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January 8, 2003

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

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

Ladies and Gentlemen:

We are pleased to have the opportunity to offer our comments to the Public Company Accounting Oversight Board (referred to hereinbelow as PCAOB or the Board) specifically in response to its request regarding its Proposed Auditing Standard, *Audit Documentation*. Subject to our comments, detailed in the succeeding paragraphs, we believe, in general, that the proposed standard represents a significant and appropriate forward step in the standardization of audit documentation when compared to the current standard set forth in Statement on Auditing Standards No. 96, *Audit Documentation* (AU Sec. 339). SAS 96 affords little more than guidance as to what an auditor should consider documenting, while the proposed standard contains solid requirements.

For ease of reference, we have numbered the substantive paragraphs in the remainder of this letter.

Overriding Concerns

1. While we agree that SAS 96 permits too much auditor discretion as to the nature and extent of audit documentation required to reasonably assure achievement of its objectives, and that a more rigid standard is, therefore, appropriate, we nevertheless believe that the proposed auditing standard goes too far in some significant respects in eliminating both opportunities and obligations to apply sound professional judgment. We draw this conclusion largely based on the following facts and circumstances:

    a. The nature and extent of documentation that is retained in an audit file typically has been (and should be, in our opinion) influenced in some significant respect, based on advice from attorneys, by a defense strategy to be employed in the event of civil litigation, an ever increasing risk to auditors in today's environment, despite the recent Congressional and regulatory efforts to improve audit quality. In this regard, while we believe that audit documentation should contain all information necessary in the auditor's judgment to support one's audit report, including evidence of the exploration of relevant material that may support alternative conclusions, if any, we do not believe that an auditing standard should require an auditor to retain erroneous, irrelevant or superseded material that can serve no useful purpose other than as a roadmap to enable an adversary to attack the auditor or successfully thwart his or her defense.

b. In its proposed Rule 3101 (and in the Statement of Authority preceding each PCAOB standard), unlike its predecessor, the Auditing Standards Board, the PCAOB has carefully defined and uses terms like *must*, *shall*, and *is required* to indicate "unconditional obligations," which, if not discharged, constitute violations of PCAOB Rule 3100. As pointed out in footnote 4 to proposed Rule 3101, the Sarbanes-Oxley Act of 2002 provides that any violation of the Board's rules is to be treated for all purposes as a violation of the Securities Exchange Act of 1934, or the rules and regulations issued thereunder, and will expose the violator to the same penalties, and to the same extent, as many other violations of the federal securities laws, thus effectively criminalizing alleged violations of PCAOB rules and standards that may be merely the product of good faith differences in judgments or inadvertent. Accordingly, although we believe the use of such terms as *must*, *shall*, and *is require*, as defined, is warranted in some circumstances, we also believe Board should be extremely judicious in such use. (Specific examples of this concern follow below in paras. 7 and 10-12.)

Objectives of Audit Documentation

2. We noted that para. 3d of the proposed auditing standard lists among the implied objectives of audit documentation to provide for review of audit work by a successor auditor. Although perhaps beyond the scope of the proposed auditing standard, as presently envisioned, we also noted that the predecessor standards (now collectively referred to pursuant to PCAOB Rule 3200T as *Interim Auditing Standards*) have provided for successor responsibilities but never placed any professional responsibilities on predecessors to communicate with successors in connection with auditor changes. We believe that it would serve the investing public's best interests for the Board to adopt (perhaps in a different release) enforceable requirements for predecessor auditors to share information with successors.

Content of Audit Documentation

3. In the introductory portion of Release No. 2003-023, the Board refers to what it calls a proposed "reviewability" standard that would include the substance of the General Accounting Office's (GAO) documentation standard (*Government Auditing Standards*, § 4.22), which requires that audit documentation include, among other things, evidence that supports the auditors' *significant judgments* and conclusions. We note that the reference to *significant judgments* in the GAO standard is conspicuously absent from para. 5a of the proposed PCAOB auditing standard, and we believe it should be inserted in the final version.

4. In addition, while adequate for governmental audits, because (as pointed out by the Board in the introductory portion of Release No. 2003-023) the requirement embodied in § 4.22 of the GAO standard serves primarily to enable experienced GAO auditors to complete their reviews efficiently, in the more diverse world of risks and other complexities that are inherent in private-sector, corporate financial reporting, a reviewer who is merely *experienced* should not be expected to complete the review effectively, regardless of the quality of the documentation. To be qualified to conduct the review, a reviewer should have to have ***appropriate***, often industry-specific, experience. Auditors should not be burdened by the standard with an obligation to create documentation sufficient to overcome a reviewer's lack of sufficient specific experience as may be appropriate for the assignment. Accordingly, we recommend that the word, *appropriately*, be inserted in the final version of the proposed auditing standard to modify the word, *experienced*, and that explanatory language be added (perhaps in a footnote) as to how the word, *appropriately*, should be interpreted.

