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Recipient Secretary, Public Company Accounting Oversight Board

Sender Hans Wey, Member of the Executive Committee, and Walter Hess, General Secretary

PCAOB Rulemaking Docket Matter No. 012 PCAOB Release No. 2003-023:
Proposed Auditing Standard on Audit Documentation and proposed Amendment to Interim Auditing Standards
General Comments

Also by e-mail: comments@pcaobus.org
PCAOB
Office of the Secretary
Mr. Gordon Seymour
1666 K Street, N.W.
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U.S.A.

Dear Mr. Seymour

The Swiss Institute of Certified Accountants and Tax Consultants (the "Institute") appreciates the opportunity to submit our general comments to the U.S. Public Company Accounting Oversight Board ("PCAOB") regarding the rulemaking proposed in PCAOB Release No. 2003-023, ***Proposed Auditing Standard on Audit Documentation and Amendment to Interim Auditing Standards*** (PCAOB Rulemaking Docket Matter No. 012, the "Proposed Standard") by which it implements Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act").

In our three previous letters to the PCAOB and the SEC dated March 27, 2003 (the "March Letter"), July 2, 2003 (the "July Letter") and August 18, 2003 (the "August Letter"), we have provided comments as to how the Act and the proposed registration system for foreign public accounting firms will affect our members. Furthermore, in these letters we highlighted areas where the PCAOB's proposed rules conflict with Swiss law. We refer to our March, July and August Letters and declare them as integral parts of this submission, as many of our comments made therein also apply to the Proposed Standard.

A. General Comments

With regard to the Proposed Standard, we would like to re-emphasize the following:

We have the same intention and are aiming for the same goal as the U.S. legislator, the SEC and the PCAOB, namely "to protect the interests of investors and further the public interest in the

preparation of informative, accurate and independent audit reports for companies the securities of which are sold to, and held by and for, public investors" (Sec. 101(a) of the Act).

Nevertheless, we would like to take this opportunity to emphasize that the Proposed Standard contains certain provisions that would create serious conflicts with Swiss Law.

B. Topics of Concern regarding the Proposed Standard

The chief topics of concern to us are the following:

I. Reviewability Standard and Presumption

II. Period for Assembly of Audit Documentation

III. Multi-location Audits

IV. Part of Audit Performed by Other Independent Auditors

I. Reviewability Standard and Presumption

(1) Objectives and Use of Audit Documentation

We completely support the PCAOB's assessment of the importance of audit documentation in para. 2 of the Proposed Standard. For the avoidance of notional unclarity, we would like to distinguish two types of documentation:

(a) Opinions, client memoranda, inter-office memoranda and related correspondence between an audit firm and its client or the lead auditor (principal auditor), which are designed to be released to the audit client, the lead auditor (in case of a contribution to a consolidated audit), and (regarding opinions, but not client memoranda, management letters or similar) to third parties, even the public at large, and

(b) workpapers (one word) (internal memoranda, internal correspondence, work schedules, document lists, internal e-mails etc.), which are designed for internal use within the audit firm exclusively, and which are not normally released to third parties, not even the audit client, except under very particular circumstances.

Thus, contrary to para. 3 lit. d and f of the Proposed Standard, workpapers would not normally be available to advisors engaged by the audit committee or representatives of a party to an acquisition.

As regards the Swiss legal situation, non-Swiss quality control reviewers and non-Swiss external inspection teams (para. 3 lit. c and e of the Proposed Standard) may under certain circumstances

review workpapers, but are not normally being sent workpapers except after consultation with and specific approval by the client, and after deletion/elimination of information covered by secrecy duties which cannot be waived by the audit client (data protection, banking secrecy regarding bank client information, business secrets of business contacts of the audit client, employee data, information whose release would constitute economic espionage, etc.[1])

(2) GAGAS as inappropriate Standards

GAGAS (Generally Accepted Government Auditing Standards) are auditing standards established by the U.S. General Accounting Office publication "Government Auditing Standards". They are promulgated by a U.S. governmental agency, designed for the specific purpose of auditing governmental agencies and bodies (public and private) acting under a governmental contract or grant. The scope and underlying premises of such an audit are substantially different from one performed in accordance with GAAS or similar standards, *e.g.*, an auditor under GAGAS also has the responsibility for "Detecting Material Misstatements Resulting from Violations of Contract Provisions or Grant Agreements, or from Abuse" (GAGAS § 4.17, 4.19).

