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January 8, 2004

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
Proposed auditing standard, *Audit Documentation*, and proposed amendment to the Board's interim auditing standard, "Part of Audit Performed by Other Independent Auditors."

Dear Board Members and Staff:

In general I believe that the proposed auditing standard is reasonable. However, I do not believe the proposed amendment to interim auditing standards concerning circumstances when other independent auditors perform part of the audit is desirable. The following are my comments and suggestions relating to these proposals.

Overall Portrayal of Public Company Accounting Oversight Board Audit Standards

As noted in the Public Company Accounting Oversight Board ("PCAOB' or "Board") Release, Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act of 2002 (the "Act") 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 auditor's report. It is clear from the Act that the Board's mandate relates to audits of publicly held companies. That is acknowledged in this Release's STATEMENT OF AUTHORITY with the statement: "The Board has adopted Rule 3100 to require all registered public accounting firms to adhere to the Board's auditing and related professional practice standards (including interim professional standards) *in the audits of public companies*" (Emphasis added).

Because the Board's mandate is limited to audits of publicly held companies, I do not believe it is appropriate for the Board to claim that this proposed audit documentation standard, when it becomes final, will supersede AU sec. 339 or that the accompanying proposed amendment to interim auditing standards would amend AU sec. 543. In performing an audit of financial statements, I believe that, in the absence of any compulsory written standards, an auditor has a professional responsibility to abide by standards that are sufficiently high and to apply procedures that are sufficient to obtain enough evidence to support an opinion about the fairness, in all material respects, of the financial statements being reported on. It is the auditor's opinion about the fairness of the financial statements that is the important factor. The adherence to any set of auditing standards simply lets those who place reliance on the audited financial statements know that the auditor has abided by a certain set of defined conventions in applying procedures to help form an opinion. Generally Accepted Auditing Standards ("GAAS") then are simply the defined conventions of the auditing profession. They are established by the auditing profession and, when they are referred to in an auditors report, are meant to provide assurance that the auditor stuck with the conventions of the auditing profession in providing assurance about the financial statements. GAAS provides assurance about the assurance an auditor provides on financial statements. Without GAAS, an auditors report on financial statements might read:

> We have audited the accompanying balance sheet of X Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
>
> We conducted our audit by applying such procedures as we considered necessary to obtain reasonable assurance about whether the financial statements are free of material misstatement. We believe that our audit provides a reasonable basis for our opinion.
>
> In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20XX, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In my view, the “Generally Accepted” phrase within GAAS implies that GAAS is a set of conventions established with the consent of the auditing profession. In the United States, GAAS has been established through the American Institute of Certified Public Accountants (AICPA) because that organization is the largest voluntary membership body of public accountants in the United States; thus it is the single most representative organization of the views of certified public accountants. While many individual members of the AICPA may not agree with the Statements on Auditing Standards (SAS's) emanating from it, the AICPA is still more representative of Certified Public Accountants (CPAs) as a group than any other body; thus it may be said that SAS's are issued with the consent of the accounting and auditing profession.

In contrast, audit standards issued by the PCAOB are imposed by law on auditors of publicly held companies rather than being issued with the consent of the profession. Auditors may abide by PCAOB Standards imposed on them but not agree with those standards; so in my view, Board imposed standards should not be considered "generally accepted." I am aware that some people will respond to this view by noting that the same thing might be said about the current GAAS established by the AICPA since there are certainly a number of auditors who do not fully agree with current GAAS. To that point I respond by referring to the above-mentioned notion that the AICPA remains the single most representative body of CPAs.