5. Para. 5b of the proposed auditing standard would require that the audit documentation permit one "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.***" [Emphasis added.] We believe there is wide

diversity in practice particularly with regard documentation of the extent of the review. It is not clear whether the emphasized words (a) are intended to require a reviewer to sign and date every work paper reviewed, (b) would permit a reviewer to sign off on groups of related work papers, or (c) would permit a single signoff on a quality control checklist. Except for our views with respect to concurring reviewers as indicated in para. 6, hereinbelow, we believe alternative (b) to be both adequate and most practical among the three choices. It is also not clear whether the proposed requirement would be limited in its applicability only to a "primary" responsible reviewer or whether and how the requirement might apply to multiple levels of review. For example, would the proposed documentation standard require a concurring reviewer to document the specific matters selected for review by the concurring reviewer and when they were reviewed? We believe that if the intent of the proposed auditing standard includes reasonable standardization of the nature and content of audit documentation, then we also believe that these matters should be clarified in the final version.

6. To govern the performance of concurring reviews, PCAOB Rule 3400T adopts, as part of the *Interim Quality Control Standards*, the requirements of *SEC Practice Section Reference Manual* (SECPSRM) § 1000.08(f) (which, in turn, incorporates Appendix E (SECPSRM § 1000.39). Appendix E states that the concurring reviewer's responsibility "is not the equivalent of the audit engagement partner's responsibilities" and points out that a concurring reviewer "generally is not in a position to make the informed judgments on significant issues expected of an audit engagement partner." While certain items in the work papers are specified by Appendix E as requiring review, it states, in effect, that the extent of review of other documentation is a matter of the concurring reviewer's professional judgment. We believe that if the requirement in para. 5b of the proposed auditing standard were to be clarified to require that all individual work papers reviewed be signed and dated, and that such requirement be extended to multiple levels of review, including the concurring reviewer, it will have the undesirable effect of making the concurring reviewer accountable for the scope of his or her review. This will significantly change the character of the concurring review and likely cause the concurring reviewer to accept *de facto* responsibilities equal to that of the engagement partner, despite the reviewer's less intimate contact with and knowledge of the engagement. Therefore, it will likely cause the scope of concurring reviews to escalate beyond reason, for self-protective purposes. Not only will this add time and costs to audits, but it will also likely impair the ability of accelerated filers to meet the more stringent filing deadlines that apply to them. We do not believe that such a change is warranted and recommend that the final version of the auditing standard clearly set forth that a single sign-off on an appropriate conclusion (negatively expressed), such as provided for in SECPSRM § 1000.39[1], should be adequate with regard to the concurring review.

7. Para. 9 of the proposed auditing standard requires auditors to document, among other things, *significant findings or issues*, which term is defined also in para. 9. In contrast, para. 10 of the proposed auditing standard requires that auditors "***must*** identify ***all*** significant findings or issues ..." [emphasis added]. Because it is rooted in the imprecise word, *significant*, the definition of *significant findings or issues* is inherently, and therefore necessarily, highly subjective. (In fact, six out of eight of the examples of *significant findings or issues* listed in para. 9, which are characterized as not all-inclusive, also include the word *significant*.) When a subjective term such as significant is coupled (as in para. 10 of the proposed standard) with word like *must*, as defined (see para. 1b, hereinabove), and *all*, it makes auditors extremely vulnerable to second guessing and causes them unwarranted exposure to unduly severe consequences in the form of civil liability, regulatory penalties and even criminal charges.

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[1] Such a conclusion would state that based on performance of the required procedures, no matters came to the reviewer's attention that would cause him or her to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects or that the firm's audit was not performed in accordance with generally accepted auditing standards, except as set forth in the audit report.

Rebuttable Presumption

8. Para. 6 of the proposed auditing standard states that failure to "document the procedures performed, evidence obtained, and conclusions reached," and that "failure to do[2] so creates a presumption that the procedures were not applied, the evidence was not obtained, and the conclusions reached were not suitably supported. This presumption is rebuttable by persuasive other evidence that the procedures were applied and the evidence was obtained to provide sufficient support for the conclusions reached." The Board explains in the introductory portion of Release No. 2003-023 that this language was intended to represent the substance of California's statute on audit documentation.

9. We firmly believe that the California statute was ill-conceived and hastily drafted, that it inappropriately pre-judges facts and circumstances and denies auditors their rights to a fair consideration thereof in a court of law and, accordingly, that it should not be used as a model for other legislation or regulation. Moreover, we believe it is entirely inappropriate for a professional standard effectively to predetermine for a court the relative value of evidence that may come before the court, which predetermination is inherent both in the establishment of such a rebuttable presumption in the proposed auditing standard and in what we perceive to be extremely prejudicial language set forth, not in the body of the proposed standard, itself, but only in the introductory portion of Release No. 2003-023, that is, that "the Board contemplates that oral explanation alone would not constitute persuasive other evidence." (Interestingly, this is the only matter about which the Board specifically requested comment.) We believe a court or other judicial body should have the discretion to freely consider and evaluate the relative weight and credibility of evidence brought before it without the influence of a standard-setting body that has not had the opportunity to hear the relevant facts and circumstances in the case. We believe a standard-setter's influence should extend only to the ***performance*** of professional services.