The nature, scope and underlying premises of an audit performed in accordance with GAGAS are so profoundly different from an audit performed by accounting firms under GAAS as to make the application of GAGAS to public company audits appear unrealistic and unnatural.

Also GAGAS are not known outside the U.S. and thus impractical to be applied in an international context and to non-U.S. accounting firms.

(3) Reviewability Standard, in particular Personal Discussions as Source for Audit Opinion

The concept that "audit documentation must contain sufficient information to enable an experienced auditor… to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached" (para. 5 of the Proposed Standard, which, unlike para. 9, does not provide for a materiality threshold) in our view neglects the importance of oral discussions held with representatives of the audit client and within the audit firm at all levels, and also of the professional judgment applied by individual partners and senior managers responsible for an audit. It would be impractical, even counter-productive, and in any case not cost-effective, to document all of such discussions in writing in sufficient detail so that such documentation would be understandable on its own, without oral commenting by the responsible auditor.

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[1] See B.III(2) below. We refer to our March Letter and July Letter for a more encompassing description of applicable Swiss secrecy duties.

We would, however, not object to a standard that would require documenting of **material information** (gained from whatever source and in whether form, oral or in writing), and of the **results** of the audit and the **conclusions** drawn therefrom (*cf.* para. 9 of the Proposed Release).

(4) Disagreements and Inconsistent Findings and Issues

While we agree that there should be a possibility for partners and senior managers responsible for an audit engagement to put any differing opinions, professional discussions and non-resolvable disagreements on record, it seems impracticable and counter-productive to evidence any and all disagreements among members of the engagement team (para. 9 lit. d, para 12 second sentence of the Proposed Standard), in particular if they relate to non-material items or are later withdrawn by the person that has brought them up.

Similarly any conclusion in an audit process is reached by weighing factors and information that, taken individually, may be seen as supporting contradictory conclusions, but that may be reconcilable in light of the overall situation of the audited company. Documenting them in the auditor's final conclusions statement would give them a weight unwarranted in the overall process. Doing so, again, would be impracticable and counter-productive (para. 12 first sentence of the Proposed Standard).

(5) Presumption

The exclusion of oral testimony as a means to rebut the presumption of para. 6 second sentence of the Proposed Standard, as set forth in Part A of the Proposed Standard[2], cannot be reconciled with the concept that partners and senior managers responsible for an audit may form their professional opinion (also) on the basis of oral discussions and other soft factors that do not lend themselves to complete and encompassing documentation. These persons should, under any circumstance, be allowed to testify in support of the work performed in the course of an audit and the conclusions drawn therefrom, even if not reflected, or not reflected in all detail, in the audit documentation. Insofar as the presumption excludes oral testimony as means for rebuttal, it is unacceptable for us.

II. Period for Assembly of Audit Documentation

While we agree that audit documentation should be completed within a reasonable period of time after completion of the audit process and release of the audit, we feel that the 45 day period set as a maximum for such assembly in para. 14 third sentence of the Proposed Standard would pose an incommensurate burden on the audit firm without any corresponding benefit. Having to assemble the documentation immediately after conclusion of an audit would bind staff that the audit firm

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[2] Part A of the Proposed Standard , page 4, end of third para.: "The Board contemplates that oral explanation alone would not constitute persuasive other evidence …"

should be free to assign according to most pressing needs. This short maximum assembly period would be particularly burdensome for smaller auditing firms with a limited number of qualified personnel.

We thus propose not to specify the maximum duration, or at least to extend the period for assembly of audit documentation to a maximum of 90 days.

III. Multi-location Audits

Paragraph 16 first and second sentence[3] of the Proposed Standard, taken literally, would require the auditor of a Swiss subsidiary of a non-Swiss issuer to submit its audit documentation (originals or copies) to the principal audit firm.

In our understanding, such encompassing document production to the principal auditor outside Switzerland would violate Swiss law in several aspects, and would impose an impracticable and unduly costly burden on audit firms and their clients.

Audit documentation often contains detailed information regarding the business operations of a Swiss subsidiary, such as information on its employees, bank or security trader's clients, suppliers, governmental agencies, or other third parties as well as transactional and contractual data that may be protected under Swiss law.

