

AMERICAN BAR ASSOCIATION
Section of Business Law
750 North Lake Shore Drive
Chicago, IL 60611

January 30, 2004

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Rulemaking Release No. 2003-023, Docket No. 012

Dear Board Members:

On behalf of the Committee on Law and Accounting and the Committee on Federal Regulation of Securities Section of Business Law of the American Bar Association (jointly, the "Committees"), we are pleased to have the opportunity to comment on the Public Company Accounting Oversight Board's (the "PCAOB") proposed auditing standard relating to the retention of audit documentation (the "Proposed Standards").

The comments expressed in the letter represent the views of the Committees only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, they do not represent the official position of the ABA Section of Business Law, nor do they necessarily reflect the views of all members of the Committees.

As a general comment, the Committees fully understand and appreciate that the PCAOB was created to enhance the quality of public company audit practice and that a requirement to maintain a complete record of all audit procedures will not only tend to assure that complete and thorough audits are performed, but also will facilitate the PCAOB's inspections of firm practices. Nevertheless, we are concerned that the Proposed Standards would impose substantial additional burdens on registered firms and their public company clients that may not be cost-beneficial. Indeed, we see no evidence that the PCAOB has even considered these additional cost burdens. Nor does the Release explain the rationale or basis for its proposals.

The PCAOB is not a government agency, and accordingly it is not required to follow the Administrative Procedure Act. Nonetheless, we believe the Board will enhance both the acceptance of its rules and the standard-setting process as a whole if it fully explains the purposes behind rule proposals and considers the cost-implications.

Accordingly, we encourage the PCAOB to review the Proposed Standards from this perspective and to discuss its findings in its adopting release. As more fully discussed below, we

also believe that the requirement to store work papers from foreign components of an audit may be in conflict with the laws of certain foreign countries.

What Is Audit Documentation?

The Proposed Standard seems to significantly expand what has traditionally been deemed to be included within the term “audit work papers.” That definition is stated in Paragraph 2 of the Proposed Standard (namely; “records on the planning and performance of the work, the procedures performed, evidence obtained and conclusions reached. . .”).¹ Under the Proposed Standard, however, an auditor is also required to include documentation of compliance with independence, training and proficiency standards (Paragraph 8), as well as a “completion memorandum” addressing the issues specified in Paragraph 9 of the Proposed Standard. Moreover, under the Proposed Standard audit work papers must also “demonstrate how the audit complied with the principal auditing and related professional practice standards” (Paragraph 7). While we appreciate the Board’s desire to have audit work papers become a self-contained record of all aspects of an audit so as to facilitate the Board’s inspection function, these additional requirements are going to greatly increase the record-keeping burdens of public company auditors and the cost of providing audit services to their public company clients. We wonder whether all of these additional requirements are both necessary and cost-beneficial.

In the same regard, we note that Paragraph 4 of the Proposed Standard lists numerous categories of documents deemed to constitute “audit documentation” if they were “created or obtained in connection with the engagement” This would seemingly include miscellaneous communications such as requests to the client for supporting documents, superseded drafts of financial statements and work papers and a host of other documents that would add little to an understanding of the auditor’s opinion or audit processes. Therefore, we believe that it would clearly be helpful for the Proposed Standard to provide further guidance as to what is and is not required to be included in the audit documentation. For example, must an auditor document his or her efforts to ascertain whether the client has paid its annual assessment to the PCAOB? This problem is somewhat exacerbated by the requirement that the audit firm document its “significant findings or issues” terms which the Proposed Standard defines in an open-ended manner.

We further note that Paragraph 12 requires the inclusion of findings and documents that are inconsistent with the auditor’s final conclusions as well as the procedures applied with respect to such matters. Similarly, Paragraph 9(d) requires the documentation of disagreements among members of the engagement team.² These particular requirements contain no materiality screen; nor do they seemingly contemplate that the audit partner may have simply not found the

¹ Because the auditor’s opinion on the client’s internal controls is deemed to be an integral part of the audit, the audit documentation rules presumably encompass the audit firm’s work papers relating to this aspect of its engagement. This should be clarified in the final rule.

² If the PCAOB elects to include this requirement, it should provide further guidance as to when a difference of views among members of an audit team constitutes a “disagreement.”

audit evidence to be credible or the arguments of dissenting members of the audit team to be persuasive. While we appreciate that an auditor must go through the thought process by which such audit evidence is rejected, we are not aware that such instances have proven sufficiently problematic to warrant a further documentation requirement in view of the new burdens already being imposed upon public company auditors and their clients who ultimately must absorb the costs of these additional efforts. We, therefore, suggest that these requirements be deferred until the cost burden of the Proposed Standard can be better assessed.