In addition to the reasons discussed above, I do not believe that the Board has the right to supersede AU sec. 339 or to amend AU sec. 543 because all AU sections simply represent the codified SAS's, which are the copyrighted property of the AICPA. I would also state that the AICPA and each individual CPA has a right to disagree with the Board and to concoct what ever standards they please. It is the perception that the audit standards in use were not sufficiently effective that lead to the establishment of the Board, but another view is that the audit standards in existence were not being followed. Still another view might be that both of these views are true to some extent. It can be difficult to determine whether the current standards are just not enough or whether they have just not been followed and I suspect that many people would say that both of those conditions have existed. History is repeating itself in the sense that audit failures have lead to the establishment of more and more effective standards. However, as standards become more and more refined, adherence to them becomes more difficult. Difficulties in adhering to audit standards come about from their complexity, their practicability, the sheer volume of them, and from economic factors. Needless to say, as standards become more complex, less feasible, more voluminous, and more costly, the more they will be ignored or compromised. There is a challenge to find a sensible mix. In addition, and to me more important, individual auditors and firms must be held to high standards as professionals. It is simply not possible to write standards that anticipate every possible situation. As professionals, CPAs must be prepared to apply judgment and perform procedures that may not be specifically required if the situation so demands. The public does have a right to expect professional judgment and behavior. Therefore, CPAs cannot simply fall back on the excuse that they followed the standards required of them; however, at the same time, the public cannot expect auditors to be watchdogs or guardians. As the auditing profession has matured from infancy 100 years ago the standards added along the way, in my view, have become more oriented toward building in specifics as opposed to establishing broader requirements. The Board certainly has the legal right to impose audit standards for public company audits, but that right does not extend to audit standards for audits of nonpublic entities. There is a difference in the realities of operations between public and nonpublic entities. That difference requires differences in the professional approach taken in audits of the two types of entities that to me does not imply differences in the quality of audit services performed.

Because of the foregoing considerations, I believe that the Board should portray the auditing standards it imposes as supplemental to GAAS and required for audits of publicly held companies. This approach is not unprecedented. For example, auditors of state and local governmental entities must apply so-called "yellow book" standards where the entity receives federal funding in excess of a defined amount. In that case, auditors apply Generally Accepted Governmental Auditing Standards ("GAGAS") as well as GAAS in conducting their audits.

Following that example, an auditors report on a publicly held company might read:

> We have audited the accompanying balance sheets of X Company as of December 31, 20X2 and 20X1 and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
>
> We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to audits of publicly-held companies issued by the Public Company Accounting Oversight Board. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
>
> In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

This view can raise the question as to differences in the way that Board imposed auditing standards are treated when compared with accounting principles issued and/or approved by the Financial Accounting Standards Board (FASB). Both the PCAOB and the FASB are established as independent not-for-profit organizations and adherence to the standards of both are required by the Securities and Exchange Commission ("Commission" or "SEC").

The subjects of whether generally accepted accounting principles (GAAP) are truly "generally accepted" and of "Big-GAAP" and "Little-GAAP" have often been addressed and I do not believe it is appropriate to discuss those topics in this letter. From the auditor's standpoint, the requirements of the PCAOB have a direct relationship to the auditor, whereas the requirements of the FASB directly relate to the entity subject to the audit and are subject to testing by the auditor.

Audit Documentation

Reviewability Standard

This proposed rule would adopt the substance of the General Accounting Offices' ("GAO") documentation standard for government and other audits conducted according to GAGAS. As stated, "the Board's proposed standard would require that audit documentation 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. This experienced auditor also must be able to determine who reviewed the work and the date of such review."

I support this proposal without qualification. These requirements should not need explanation or justification. They are necessary to demonstrate that the proper audit procedures were performed and that standards adhered to on a timely basis.

This proposal is in the best interest of the auditor should the audit work ever come into question.

Rebuttable Presumption

As stated, “the proposed standard would adopt the substance of the state of California's statute on audit documentation, which creates a rebuttable presumption that the failure to document work performed indicates that the work was not performed.” Further, “the proposed presumption could be rebutted by persuasive evidence that the procedures were applied, the evidence was obtained, or sufficient support was provided for the conclusions reached.” However, “the Board contemplates that oral explanation alone would not constitute persuasive other evidence and invites comment on the addition of such a requirement to the proposed standard.”

As with the proposal concerning reviewability, the merits of this proposal seem obvious. It also is in the best interest of the auditor should the audit work ever come into question and is obviously necessary to demonstrate that the work was performed on a timely basis.

Retention of Audit Documentation

In addition to requiring that an auditor retain audit documentation for seven years after completion of the engagement, the minimum period permitted under the Act, “the proposed standard would add a new requirement that the audit documentation must be assembled for retention within a reasonable period of time after the auditor's report is released. Such reasonable period of time ordinarily should not exceed 45 days.”

I also wholeheartedly support this proposal and also believe it is in the best interest of the auditor. The notion of assembling the audit documentation within a reasonable period of time after the auditor's report is released is sensible since it becomes more difficult to assemble documentation as time moves the farther away from the release date and auditors become involved with other matters and is necessary to demonstrate that the work was performed on a timely basis. Whether 45 days should constitute “a reasonable period” could be the subject of endless debate; however, unless there are extenuating circumstances causing a late start to the audit, the period should not extend beyond the commencement of the limited review of the next fiscal year’s first quarter.

