditor.

We realize that certain points raised by us are critical, and would like to assure the PCAOB that we do not intend our comments to undermine the work undertaken by the Board members and staff. We hope, rather that our comments will be of value in the establishment of PCAOB Auditing Standards which fulfill the objectives of the Sarbanes Oxley Act while at the same time being practicable and capable of application by all those public accounting firms required to be registered with the PCAOB. We hope that you have found our comments useful. If you have any questions about our comments, we would be pleased to be of assistance or to meet with you.

Yours very truly,



Wolfgang Schaum
Executive Director



Wolfgang P. Böhm
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