Undocumented Procedures

Paragraph 6 of the Proposed Standard provides that a failure to document the procedures performed, evidence obtained and conclusions reached creates a rebuttable presumption that the procedures were not applied, the evidence was not obtained and *the conclusions reached were not suitably supported*. As you are undoubtedly aware, every set of financial statements contains literally hundreds, if not thousands, of assertions regarding the existence, value and ownership of client assets, not to mention the reasonableness of hundreds of accounting estimates. Accordingly, this presumption will require audit firms to formally record literally scores of tests and comparisons that they make during the course of their audit, greatly retarding the audit process. Thus, while this well-intended change is quite logical, it nevertheless will compel a much higher degree of documentation that will only further add to the cost of audit services. This added burden could be significant, especially for small public companies.

It is also unclear from the Proposed Standard what evidence is necessary to rebut the presumption. The Proposed Standard only refers to “persuasive other evidence.” This is a highly subjective standard that could easily be misinterpreted. Under current practice an auditor has been permitted to prove that he or she performed an audit procedure through his or her own testimony, if that testimony were deemed credible. If the PCAOB intends to depart from this practice, it is important that the Proposed Standard be explicit. Moreover, is the Board purporting to establish a standard that only pertains its own disciplinary procedures or one to be applied in civil litigation as well? It would appear that, since it is an auditing standard, the standard would be applicable in civil litigation, and we are concerned about the impact it might have in lawsuits against accounting firms. We encourage the PCAOB to address these issues when it reconsiders the Proposed Standard.

Amendments To Work Papers

Paragraphs 14 and 15 of the Proposed Standard address the issue of changes to work papers and pose a minor contradiction. Whereas Paragraph 14 seems to contemplate that an audit firm has up to 45 days following the completion of an audit to finalize its audit work papers, Paragraph 15 seems to require that superseded versions of audit work papers not be discarded following the completion of the engagement even if superseded within the 45-day period. We suggest that the prohibition regarding discarding work papers commence at the conclusion of the 45-day period.

We also note that Paragraph 15 requires that *all* additions to the work papers made after the completion of the engagement be currently dated. Thus, if the engagement partner spots a deficiency in the work papers when making his or her final review and decides to issue the audit

report based upon a representation from a staff accountant that an undocumented audit procedure was actually performed, the work paper subsequently created to evidence that procedure would have to be dated as of the date of the creation of the work paper and not as of the date the audit procedure was performed, and this would be true even if the work paper were created during the 45-day period following the completion of the engagement. Even though this rule might cast some suspicion upon the firm's performance of the audit procedure, it will create an incentive to document work as it is performed, which we believe is appropriate.

Retention of Work Papers

Perhaps the most troubling aspect of the Proposed Standard is the requirement that all work papers associated with the engagement be maintained "at the office issuing the auditor's report." Although we recognize that this requirement would assure that the engagement partner would have all relevant data before him or her when signing off on the report and would facilitate a review of the engagement by the PCAOB inspection team, we are informed that this requirement could pose problems with respect to audits of certain multi-national corporations with material operations in those countries in which there are privacy laws prohibiting the transfer of client records. It is also our understanding that in order to avoid these restrictions the audit firm would have to obtain the client's consent prior to acceptance of the engagement to permit the transfer of the audit work papers; and in some countries (such as France) these restrictions may not even be subject to waiver. We, therefore, encourage the PCAOB to carefully consider the discussion of this subject being submitted by the large international accounting firms, and provide guidance in its release promulgating its final rule.

Reading Paragraph 16 literally, the audit work papers (going back seven years) would have to be maintained "in the office" issuing the audit report. We assume that this does not preclude the storage of certain of these files in off-site storage warehouses. If not, this could pose a substantial storage burden on firms that still maintain a significant portion of their work papers in hard copy format.

Successor Auditor Reviews

Paragraph 4 (b) of the Proposed Standard makes reference to "successor auditor reviews" of audit work papers, but omits the purpose of such reviews. While this standard may not be the appropriate place in which to address the issue of such reviews, we believe that there is a void in the audit literature regarding the purpose of such reviews and the extent to which a successor auditor is permitted to rely upon the work performed by the predecessor auditor, especially with reference to the opening balance sheet.

Ownership of Audit Work Papers

Audit work papers, under the Statements on Auditing Standards promulgated by the Auditing Standards Board, are considered the property of the auditor and not the client. This is an important concept and we believe that it should also be embodied in the rules of the PCAOB.

Concluding Remarks

We appreciate the opportunity to comment on the PCAOB’s Proposed Standard. If you have any questions regarding the substance of our comments, those questions should be addressed to the undersigned.

COMMITTEE ON LAW & ACCOUNTING

/s/ Thomas L. Riesenber

By _____
Thomas L. Riesenber, Chair

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