Subsequent Changes to Audit Documentation

As stated, “the proposed standard would also require that any changes to the working papers after completion of the engagement be documented without deleting or discarding the original documents. Such documentation must indicate the date the information was added, by whom it was added, and the reason for adding it.”

This proposal is also in the best interest of the auditor should the audit work ever come into question. It too serves as a further demonstration that the required work was performed on a timely basis and as a demonstration of the auditor's integrity.

Multi-location Audits

As stated, "the proposed standard would require that sufficient audit documentation, including documentation of work performed by others, 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. The auditor issuing the report may, however, prepare and retain audit documentation of the work performed by others as a part of the review of such work, as long as this documentation complies with the requirements of this proposed standard."

I do not believe it is necessary for the issuing office to retain all audit documentation as long as that office can be assured that the documentation it expects other offices to retain exists and is in compliance with the standards and requirements for audit documentation. To a great extent, this seems to be a matter of firm choice. It would always be acceptable for a firm to choose to retain all audit documentation at the issuing office, but not always necessary to ensure high audit quality. It is important that the office issuing the auditor's report be in full control of the audit work performed, so there is a need for some amount of audit documentation at that location. The Board may wish to refine the term "sufficient audit documentation" as it applies to these circumstances. For multi-office firms, the firm's structure could be an important factor to consider. If, for example, the firm is tightly controlled with requirements that each participating office follow exacting procedures in accordance with firm-wide policy and originating office instructions, then the amount of audit documentation maintained at the originating office may not need to be very much if the participating offices are required to maintain the documentation of all the audit work required of them in accordance with applicable standards. However, if the firm operates more as a confederation of independent offices, each being relatively autonomous, then a greater amount of audit documentation should be maintained at the office issuing the auditor's report. Since it can be more difficult to control a firm's foreign affiliates it may be important that working papers from the audits of foreign affiliates be available and accessible at the accounting firm's office issuing the audit report so that that office is assured about the audit quality of it's foreign affiliates work and about the sufficiency of the audit documentation they maintain.

If a particular multi-office engagement is chosen for PCAOB inspection, the audit documentation from participating offices could be sent to the issuing office for the inspection.

Using the Work of Other Auditors

When reporting on a company's consolidated financial statements, an auditor may use the work of other auditors who have audited one or more affiliates or divisions of the company. Current standards require the principal auditor to consider performing certain procedures designed to provide assurance about the quality of the audit work performed by another auditor when it is decided not to make reference to the work of that other auditor. Under this release, sufficient audit documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor as if the principal auditor had performed the work himself or herself. In addition to reviewing the audit documentation of the other auditor, the principal auditor should consider whether it is necessary to visit the other auditor and discuss the audit procedures followed and the results thereof and whether it is necessary to instruct the other auditor as to the scope of work to be performed.

This proposal is in the best interest of the principal auditor should the audit work ever come into question and can help to ensure that the other auditor performs as he or she should under required standards. This is a proposal that provides the principal auditor with the added leverage that might be necessary to insist upon access to another auditors' audit documentation. Nevertheless, this proposal should not be necessary. If a principal auditor believes that the procedures required by the current AU §543.12 must be applied in order not to have to make reference to the work of another auditor then he or she must be prepared to insist on that access or, if necessary, resign from the engagement. I believe there are negative implications if an auditor must rely on a requirement such as the one proposed to force legitimate access to the audit documentation of another auditor for the purpose of determining whether reliance on the work of that other auditor is warranted. If a principal auditor believes the procedures contained in the current AU §543.12 should be applied but does not carry out those procedures because of resistance from the other auditor or the client, then questions arise about the principal auditor's independence, the integrity of the other auditor, and/or the integrity of the client. Therefore, I do not support this part of the Board's proposals because they are not necessary.

Attached is a copy of the Board's Proposed Audit Documentation Standard and a copy of the Board's Proposal on Part of the Work Performed by Other Independent Auditors, both marked with my suggestions for changes. Thank you for the opportunity to comment.

Sincerely,

s Robert J. Sonnelitter, Jr.