(1) Summary of conflicts between the PCAOB's requirement to produce audit documentation and Swiss law

Any document production to the principal auditor outside Switzerland would violate Swiss law and expose the Swiss audit firms, their partners and employees to criminal and civil liability:

(a) where doing so is prohibited by, or would conflict with mandatory Swiss and other applicable law,

(b) where prohibitions by or conflicts with Swiss law could be avoided by consents and waivers of our clients and third parties but such consents and waivers are either unobtainable or invalid, including instances where the validity of such consent and waiver is doubtful and cannot be confirmed or has not yet been confirmed when documents are due for production,

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[3] "Audit documentation sufficient to meet the requirements of paragraphs 4 - 12 (including documentation of work performed by others, such as affiliated firms) must be retained by the office issuing the auditor's report. With respect to the audit documentation related to the work performed by others, the auditor issuing the report ordinarily should retain the original audit documentation or copies of such documentation."

(c) where doing so could reasonably be expected to expose the Swiss audit firm or its associated persons to civil liability towards other parties or legal sanctions (civil or criminal, financial or otherwise) with potentially significant negative impact.

The alternative provided by the third sentence of para. 16 of the Proposed Standard[4], as we read it, does not bring any remedy to this problem because it refers back to para. 4 - 12 of the Proposed Standard, so that the principal auditor appears to be obliged to redo the audit work in order to achieve the required degree of completeness of documentation.

(2) Details of legal conflicts

(a) First of all, since the duty for such document production rests on a standard promulgated by the PCAOB, it is obvious that its chief purpose would be to allow the PCAOB or the SEC direct and unhindered access to such documentation in case of an investigation. It would thus be viewed from a Swiss perspective as a preparatory measure for and circumvention of the limitations imposed by Swiss law on acts of a foreign states performed in Switzerland. There is thus a substantial risk that an audit firm in Switzerland, complying with the request set forth in para. 16 first and second sentence of the Proposed Standard, would violate article 271 of the Penal Code ("PC"), a provision of criminal law protecting the **Swiss sovereignty on Swiss territory**. As such, a Swiss audit firm, its partners and employees that gather documentation from third parties to comply with such a request would be acting in violation of article 271 PC and thus would expose themselves to criminal liability.

(b) Furthermore, a Swiss audit firm, its partners and employees that produce audit documentation pursuant to para. 16 first and second sentence of the Proposed Standard would violate **auditors' secrecy**, which is provided for under Swiss criminal law (article 321 PC) as well as by private company law (in particular article 730 of the Swiss Code of Obligations, "CO"); **data secrecy** which is provided for under article 35 of the Federal Law on Data Protection ("DPL"); and **manufacturing and business secrecy** which is provided for under article 162 PC. Furthermore, article 273 PC (economic espionage) of the Swiss criminal law may also be violated.

(c) If the audit client is a bank or a securities dealer, the production of audit work papers under these circumstances is very likely also to violate **banking secrecy** duties, which are provided for under the Banking Act ("BA") and / or **stock exchange and securities**

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[4] "Alternatively, if the auditor considers it necessary in the circumstances, the auditor issuing the report should prepare and retain audit documentation of the work performed by others as part of the review required by paragraph 12 of AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, as long as the audit documentation complies with paragraphs 4-12 of this standard." This provision also does not consider the situation where part of the audit is conducted by an audit firm belonging to the same network.

traders secrecy duties, which are provided for under the Stock Exchange and Securities Traders Act ("SESTA"); the violation of both regulations constitutes a criminal offence punishable by imprisonment or a fine.

(d) Furthermore, the production of audit documentation under these circumstances could be in conflict with the **principles of the Data Protection Law** ("DPL") in Switzerland.

In order to avoid violations of the Swiss legal provisions referred to in the four preceding paragraphs, the audit documentation would have to be cleansed of any sensitive information before delivery to the principal auditor. So cleansed, however, it would lose its characteristics as audit documentation and would no longer satisfy the requirements set forth in para. 4 through 12 of the Proposed Standards.

(3) Consent or waivers

A **consent or waiver** by the audit client may avoid some of the conflicts with Swiss Law detailed above. However, in those instances where the information is also protected in favor of a third party (such as clients of the audit client, in particular but not limited to bank clients), the consent or waiver by such third parties would also by required prior to the production of workpapers to the principal auditor outside Switzerland. It can be anticipated that consents from such third parties would not be obtainable. In particular, with respect to audit clients who are banks or securities traders in the sense of the BA or the SESTA, respectively, we consider it not only impossible to obtain such consents from all of the third parties who could potentially be affected by the production of audit workpapers, but such consent gathering would also be against Swiss public policy.

