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SEPTEMBER 10, 2003

FOR THE ROUNDTABLE ON AUDIT DOCUMENTATION

On September 29, 2003, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") will convene a roundtable to discuss issues relating to audit documentation. The roundtable will start at 2:00 p.m. and conclude at 5:00 p.m. The Board has invited representatives of accounting firms, public companies, investor groups, regulators, and other interested parties to participate in the roundtable discussion. This paper contains the agenda of roundtable issues.

Overview

Among the many issues addressed by the Sarbanes-Oxley Act of 2002 (the "Act") is the preservation of financial and audit records. Section 802 of the Act requires that all "audit and work papers" of a public company auditor be retained for at least five years. Section 802 also directs the Securities and Exchange Commission ("SEC" or the "Commission") to adopt rules more specifically defining this requirement, and on January 24, 2003, the SEC adopted rules in response to this directive. These rules^{1/} specify that auditors must retain certain types of documents, including "workpapers," for at least seven years. "Workpapers" is defined to mean –

Documentation of auditing or review procedures applied, evidence obtained, and conclusions reached by the accountant in the audit or review engagement, as

^{1/} Retention of Audit and Review Records, 17 CFR § 210.2-06 (2003), effective for audits or reviews completed on or after October 31, 2003.

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required by standards established or adopted by the Commission or by the Public Company Accounting Oversight Board.^{2/}

In its Release accompanying the adoption of this rule, the SEC "recognize(d) that the Oversight Board, subject to Commission oversight, has the ability to review and change the nature of and scope of the required documentation of procedures, evidence, and conclusions related to audits and reviews of financial statements."^{3/} This recognition is consistent with Section 103(a)(2)(A)(i) of the Act, which expressly directs the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the audit report.

Good documentation is a natural byproduct of an effective audit. The Board has determined that it is necessary to address this issue at this time in order to ensure quality audits and facilitate the work of the PCAOB inspection staff. The purpose of the Roundtable is to review the existing standard, Statement on Auditing Standards ("SAS") No. 96, *Audit Documentation*,^{4/} previous recommendations regarding audit documentation, and related questions posed by both the adoption of the Act and the SEC's rule implementing Section 802.

Background

The Panel on Audit Effectiveness^{5/} made the following recommendations to the Auditing Standards Board ("ASB") with respect to audit documentation –

- Enhance SAS No. 41, *Working Papers* [superseded by SAS No. 96] to include criteria regarding the minimum documentation working papers should

^{2/} 17 CFR § 210.2-06(b).

^{3/} SEC Release No. 33-8180 (Jan. 24, 2003).

^{4/} Adopted by the Board as an Interim Auditing and Related Professional Practice Standard on April 18, 2003.

^{5/} In 1998, at the request of the then-chairman of the SEC, the Public Oversight Board appointed a panel to complete a comprehensive review and evaluation of the way audits are performed. *The Panel on Audit Effectiveness* completed its work and delivered its report and recommendations in August 2000.

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contain. The criteria for documentation to be included in working papers should be sufficiently specific to enable reviewers to understand the audit work performed, who performed and reviewed the work, and the nature of the audit evidence examined.

- Provide sufficient guidance in the quality control standards about working paper documentation to enable firms and peer reviewers to judge the quality of engagement performance (including the supervision of the work of assistants). The ASB should link the two sets of working paper standards to each other.
- Review all the fieldwork standards to ensure that there is definitive guidance within the SASs (or elsewhere in the *generally accepted auditing standards* hierarchy) on the type and extent of documentation that should be contained in the working papers. For example, the ASB should consider areas where specific documentation requirements similar to those contained in SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* [superseded by SAS No. 99], would likely enhance audit effectiveness, and it should amend or modify the SASs accordingly.

Roundtable Agenda

A. Objectives of Audit Documentation

Standards for preparing and maintaining audit documentation (also referred to as *work papers* or *working papers*) have existed for many years. The main purposes of audit documentation have been to provide the principal support for the representations in the auditor's report and to assist in the planning, performance, and supervision of the engagement.

Discussion Questions –

1. Are there any other important objectives of audit documentation?
2. Should audit documentation also assist in the review of the quality of the audit work?

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B. Scope of Audit Documentation

For numerous years, auditors have been required to comply with the 10 generally accepted auditing standards in discharging their duties in an audit of financial statements. These 10 standards consist of three general standards (independence, due professional care, and training); three standards of fieldwork; and four standards of reporting. The current standard on audit documentation, SAS No. 96, states that audit documentation should be sufficient to show that *standards of fieldwork* have been observed.

Discussion Question –

3. Should audit documentation demonstrate that the auditor has complied, not only with the standards of fieldwork, but also with all standards, including auditor independence, due professional care, and training?

C. Form and Content of Audit Documentation

SAS No. 96 also states the following with respect to the sufficiency of audit documentation –

Audit documentation should be sufficient to (a) enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of auditing procedures performed, and the evidence obtained; (b) indicate the engagement team member(s) who performed and reviewed the work; and (c) show that the accounting records agree or reconcile with the financial statements or other information being reported on.

However, *generally accepted government auditing standards* ("GAGAS") go beyond SAS No. 96 with respect to what constitutes sufficient audit documentation. Under GAGAS, the field work standard related to audit documentation for performance audits is as follows –

Auditors should prepare and maintain audit documentation. Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor, who has had no previous connection with the audit, to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.

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Moreover, *The Panel on Audit Effectiveness* recommended that sufficient guidance about audit documentation be provided to enable accounting firms' internal inspection teams as well as others, including reviewers outside of the firms, to assess the quality of engagement performance.