Robert J. Sonnelitter, Jr., CPA
Principal
Sonnelitter Professional Services, LLC

RELEASE

PCAOB Release 2003-023
November 21, 2003
Page A1–4 – Standard

Auditing and Related Professional Practice Standards

Proposed Auditing Standard
Audit Documentation
[Supplements AICPA Professional Standards, AU sec. 339]

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Introduction

1. This standard establishes general requirements for documentation the auditor should prepare and retain in connection with any engagement conducted in accordance with auditing and related professional practice standards. This standard does not supplant specific documentation requirements of other auditing and related professional practice standards.

Objectives of Audit Documentation

2. *Audit documentation* is the principal record of the basis for the auditor's conclusions and provides the principal support for the representations in the auditor's report. Audit documentation also facilitates the planning, performance, and supervision of the engagement and provides the basis for the review of the quality of the work by providing the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Audit documentation includes records on the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as *work papers* or *working papers*.

3. Audit documentation is reviewed by members of the engagement team performing the work and by others. For example:

a. Auditors who are new to an engagement review the prior year's documentation to understand the work performed as an aid in planning and performing the current engagement.

b. Supervisory personnel review documentation prepared by assistants on the engagement.

c. Engagement partners and engagement quality control reviewers review documentation to understand how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions.

d. A successor auditor reviews a predecessor auditor's audit documentation.

e. Internal and external inspection teams review documentation to assess audit quality and compliance with auditing and related professional practice standards; applicable laws, rules, and regulations; and the firm's own quality control policies.

f. Others, including advisors engaged by the audit committee or representatives of a party to an acquisition might review audit documentation.

Content of Audit Documentation

4. The auditor must prepare audit documentation in connection with each engagement conducted in accordance with auditing and related professional practice standards. Audit documentation ordinarily consists of memoranda, correspondence, schedules, and other documents created or obtained in connection with the engagement and may be in the form of paper, electronic files, or other media.

5. Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

a. To understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and

b. 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.

6. Auditors, including any specialists, should document the procedures performed, evidence obtained, and conclusions reached. Failure to do 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.

7. Because audit documentation provides the principal support for the representations in the auditor's report, it should:

a. Demonstrate how the audit complied with auditing and related professional practice standards;

b. Support the basis for the auditor's conclusions concerning every material financial statement assertion; and

c. Demonstrate that the underlying accounting records agreed or reconciled with the financial statements.

8. Certain matters, such as auditor independence and staff training and proficiency, may be documented in a central repository for the firm or the particular office participating in the engagement. If such matters are documented in a central repository, the audit documentation of the

engagement should contain a reference to the central repository. Documentation of matters unique to a particular engagement should be included in the audit documentation of the pertinent engagement.

9. The auditor must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached. *Significant findings or issues* include, but are not limited to, the following:

a. Significant matters involving the selection, application, and consistency of accounting principles, including related disclosures. Such significant matters include accounting for complex or unusual transactions, accounting estimates, and uncertainties as well as related management assumptions.

b. Results of auditing procedures that indicate a need for significant modification of planned auditing procedures or the existence of material misstatements or omissions in the financial statements or the existence of significant deficiencies in internal control over financial reporting.

c. Audit adjustments and the ultimate resolution of these items. For purposes of this standard, an *audit adjustment* is a proposed correction of a misstatement of the financial statements that could, in the auditor's judgment, either individually or in the aggregate, have a material effect[1] on the company's financial reporting process. Audit adjustments include corrections of misstatements, of which the auditor is aware, that were or should have been proposed based on the known audit evidence.

d. Disagreements among members of the engagement team or with others consulted on the engagement about conclusions reached on significant accounting or auditing matters.

e. Significant findings or issues identified during the review of quarterly financial information.

f. Circumstances that cause significant difficulty in applying auditing procedures.

g. Significant changes in the assessed level of audit risk for particular audit areas and the auditor's response to those changes.

h. Any other matters that could result in modification of the auditor's report.

10. The auditor must identify all significant findings or issues in an engagement completion memorandum. This memorandum should be as specific as necessary in the circumstances for a reviewer to gain a

[1] Materiality includes both quantitative and qualitative considerations as discussed in SEC Staff Accounting Bulletin No. 99.

thorough understanding of the significant findings or issues. This memorandum should include cross-references, as appropriate, to other supporting audit documentation.

11. Documentation of auditing procedures that involve the inspection of documents or confirmation, such as tests of details and tests of operating effectiveness of controls, should include identification of the items tested.[2] Documentation of auditing procedures that involve the inspection of significant contracts or agreements should include abstracts or copies of the documents.

