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January 20, 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 - Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards

Dear Mr. Secretary:

BDO Seidman, LLP respectfully submits the following comments on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") proposed auditing standard ("the proposed standard") on audit documentation and proposed amendment to AU section 543, *Part of an Audit Performed by Other Independent Auditors*. BDO Seidman, LLP is pleased to have participated in the 2003 PCAOB roundtable discussion on Audit Documentation. Additionally, we currently serve on an AICPA Task Force that is reconsidering documentation issues, and the Firm previously participated in the development and ASB approval process leading to the issuance of SAS 96, *Audit Documentation*.

We recognize the importance of continuing to refine and improve standards that will restore confidence in our financial reporting environment and are eager to participate further in the initiatives of the PCAOB and other regulatory bodies to advance the quality of our professional standards. We appreciate the dedicated effort necessary to develop quality standards.

We also recognize the importance to the audit process of clear and adequate documentation. Not only will such documentation provide a roadmap for engagement team members and reviewers of workpapers, but it will also provide a foundation upon which auditors can perform higher quality audits.

While we support the Board's objective of solidifying the audit documentation process, there are certain aspects of the proposed standard that cause us concern. Our comments are categorized between those of significant concern and those requiring clarification.



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ISSUES OF SIGNIFICANT CONCERN

Implementation Date

The proposed standard would be effective for audits completed on or after June 15, 2004. In our view, this is not a reasonable implementation timeframe for the reasons noted below:

Retroactivity

Based on the proposed timetable for the issuance of this standard, it is likely that a final standard cannot be approved by the SEC before March or April. Thus, issuers with a June year-end may be in or close to the final quarter of their fiscal year before the final requirements are known. Audits of these issuers may already be in progress, with certain phases of preliminary work completed. The proposed implementation date would retroactively apply the standard to work already performed that may or may not have been documented under the criteria of the proposed standard. We believe this would be unprecedented and inappropriate. To the extent that there might be circumstances where it would be necessary to reconsider prior documentation in light of this proposed standard or as a result of clarifications of certain provisions in this proposal, it may not be practical or even possible to recreate documentation of prior work (for example, due to issuer system limitations). In addition, members of the audit team who performed work during the early stages of the audit may no longer be with the firm.

Compression of Additional Work

The changes in audit documentation requirements and workpaper assembly procedures would occur contemporaneously with the following issues, audit procedures, and new audit requirements. It would unnecessarily distract auditors and, therefore, could be counterproductive to the effective implementation of this important standard:

- High quality audits require careful planning. Communication and training needs to precede implementation of a standard that introduces new performance requirements. The complexity of some large multi-national engagements may make the implementation of this requirement unachievable for current engagements in the proposed timeframe. Moreover, the additional work in developing processes and procedures, and training of staff to understand the proposed new file accumulation requirements for many fiscal year issuers, will take place in the same time frame as this year's auditing "busy-season," when the focus instead should be on finalizing the audits of calendar-year issuers. Traditionally, this has been a period of very significant audit effort. That is particularly the case this year, as companies and auditors are in the process of meeting accelerated filing deadlines and new SEC independence and other requirements. We believe it would be counterproductive, and not in the public interest, to distract auditors from these efforts by requiring them to undergo documentation training during that period.



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- Significant additional procedures already are required for the first time on 2003 audits to address fraud risks in response to SAS 99, and the additional quarterly inquiries, procedures, and responsibilities (including fourth quarter procedures and assessments) were required for the first time this year by SAS 100.
- As currently proposed, accelerated filers with a June 2004 year-end will also be reporting for the first time on the effectiveness of their internal controls. We believe that Section 404 audits will lead to a substantial increase in the volume of documentation and will raise significant technical implementation issues, as such audits have not previously been performed. This has been confirmed by the work of the PCAOB and AICPA implementation Task Forces on which BDO Seidman participates. Given the complexity of the subject matter and, in our view, the lack of timely specific performance and documentation requirements in the internal controls proposal (see BDO Seidman's November 22, 2003 response to the PCAOB's ED, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*), there will need to be a significant focus in the last quarter of the fiscal year on the newly issued technical requirements of the final internal control audit requirements.

- *Remote Locations*

The proposed standard requires that workpapers from remote locations, including foreign jurisdictions, be assembled in the office issuing the auditor's report. Logistically, we believe that for some audits this will be difficult to achieve due to legal impediments in certain other countries (see comments below regarding workpapers prepared by foreign auditors). We hope that, over time, any legal impediments will be removed; but firms do not have any control over the laws that established these impediments.

Furthermore, we understand that an important motivation for the imposition of this requirement is to facilitate the inspection and enforcement process, which will likely only apply to a small subset of public company audits. However, the costs of compliance, which we believe will be very substantial in some circumstances, will apply to all issuers. In our view, this requirement does not in itself improve the quality of the audit.

