

20 January 2004

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington DC 20006-2083  
USA

Dear Sirs

**PCAOB Release No. 2003-023: Rulemaking Docket Matter No. 012**

**Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards**

The Institute of Chartered Accountants in England & Wales is pleased to provide a letter of comment in response to the PCAOB's proposed standard on audit documentation and proposed amendment to interim auditing standards.

The Institute is the largest body of professionally qualified accountants in Europe with over 125,000 members operating under a Royal Charter. Individual members are engaged in many sectors in business, the public sector, and in practice.

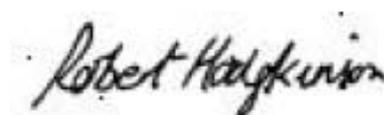
We are cognisant of the challenges faced by the PCAOB in preparing this proposed auditing standard. Audit documentation is crucial to audit quality. Balancing the requirements of the Sarbanes-Oxley Act, cost-benefit considerations, and the needs and views of investors, regulators and external auditors requires careful consideration.

We hope that the PCAOB will give due consideration to the impact of its proposals on the IAASB's global auditing standards and will recognise the growing significance of those standards in discharging its responsibilities in issuing this standard.

This letter contains key comment on the purpose of audit documentation, group audits, inconsistent or contradictory information, the 'rebuttable presumption', and on the assembly of audit documentation. Further specific comments are also provided.

If you require any further information, please do not hesitate to contact me.

Yours sincerely



Robert Hodgkinson  
Director, Technical  
Direct line: +44 20 7920 8492  
e-mail: robert.hodgkinson@icaew.co.uk

## Key Comments

### *Purpose of audit documentation*

Whilst 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 and laws, we emphasise the *primary* and most important purpose of audit documentation which is to provide the principal support for the representations in the auditor's report. There is a risk that consideration of regulatory requirements may be self-defeating in that it may overshadow the primary purpose and shift the focus of audit documentation *away* from audit quality. We believe that there is a very real danger that overly prescriptive requirements for audit documentation will result in 'defensive auditing', by which we mean the performance of unnecessary audit procedures and the production of unnecessary audit documentation for the purposes of compliance only. It is similar to what is often described as 'defensive medicine'.

### *Group audits*

We are particularly concerned about the proposals for the review and retention of documentation for group audits (paragraph 16 of the proposed standard and the proposed amendments to AU section 543.12). The logistical and confidentiality issues noted below when taken together make the proposals unworkable as they stand. The proposals fail to recognise the mechanisms used by all networked firms on multinational audits to achieve audit quality and avoid costly and onerous multiple reviews and duplication of documentation. The proposals would result in the retention of documentation for compliance purposes only, with little or no improvement to audit quality. Indeed, it is possible that these proposals would actually result in deterioration in audit quality as firms diverted their resources from genuine quality control activities to compliance activities.

### *Principal auditor: obtaining and maintaining audit documentation*

The proposals do not address the logistical difficulties and cost implications involved in obtaining and maintaining audit documentation on a timely basis for multi-national audits. The definition and description of 'audit documentation' in paragraphs 2 and 4 can be read as requiring the retention of a great deal of administrative information (such as details of hotel bookings) that is normally discarded in practice because it is wholly irrelevant to audit quality and we believe that the requirements are likely to be interpreted inconsistently in practice.

### *Confidentiality*

Data protection legislation across Europe, together with other statutory requirements and professional and common law obligations, conflicts directly with the proposed requirements. European legislation does not permit personal information (about staff, customers or suppliers for example) to be divulged to anyone without the consent of the individual. Obtaining all-embracing consents would be impossible in practice.

The risk that working papers prepared by other auditors could be used without their consent in legal proceedings and for other purposes is likely to deter other auditors from co-operating fully with the principal auditors and hamper an effective working relationship. This is not conducive to enhanced audit quality or investor protection and there are many situations in which for legal or constitutional reasons, it is not possible to avoid having different auditors within a group.

It is argued that the requirements will improve audit quality by enhancing the probability that all audit documentation will be prepared consistently to the same standards of audit quality. We question this assumption. Standards of audit quality must be enforced *before* audit documentation is prepared. This is achieved by means of a proper assessment by the principal auditor of the independence, competencies and standards of other auditors before a decision is taken to use their work, and by clear instructions to, and communications with, the other auditors whilst the work is performed. 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. Furthermore, the requirement for the principal auditor to review such documentation creates a double review requirement which is both costly, not least because of the requirement for translations, and unnecessary.

We fear that it is perfectly possible that the requirements will become self defeating in some jurisdictions because companies and auditors may be tempted to avoid excessive documentation and duplication of review by referring to multiple separate audit reports in the group audit report. This cannot be a desirable outcome in terms of clarity and accountability.

***Inconsistent or contradictory information***

Paragraph 12 of the proposed standard requires that information identified relating to significant findings that is inconsistent with or contradicts the auditor's final conclusions must be included in audit documentation.