12. In addition to the documentation necessary to support the auditor's final conclusions, information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions must also be included in the audit documentation. The relevant records to be retained include, but are not limited to, procedures performed in response to the information, and records documenting consultations on, or resolutions of, differences in professional judgment among members of the audit team or between the audit team and others consulted.

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[2] The identification of the items tested may be satisfied by indicating the source from which the items were selected and the specific selection criteria, for example:

- If an audit sample is selected from a population of documents, the documentation should include identifying characteristics (for example, the specific check numbers of the items included in the sample).
- If all items over a specific dollar amount are selected from a population of documents, the documentation need describe only the scope and the identification of the population (for example, all checks over $10,000 from the October disbursements journal).
- If a systematic sample is selected from a population of documents, the documentation need only provide an identification of the source of the documents and an indication of the starting point and the sampling interval (for example, a systematic sample of sales invoices was selected from the sales journal for the period from October 1 to December 31, starting with invoice number 452 and selecting every 40th invoice).

Retention of and Subsequent Changes to Audit Documentation

13. Audit documentation must be retained for seven years from the date of completion of the engagement, as indicated by the date of the auditor's report,[3] unless a longer period of time is required by law.

14. Prior to granting permission to use the auditor's report in connection with the issuance of the company's financial statements, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation must be assembled for retention within a reasonable period of time following the first time the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements. Such reasonable period of time ordinarily should not be more than 45 days.

15. Circumstances may require subsequent additions to the audit documentation. If evidence is obtained after completion of the engagement, or if work performed before engagement completion is documented after completion, the documentation added must indicate the date the information was added, by whom it was added, and the reason for adding it. Audit documentation must not be deleted or discarded; however, information may be added, including an explanation of its relevance, as long as the information identifies the date the information was added; by whom it was added; and the reason for adding it. The auditor should also identify and document changes to audit documentation as a result of post-issuance procedures. Documentation should include the nature of the change, the date of such change, by whom the change was made, and the reason for the change.

16. Audit documentation sufficient to meet the requirements of paragraphs 4-12 that relates to work performed by other offices of the principal auditor must be available to the office issuing the auditor's report. Documentation of work performed by others, such as affiliated firms that is sufficient to satisfy the principal auditor that those other auditors have met all required auditing standards including the requirements of paragraphs 4-12 must be retained by the office issuing the auditor's report. If the auditor issuing the report considers it necessary in the circumstances, the auditor issuing the report might retain the original audit documentation of the other auditors or copies of such documentation or alternatively, prepare and retain audit documentation of the work performed by others as a 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.

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[3] If a report is not issued in connection with an engagement, then the date of completion of the engagement would be the date that fieldwork was substantially completed.

17. The auditor also may be required to maintain documentation in addition to that required by this standard.[4]

Implementation Date

18. This standard will apply to engagements completed on or after June 15, 2004.

[4] 4/ For example, the SEC requires auditors to retain memoranda, correspondence, communications (for example, electronic mail), other documents, and records (in the form of paper, electronic, or other media) that are created, sent, or received in connection with an engagement conducted in accordance with auditing and related professional practice standards and that contain conclusions, opinions, analyses, or data related to the engagement. (Retention of Audit and Review Records, 17 CFR § 210.2-06, effective for audits or reviews completed on or after October 31, 2003.)

RELEASE

Part of Audit Performed by Other Independent Auditors – An Amendment to Interim Standards

This proposal would supplement AICPA Professional Standards AU sec. 543.12 as follows:

When the principal auditor decides not to make reference to the audit of the other auditor, in addition to satisfying himself as to the matters described in AU sec. 543.10, the principal auditor should consider the need 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 who participated in the engagement is reviewed. In those cases where the other auditor is issuing a report on the financial statements of a material consolidated subsidiary or affiliate of the client, the audit documentation of the work performed by the other auditor should be reviewed by the principal auditor to the extent he or she considers necessary to satisfy himself or herself that all the requirements of GAAS and PCAOB Auditing and Related Professional Practice Standards have been met. In the planning phase of the audit, throughout the audit, and later upon reviewing the audit documentation of the other auditor, the principal auditor should consider the degree to which it is necessary to visit the other auditor and discuss the audit procedures followed and the results thereof and the degree to which it is necessary to instruct the other auditor as to the scope of work to be performed.

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