- *45-Day Rule*

The proposed standard requires the review and inclusion in the completed audit file of all workpapers, including those prepared by other firms and by those operating in other auditing jurisdictions. It is stated that a complete audit file would ordinarily be finalized within 45 days from the auditor's approval to release the report. This provision requires, at the least, a significant new administrative process to assemble these audit files in the reporting location, and will require firms to develop processes and guidance on how this can be most efficiently and effectively accomplished. If the Board adopts this provision to require all workpapers to be in one location, we



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suggest that it consider initially implementing this rule with a requirement to finalize the audit file within, say, 60 days. The deadline could be modified in the future if supported by the implementation experience and feedback from the inspection process.

* * * *

For the reasons stated above, we strongly urge the Board to defer the effective date of the final standard to years beginning after June 15, 2004 and, in any event, no sooner than for audits beginning 60 days after the final standard is approved by the SEC and published. We do not believe that this recommended deferral will dilute the response to specific corporate and professional issues that led to the Sarbanes-Oxley Act of 2002. We concur with the Board's view that in many areas the proposed standard does not go beyond the recently effective SAS 96 on audit documentation. We also believe that SAS 96 was a substantial advancement in standards that addressed the bulk of the documentation issues that had been identified prior to its release, and those issues noted in the Report of the Panel on Audit Effectiveness. Thus, we strongly urge the Board to consider our suggested deferral dates in this context.

Work Performed by Others

A significant new requirement of the proposed standard is that documentation of the work performed by others be retained by the office issuing the auditor's report. We are aware that there are legal impediments (e.g., the United Kingdom's Data Protection Act) in many foreign countries that will need to be addressed before this requirement can be fully achieved. We do not believe the proposed timeframe for implementation will be sufficient to resolve existing and possible new objections to this requirement on the part of governments and professional associations in other jurisdictions.

We believe that further discussion and better understanding on the part of all parties will enable the PCAOB to accomplish its objectives of quality and consistency in documentation, but that pressing this issue within the proposed timeframe will be counterproductive to the Board's goals and the firms' ability to meet the requirements of the standard. In this regard, we reference the Audit Documentation Comment Letter submitted to the PCAOB by the law firm of Linklaters, London.

Accordingly, we recommend that the Board defer the effective date of the requirement to obtain workpapers of foreign auditors where there are legal impediments, until such impediment issues are satisfactorily resolved by all parties.



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Subsequent Changes to Audit Documentation

Paragraph 15 of the proposed standard states that, 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. We believe that the use of the date of “completion of the engagement” for this purpose (the date of the completion of fieldwork) is inappropriate. We believe that if the Board mandates that file deletions may not be made after a specific date, the date that should be used is the date on which a complete and final set of audit documentation is assembled.

It is customary for many audit administrative and file clean-up procedures to be performed subsequent to the completion of fieldwork. To mandate that no deletions from the file occur during this period and that each addition to the file be accompanied by an explanation of its reason for being added will increase the cost and time necessary to perform this task without an increase in audit quality. Documents retained unnecessarily will need to be clearly and extensively annotated as to why they are superseded or irrelevant; otherwise, the retention of irrelevant or superseded documents may create a confusing record of the audit procedures performed and conclusions reached. Furthermore, the imposition of the “completion of the audit” date as a deadline for discarding irrelevant or superseded documents may have the unintended effect of encouraging the premature or erroneous discarding of documents.

Oral Explanations

Paragraph 2 states that “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” [emphasis added]. While this statement seems to recognize that undocumented (i.e., oral) evidence could provide some degree of support for the auditor’s work, paragraph 6 states that lack of documentation creates a rebuttable presumption that the procedures were not applied, the evidence was not obtained, and the conclusions were not suitably supported. In our view, some weight should be given in the standard to oral explanations since it is not realistic to assume that an auditor can document the entirety of his or her thought process. To document every communication and thought during the audit could result in volumes of documentation (much of which would be inconsequential) and would not give practical recognition to the constant stream of oral interaction between the auditors and the issuer.

One cannot anticipate all engagement issues and problems that may only become evident after the completion of the audit. These situations could require further explanation or amplification of the work performed. We acknowledge the process the Board has outlined to permit the amplification of documentation in a completed audit file. However, in some cases, it will not be possible to anticipate the nature of the inquiries made and it may not be possible to modify the file due to legal constraints. Our view is that oral explanations will often be needed to provide necessary *supplemental* information to the existing documentation, but we support the view that oral explanations



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are not an appropriate substitute for appropriate written documentation of the *principal* procedures performed and the conclusions reached.