Discussion Questions –

4. Should audit documentation contain sufficient information to enable an experienced auditor, with no previous connection with the engagement, to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached?
5. Should audit documentation contain sufficient information to determine who performed the work and the date such work was completed, as well as the person who reviewed the work and the date of such review?

D. Adequate Audit Documentation

SAS No. 96 explicitly states that "there is no intention to imply that the auditor would be precluded from supporting his or her report by other means in addition to audit documentation." However, the SEC's Enforcement Division and other regulators repeatedly have been critical that this *other means* principally consists of the auditor's own oral explanations after the fact. During 2002, the state of California enacted legislation related to the practice of public accountancy. Among other things, this legislation established specific audit documentation standards including a presumption that if the audit procedures were not documented, then the work was not performed. Specifically, the law states –

Failure of the audit documentation to document the procedures applied, tests performed, evidence obtained, and relevant conclusions reached in an engagement shall raise a presumption that the procedures were not applied, tests were not performed, information was not obtained, and relevant conclusions were not reached. The presumption shall be a rebuttable presumption affecting the burden of proof relative to those portions of the audit that are not documented as required in subdivision (b) [not reflected here]. The burden may be met by a preponderance of the evidence.^{6/}

^{6/} California Business and Professions Code § 5097(c).

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In today's environment, in the absence of adequate audit documentation, inspection teams, regulators, and others typically have only the auditor's oral explanations to determine compliance with the standards. This is a poor source of evidence and one that is insufficient for inspection teams, regulators, and others to discharge their responsibilities.

Discussion Questions –

6. Should the failure to document the procedures applied, evidence obtained, and conclusions reached create a rebuttable presumption that the work was not done?
7. Should the Board expressly prohibit the use of oral explanations as sufficient "other means" to support audit evidence?

E. Changes to Audit Documentation

On numerous occasions, principally in the investigative and enforcement context, the SEC has stated its position on what it expects of auditors when documenting their work. Within the case, *In the Matter of S.D. Leidesdorf & Co., Kenneth Larsen, Joseph Grendi (Accounting Series Release No. 209, February 1977)*, the SEC clearly articulated its position on working papers, as well as the importance of documenting any subsequent changes to the working papers –

Working papers prepared or collected by auditors in the course of an audit provide the single most important support for their representation regarding compliance with generally accepted auditing standards. They serve as the repository for the competent evidential matter necessary to afford the auditors with a reasonable basis for opining on an issuer's financial position. Transactions or events occurring long after the balance sheet date often require reference to prior working papers, and such working papers may have significant usefulness in future audits. It is therefore imperative that auditors preserve their working papers in a complete and unaltered form.

Auditors should be encouraged to devise orderly procedures for the proper control over the contents of working papers. Moreover, the Commission recognizes that the necessity for evidential matter to be included in the auditor's working papers varies substantially depending on individual audits. When any alterations or additions are made to the working papers subsequent to the issuance of the auditor's report, however, such alterations or additions should

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themselves be properly documented and indicate the time and circumstances under which they are made.

All audit documentation should be complete before auditors issue their report. Moreover, any post-audit review procedures should be identified and dated. For example, in a more recent matter (May 2003), the SEC censured a firm for, among other things, making undocumented changes to working papers well after the audit had been completed and the audit report released.

Discussion Questions –

8. Is it appropriate to change (i.e., add to or delete from) the working papers after release of the audit report?
 - If so, under what circumstances would this be appropriate?
 - How should such changes to the working papers be documented?
9. Should there be a specific date or event (e.g., 30 days after the report release date) after which changes to working papers should no longer be permitted, or permitted only after proper approval?

F. Audit-Related Documentation

The SEC's final rules in implementing Section 802 of the Act (rule 2-06 of Regulation S-X) state that "the accountant shall retain records relevant to the audit or review, including workpapers and other [audit-related] documents that form the basis of the audit or review, and memoranda, correspondence, communications, other documents, and records (including electronic records), which: (1) are created, sent or received in connection with the audit or review, and (2) contain conclusions, opinions, analyses, or financial data related to the audit or review."

Discussion Questions –

10. Should an auditing standard on audit documentation include audit-related documentation as defined by rule 2-06 of Regulation S-X?
11. Should the Board provide additional specific guidance on what constitutes audit-related documentation?

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12. Should a standard on audit documentation (including audit-related documentation) apply to engagements other than audits and reviews (e.g., engagements to issue letters for underwriters in connection with financial statements filed with the SEC)?

G. Retention of Audit and Audit-Related Documentation

Section 103(a)(2)(A)(i) of the Act directs the Board to adopt a documentation standard that would require the auditor to retain audit and audit-related documentation for a period of not less than seven years after completion of an audit or review.

Discussion Question –

13. Should this retention requirement of seven years be required of all engagements performed in accordance with auditing and related professional practice standards?

H. Specific Guidance

Audit documentation should be sufficient to demonstrate that the audit complied with auditing and related professional practice standards. The auditor should document audit findings or issues that are significant, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. The volume of required audit documentation under existing standards can be great, which may make it difficult and/or inefficient for the audit engagement partner and other reviewers to identify and evaluate all significant audit findings and issues identified and documented by other engagement team members.

Discussion Question –

14. Should all significant audit findings or issues be required to be summarized in an engagement completion memorandum?

Under existing standards, specific guidance on audit documentation is included in existing pronouncements. For example, SAS No. 85, *Management Representations* (AU sec. 333), requires the auditor to obtain written representations from management and SAS No. 100, *Interim Financial Information* (AU sec. 722), requires the auditor to document procedures performed in connection with a review of interim financial information.

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Discussion Questions –

15. Should specific guidance, addressing certain subject matters, be provided in a standard on audit documentation?
16. Is it more appropriate to include specific documentation requirements in other standards that address the specific subject matter?

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The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.