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Mr. J. Gordon Seymour
Acting Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 012
Proposed Auditing Standard—Audit Documentation

Dear Mr. Seymour:

We are pleased to comment on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Proposed Auditing Standard - *Audit Documentation* (the "Proposed Standard") and Proposed Amendment to Interim Auditing Standards – *Part of Audit Performed by Other Independent Auditors* ("the Proposed Amendment"), collectively referred to as "the Proposal."

As a preliminary matter, we support the Board's effort to adopt a comprehensive standard consistent with Section 103(a)(2)(A)(i) of the Sarbanes-Oxley Act, which requires that the Board adopt a standard that registered public accounting firms "prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report." We also agree with the Board's general statements in its Release about the significance of the audit documentation standard – namely, that this standard is "one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest." PCAOB Release No. 2003-023 (November 21, 2003) ("Release") at 2.

Indeed, it is because of the importance of this issue that we are providing detailed, paragraph-by-paragraph comments as an attachment to this letter. These comments are made with one clear objective: the standard ultimately adopted by the Board should improve audit quality and help restore public trust in the integrity of the audit process. Our firm, and we believe the accounting profession as a whole, is very focused on these goals. Our ultimate clients – the investing public – depend on the thoroughness and conscientiousness of our work.

Despite our fundamental support for the Board's agenda, we are concerned with several aspects of the Proposal. The Proposal purports only to deal with the narrow question of audit documentation, but its scope is actually much broader, extending beyond what Congress mandated in Section 103 of the Sarbanes-Oxley Act. The Release does not explain why the

Board has taken this approach, what problems the Proposal is intended to address, or whether the Board has considered less far-reaching and expensive alternatives.

In particular, Paragraph 16 of the Proposed Standard would require that non-U.S. audit working papers for audits of U.S. issuers be shipped into the U.S. Further, the Proposed Amendment would amend AU Section 543 to require that auditors at the U.S. firm's office that is signing the audit opinion (*i.e.*, the principal auditor) review the audit documentation of others, including auditors in affiliated firms, who audit a subsidiary, an affiliate or a division of the SEC issuer (unless the principal auditor refers to the other auditor in its auditor's report). While we share the Board's apparent objective of improving the quality of audits on multinational corporations, we do not believe this Proposal is the appropriate means of doing so. In fact, the Proposal could actually undermine audit quality by reducing the relevance of global quality control systems and by limiting issuers' flexibility to engage other auditors with unique industry expertise or service capabilities in particular parts of the world. In addition, the Proposal raises serious conflict of law issues with respect to foreign data protection and other legal restrictions. Moreover, the Proposal would increase audit costs and would be impractical – for instance, a U.S. audit partner cannot be expected meaningfully to review work papers prepared in foreign languages. It also would create unnecessary roadblocks to the SEC's new accelerated filing deadlines.

Paragraph 16 of the Proposed Standard and the Proposed Amendment also seem to conflict with the Board's recent statement, in its Release on Oversight of Non-U.S. Public Accounting Firms, that it "seeks to become partners with its non-U.S. counterparts in the oversight of the audit firms that operate in the global capital markets." PCAOB Release No. 2003-024 (Dec.10, 2003) at 3. Further, the Board has emphasized the need to establish "an efficient and effective cooperative arrangement" with foreign regulators. *Id.* We are committed to doing everything that we can to facilitate such arrangements and to strengthen the development of non-U.S. regulatory bodies so that they can succeed in exercising effective regulation of the accounting profession. We urge the Board to modify its Proposal so that the final standard is consistent with the Board's stated objective.

In addition, we have significant concerns about Paragraph 6 of the Proposed Standard, which would establish a "rebuttable presumption" that failure to document audit work indicates that procedures were not applied, evidence was not obtained, and conclusions reached were not suitably supported. Unlike other paragraphs of the Proposed Standard, which refer to "significant" findings or issues (*see* Paragraphs 9 and 10), Paragraph 6 does not have such a threshold. An auditor makes hundreds of inquiries in the course of performing an audit and, in doing so, continuously evaluates audit evidence and representations of client personnel that affect additional procedures that might be necessary. It would be unnecessary, time-consuming, and potentially counterproductive to require the auditor to make a written record of everything he or she does during the audit, including procedures that are not significant to the overall audit results. In addition, the Release states that it "contemplates" adding to the standard a statement that "oral explanation alone would not constitute persuasive other evidence" to rebut the presumption. Release at 4. This Proposal would make the "presumption" essentially irrebuttable – if there is no written record, then oral explanation would almost always be the only evidence. Accordingly, we strongly recommend against this additional possible amendment.

The Proposed Standard focuses so much on the sufficiency of audit documentation that an unintended consequence could be that the volume and completeness of audit documentation becomes the measure of audit quality, rather than the quality of the procedures, evidence and professional judgments made throughout the audit. The Proposed Standard does not acknowledge the role of the auditor's professional judgment in the determination of the quantity, type, and content of audit documentation. Professional judgment is exercised throughout the audit process, and it certainly should be a consideration in decisions regarding audit documentation. We believe the focus of the PCAOB's audit documentation standard should be to promote performance of high-quality audits through documentation of the significant procedures performed and professional judgments made, and not on the volume of documentation.