ISSUES REQUIRING CLARIFICATION

Auditor Judgment

Both SAS 96 (paragraph 1) and the GAO “yellow book” standard make it clear that auditor judgment is important in determining the extent and form of audit documentation. However, the proposed standard appears to have omitted this concept. We believe it is unreasonable and perhaps impossible to document every aspect and nuance relating to an audit, and that judgment is clearly required in determining the quantity and form of audit documentation. For example, the proposed standard (footnote 2) provides examples of three methods for documenting the testing of items. Judgment is required in selecting an efficient and effective method to document the testing. We believe the final standard should expressly state that the use of judgment is implicit in the documentation process.

Omission of Documentation Guidance in the Proposed Standard

SAS 96 (paragraph 7) provides 6 examples of matters for the auditor to consider when determining the nature and extent of audit documentation. We believe this is helpful guidance and should be included in the Board’s final standard.

Experienced Auditor

The proposed standard states that “audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement...” to understand what work was performed and who performed it (paragraph 5). SAS 96 identifies the documentation focus to be “members of the engagement team with supervision and review responsibilities...” (paragraph 6). We understand the proposed language parallels language previously used in the context of audits performed under GAO auditing requirements. In the context of an auditor experienced in governmental auditing reviewing a governmental engagement, this was not troublesome. However, broadening this to the general public company audit environment without clarification causes us some concern. In this context we believe the term “experienced auditor” should be defined to include characteristics such as (1) a partner-level or concurring reviewer level of audit experience and (2) familiarity with the issuer’s industry.

Audit Programs

A comparison of SAS 96 (paragraph 5) to the proposed standard (paragraph 4) reveals that the proposed standard omits *audit programs* from a list of examples of documentation. In our view, audit programs are important evidence of the performance of effective planning, and serve as a cornerstone in directing the detailed audit



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procedures. They are also the traditional place to document who performed the audit work and when the work was performed. We recommend that audit programs be included as examples of documentation in the final standard.

Specialists

We suggest that the final standard clarify whether the reference to “specialists” in paragraph 6 of the proposed standard is meant to include those specialists hired by management, but whose work then will be used by the auditor. When the specialist is hired by the auditor (e.g., to advise the auditor) or the specialist is a member of the engagement team, we understand the application of this proposed requirement. However, in the case where the issuer hires a third party specialist (e.g., to perform valuation work), the auditor would not be a party to that contractual relationship. In that regard, there are issues such as the ownership and availability of the third party specialist’s workpapers that will need to be resolved.

Work Performed by Others

Paragraph 16 states “[A]lternatively... 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 Section 543, as long as this documentation complies with paragraph 4-12 of this standard.” It is unclear how this requirement differs substantially from that in the previous sentence of the proposed standard, which indicates the auditor should ordinarily retain the original audit documentation or copies of such documentation. If this alternative is intended to be a means of overcoming the impediments to the production of the actual workpapers, it is doubtful whether this is a viable solution. Furthermore, the detailed documentation required to implement this seems to be highly impractical to create.

Documentation of Significant Findings

We agree with the implication of paragraph 10 that the contents of the engagement completion memorandum should be flexible, but suggest that the provision be clarified to indicate that it is acceptable for the significant findings to be cross-referenced from a topical listing in the engagement completion memorandum to the specific supporting memoranda and other audit documentation.

Since the Board has mandated the preparation of this document and that it contain “all significant findings or issues,” we ask the Board to explicitly recognize that in some situations, facts and circumstances subsequent to the engagement can alter perceptions of what should have been considered significant. We suggest the Board clarify that the “all” in the required memorandum reflects the judgment of the engagement team at the time the memorandum was prepared based on then-existing facts and circumstances.



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Confidentiality obligation

Paragraphs 11 and 12 of SAS 96, *Audit Documentation*, specifically recognize the auditor's confidentiality obligation regarding audit documentation:

11. The auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information. Because audit documentation often contains confidential client information, the auditor should adopt reasonable procedures to maintain the confidentiality of that information.

12. The auditor also should adopt reasonable procedures to prevent unauthorized access to the audit documentation.

The proposed standard does not include this concept. We are unsure if such language will be restored in some other section of the PCAOB Auditing Standards literature, but are unaware of any reason to delete this concept from public company standards. We recommend the Board restore this concept in its final documentation standard or appropriately modify other standards to achieve this objective.

* * * * *

We appreciate your consideration of our comments and suggestions, and would be pleased to communicate or meet with the PCAOB and its staff to clarify any of our comments.

Please direct comments to Wayne Kolins, National Director of Assurance, at 212-885-8595 Wkolins@bdo.com or Lynford Graham, National Director of Audit Policy, at 212-885-8551 Lgraham@bdo.com.

Sincerely,

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