Retention of Audit Documentation

10. Para. 14 of the proposed auditing standard would require that the audit documentation must be assembled for retention within a "reasonable period of time" after the auditor's report is released, and prescribes without qualification that reasonable "ordinarily ***should*** not exceed 45 days" [emphasis added]. We observe that under proposed Rule 3101 (see para. 1b, hereinabove), the term *should* describes what is deemed to be a *presumptively mandatory obligation*. A *presumptively mandatory obligation* is almost as mandatory as one characterized with the word *must*, except that it permits certain exceptions, provided the auditor accepts the burden of demonstrating "by verifiable, objective, and documented evidence" that certain specified objectives were adequately met by alternative means. However, the meaning of the term *should* is significantly muddled in the cited instance by the modifier *ordinarily* thus making it virtually impossible to ascertain if the Rule 3101 justification burden applies.

11. We believe the seasonal and extreme deadline and economic pressures inherent and growing in the professional practice of auditing and other services typically offered by audit firms no longer permit auditors the luxury of carrying excess staff beyond the immediate needs of providing client services. We, therefore, believe that the need to get assigned staff out to uncompleted client engagements often must take priority over internal housekeeping needs. We also believe that this problem is often more severe in smaller firms such as ours, than in larger firms.

12. While we agree that final assembly should occur within a "reasonable period of time," we believe it would be inappropriate be to pre-judge a finite limit on what is reasonable in any given circumstances

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[2] We believe that this can, and likely will, be interpreted, particularly by adversaries, as meaning "failure to ***adequately*** document ...".

and, therefore, inappropriate to correct the inconsistency pointed our in para. 10, hereinabove, with an inflexible standard of 45 days. In fact, we believe that, based on circumstances, such a limit may be unreasonable as often as it is reasonable. We also believe that any failure to achieve the objective of this provision of the proposed standard when, in fact, the audit file in question was "buttoned up" in something more than 45 days, should not cause the auditor to be exposed to consequences as severe as criminal charges, regulatory penalties (for violating Rule 3100) or even onerous defensive justification burdens. Accordingly, we request that the words, "ordinarily should not exceed 45 days" be replaced in the final version of the proposed standard with an expression that would more clearly not qualify under Rule 3101 as a *presumptively mandatory obligation*, for example, "is ordinarily expected not to exceed 45-60 days, depending on the circumstances."

Subsequent Changes to Audit Documentation

13. Para. 15 of the proposed auditing standard would prohibit the deletion of any audit documentation after the period described in para. 14 thereof. It does not specify whether such documentation could or should be marked clearly as superseded and referenced to any replacement material, as we believe would be advisable to prevent confusion and undue reliance should this proscription survive the final version of the proposed auditing standard. We, however, request that the Board consider our overriding concern as expressed in para. 1a, hereinabove, and ultimately conclude that the final standard should not require an auditor to retain erroneous, irrelevant, superseded material that can serve no useful purpose other than as a roadmap to enable an adversary to attack the auditor or successfully thwart his or her defense.

Minor Editorial Point

14. Para. 2 of the proposed auditing standard states that "Audit documentation also may be referred to as *work papers* or *working papers*." We recommend that the commonly used, one-word version, *workpapers*, also be included in this sentence.

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We hope we have clearly articulated our significant concerns about the proposed standard and that the Board will accept our recommendations. However, if there are any questions, please contact either of the undersigned.

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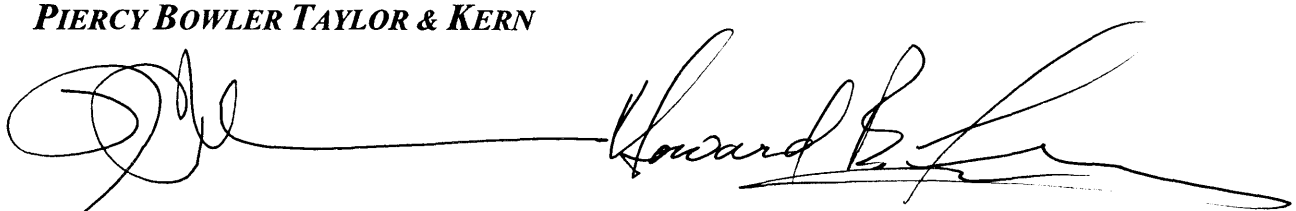

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