We stress that the violation of article 271 PC and article 273 PC (regarding information of Swiss national interest) may not be avoided by a consent or waiver.

Where a consent can avoid the violation of Swiss law, the consent must be given (i) on a fully informed basis (about the information which will be disclosed and the consequences of the disclosure) and (ii) by free will in order to be legally valid. The consent can be revoked at any time before the production of the audit workpapers. Thus, a consent to produce documents to the principal auditor would not automatically cover the production by the principal auditor upon request by the PCAOB or SEC in the course of an investigation. Client and third party consents, where obtained and valid, would have to be re-confirmed in light of a specific PCAOB request, without which release of documentation to the PCAOB or SEC, even if permitted under U.S. law as the *lex actae sitae,* would violate Swiss law and expose the Swiss auditor to criminal and penal sanctions.

(4) Problems for Principal Auditors

Central retention of audit workpapers pursuant to paragraph 16 first sentence of the Proposed

Standard does not only pose problems for our members as contributing auditors, but also in their role as principal auditors, where they are unable to meet their respective duties because contributing auditors in third countries for similar reasons as set forth above are unable or unwilling to produce their audit documentation as requested.

It goes without saying that the cleansing and consent gathering process could not be completed within the time period of 45 days.

(5) Conclusion

We recommend that the PCAOB amend and clarify paragraph 16 third sentence of the Proposed Standard so as to allow for audit documentation to be stored at the site of the auditor who has performed the work, where it would be open for review by the principal auditor in view of assuring uniformity of standards and reviewing specific results and conclusions, of course respecting the limitations imposed by Swiss law. Documentation evidencing such a review process and conclusions drawn therefrom could then be kept at the principal auditor's offices. Such review documentation itself would have to meet the requirements of para. 4 through 12 of the Proposed Standard only insofar as this is warrant for a review documentation.

IV. Part of Audit Performed by Other Independent Auditors

We do not agree with the amendment applied by the PCAOB to the documentation requirements of AU sec. 543.12 as a conclusion and part of the Proposed Standard. Where the principal auditor elects not to make reference to the audit of the other auditor (because all auditors involved are members of the same network), he or she is supposed to perform his or her duties regarding selection, quality control and selective review. The principal auditor should not, however, be required to "review the audit documentation of the other auditor to the same extent and in the same manner that the audit work of all those [employees and other associated persons] who participated in the engagement is reviewed". This approach neglects the very nature of a network of auditors, where one member relies on the work of other members of the network on the basis of common training, quality standards and uniform review procedures.

We also object to the requirement that "sufficient documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor to meet all the requirements of the [Proposed Standard]" (*cf.* what we have said in part B.I above).

We also think that a PCAOB Release regarding audit documentation standard should not use expressions that could be used to buttress theories of joint liability between the principal auditor and an independent contributing audit firm of the same network, irrespective of whether the principal auditor has fulfilled its specific duties. We thus propose to re-word the phrase "the principal auditor decides to assume responsibility for the work of other auditors" (page A2-2 second para., second sentence) by eliminating the expression "responsibility".

C. Overall Conclusions

Neither principle nor duration of audit documentation retention as prescribed by the Proposed Standard would pose any problems to our members who are affected by it in their roles as principal auditors for issuers (and as such have to register as foreign public accounting firms pursuant to Sec. 102 and 106(a) of the Act) or contributing auditors in the course of consolidated audits (and as such are subject to Section 106(b) of the Act). The Proposed Standard, however, in our opinion does not make reference to a body of standards appropriate for international audit assignments, and does not take into consideration the problems posed by international consolidated audits with their diversity of scope and procedures of review, let alone divergence of applicable laws. In particular and foremost, the reviewability standard (without reference to materiality), the exclusion of oral testimony as a means to rebut the presumption, the minimum period for assembly of documentation, and the central retention of audit documentation in a multi-location audit (including the proposed amendment to AU sec. 543.12) are unacceptable for us for incompatibility with Swiss law as well as for practical and cost reasons.

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We appreciate the opportunity to express the serious concerns of our members with regard to the Proposed Standard.

We look forward to continuing discussions with the PCAOB regarding these matters until a solution has been found that achieves our common cause, while fairly balancing the interests of the parties involved and finding practical solutions for mitigating conflicts imposed by different legal systems.

Respectfully submitted,

Swiss Institute of Certified Accountants and Tax Consultants

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