Whilst we appreciate the Sarbanes-Oxley Act and SEC Rules have detailed requirements on the retention of documentation, the intention of paragraph 12 is unclear and may be interpreted inconsistently. Auditing standards already require the resolution of issues arising from contradictory audit evidence, but it is common practice to remove initial findings from the audit file where they 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 on file would be potentially confusing and might hamper the work of reviewers within firms as well as external regulators, neither of which is conducive to audit quality. Such information does not 'support audit conclusions' and adds unnecessarily to the volume of information on file.

***Rebuttable presumption***

Paragraph 6 of the proposed standard introduces a rebuttable presumption that failure to document work performed indicates that the work was not performed. The presumption is rebuttable by persuasive other evidence that the procedures were applied and that evidence was obtained.

The presumption recognises that audit documentation serves as the principal support for the auditor's work and that there will be legitimate cases in which auditors should be permitted to support conclusions with additional documentary and oral evidence. But we strongly object to wording in the introduction to the standard which suggests that that oral explanations alone would not constitute 'persuasive other evidence' to rebut the presumption. Not only does this suggestion defeat the proposals as a whole, which describe audit documentation as the *principal* support for the auditor's work, and not as the *only* support, it runs contrary to practice in other areas of law and regulation in which oral evidence is permissible and often essential. All advanced legal systems admit oral evidence and we are very doubtful as to the legitimacy of this apparent attempt to overturn a fundamental legal principle.

Auditing standards have long recognised that oral explanations may have less value than documentary evidence, but there has never been any suggestion that such explanations have no value at all. Oral explanations and dialogue are an integral part of the audit process; it would be impossible to perform audit procedures, review audit files (either internally or externally) or communicate effectively with the audited entity without oral explanations. A requirement to document each and every detail of oral explanations would be both ineffective and burdensome. Furthermore, it would be perverse to ‘disallow’ oral explanations where they are used in the review of audit documentation with a view to its improvement.

***Assembly of audit documentation***

Paragraph 14 of the proposed standard requires that audit files must be assembled for retention within a reasonable period which should not ordinarily be more than 45 days.

We note that different US States have different requirements for the assembly of audit documentation and we support the proposal that assembly should take place within a reasonable period of time. We do not, however, consider that a period of 45 days is necessarily or even ordinarily ‘reasonable’, particularly in the light of the proposed requirements relating to the retention of all audit documentation at the office of the principal auditor. Such deadlines may in practice result in the finalisation of audit documentation in a hurry, simply to meet the deadline, with adverse consequences for audit quality. In many cases, a deadline of 45 days is simply unachievable as a result of the need to transport paper files physically from those parts of the world in which electronic audit files will not become the norm for many years to come. We suggest that either:

- the determination of what is a reasonable period be left to the judgement of the auditor (who would then be required to justify the period); or
- a longer period be permitted.

## Further Specific Comments

1. Paragraph 3 of the proposed standard, under the heading ‘Objectives of audit documentation’ refers to reviews by, amongst others, successor auditors and others including advisors engaged by the audit committee and representatives of parties to an acquisition. It is very uncommon for successor auditors to review their predecessor’s documentation in either the UK or Europe because of confidentiality requirements. Furthermore, audit working papers are not prepared for the benefit of third parties or with their needs in mind. We therefore object to the inclusion of items (d) and (f) in paragraph 3 and would like to see some reference made to audit documentation being the property of the auditor and to professional confidentiality requirements.
2. Paragraph 5 of the proposed standard requires that audit documentation should 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. No mention is made of the need for discussions with the engagement team which are absolutely essential in practice for such reviews to be effective. Nor is there any mention of the level or nature of experience required. In order for the proposal to be workable, we believe that the ‘experienced auditor’ must be assumed to have the experience comparable to that of the auditor performing or reviewing the work, to have appropriate specialist knowledge and experience, and to be fluent in the languages and accounting practices of group companies where appropriate. This is unlikely in practice which emphasises the need to recognise the importance of discussions with the engagement team.
4. Paragraph 7 (b) states that audit documentation should support the auditor’s conclusions concerning every material financial statement assertion. Whilst we agree with the requirement in paragraph 9 to document the basis for conclusions on significant findings, documenting every individual assertion would be costly, complex and unnecessary. A better and clearer requirement which would avoid confusion would be a requirement reach a single conclusion on the financial statements as a whole.
5. Paragraphs 9 and 10 of the proposed standard require that auditors document ‘significant findings or issues, actions taken to address them and the basis for conclusions reached’. Eight examples of significant findings are provided. All significant findings or issues are to be identified in an engagement completion memorandum. We do not believe that it is necessary to mandate the ‘geography’ of such matters.
6. Paragraph 14 requires that a ‘complete and final’ set of audit documentation be assembled. This would appear to preclude the necessary subsequent changes recognised by paragraph 15.