With respect to the issues raised by Paragraph 16 and the Proposed Amendment, we do offer alternative proposals that we believe would improve audit quality. For example, the Board might consider requirements for documentation of the supervision and control of the work performed by other affiliated firms that should reside in the office issuing the auditor's report.

Our other comments and suggestions also are set forth in the attachment, and we hope they will be useful to the Board in its consideration of this very important proposal. We note that the Board has only recently begun to inspect registered accounting firms, and is still in the early stages of dealing with the complex legal and practical issues relating to multinational audits. We respectfully submit that the Board should only mandate broad changes in the conduct of such audits when there is a strong factual basis for such changes, and only after trying to resolve conflict of law issues in cooperative arrangements with foreign regulators. We look forward to providing the Board with any assistance we can offer in these areas.

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We would be pleased to discuss any of these issues with the Board or members of its staff.

Respectfully submitted,

Ernst & Young LLP

Attachment

ATTACHMENT TO ERNST & YOUNG COMMENT LETTER

Our paragraph-by-paragraph comments are as follows:

Proposed Standard:

Objectives of Audit Documentation

Paragraph 1—We recommend that the Board clarify that the scope of the Proposed Standard applies only to audit reports of issuers filed with the SEC. PCAOB Rule 3100 generally requires the auditor to adhere to the Board's auditing standards in connection with the preparation or issuance of "any audit report" for an issuer and in their auditing and related attestation practices, which we interpret would not apply to reports of issuers not filed with the SEC (*e.g.*, statutory reports, reports for other regulators, SAS 70 reports, pension reports not filed in Form 11-K).

Paragraph 3—Three of the six examples of the purposes of audit documentation appropriately relate to the needs of auditors in performing the audit. However, the other three examples (d., e., and f.) relate to the needs of others, indicating that audit documentation exists for purposes other than supporting the audit. We are concerned that these examples alter existing interim auditing standards to provide that auditors must prepare audit documentation considering the needs of these third parties, a requirement that could needlessly increase the cost of an audit.

In addition, in the case of examples d. and f., there is a presumption that third parties are entitled to review the audit documentation. This is contrary to existing auditing standards (AU Section 339.10-12), which make clear that audit documentation is the property of the auditor; that the auditor has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information; and that the auditor should adopt reasonable procedures to prevent unauthorized access to the audit documentation. While auditors often grant access to their audit working papers to third parties as a convenience to their clients, there is no requirement that they do so (absent compulsory process such as a court subpoena). In any event, working papers are typically provided to third parties only when the audit client's management so authorizes and only after the third party provides a letter to the auditor stating, among other things, that it understands the audit documentation was not prepared with the needs of the third party in mind, and that in agreeing to provide access to the audit documentation the auditor accepts no professional responsibility to such third party.

Accordingly, we recommend that examples d., e., and f. be deleted from Paragraph 3. If the Board nonetheless determines to keep such examples in the Proposed Standard, we suggest doing so under a different section heading (e.g., *Other Uses of Audit Documentation*) to clearly distinguish this discussion from the performance requirements of the Proposed Standard.

Content of Audit Documentation

Paragraph 4—We recommend that the Board conform the language in the second sentence of Paragraph 4 to include the qualifying phrase found in SEC Rule 2-06(a). Thus, the second sentence of the paragraph would state: "Audit documentation ordinarily consists of memoranda,

correspondence, schedules, and other documents created or obtained in connection with the engagement **that contain conclusions, opinions, analyses, or financial data related to the audit or review**." Absent this additional language, paragraph 4 suggests that the auditor would need to retain all documents created or obtained in connection with the audit, including documents that do not contain "conclusions, opinions, analyses or financial data related to the audit or review."

The Proposed Standard also does not acknowledge the role of the auditor's professional judgment in the determination of the quantity, type, and content of audit documentation. Professional judgment is exercised throughout the audit process, and it certainly should be a consideration in decisions regarding audit documentation. We recommend the PCAOB's final standard include language similar to the language in Paragraph 7 of the interim standard on audit documentation, which states:

"In determining the nature and extent of the documentation for a particular audit area or auditing procedure, the auditor should consider the following factors:

- Risk of material misstatement associated with the assertion, or account or class of transactions
- Extent of judgment involved in performing the work and evaluating the results
- Nature of the auditing procedure
- Significance of the evidence obtained to the assertion being tested
- Nature and extent of exceptions identified
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed"

Paragraph 5—This paragraph requires that audit documentation contain sufficient information to enable "an experienced auditor, having no previous connection with the engagement" to understand the procedures that were performed, conclusions reached, and other important information. As drafted, there is no requirement that such an auditor also have a thorough understanding of the business of the company, the industry in which the company operates, or the audit firm's policies and procedures.

In our view, the "experienced" auditor also should be expected to have recent experience auditing companies in the same industry and sufficient familiarity with the audit firm's audit methodology and electronic tools. In addition, we would expect the "experienced" auditor to have gained a sufficient understanding of the audit client and its operations and systems through discussions with members of the audit engagement team.

We also think it is reasonable to presume that an experienced auditor, having no previous connection with the engagement, would require oral explanations from members of the audit engagement team to facilitate an effective review of the team's written audit documentation. The nature and extent of the audit documentation and conclusions will be influenced by the collective experience of the engagement team members in auditing similar companies and their

overall knowledge of the particular client and its industry. Review of audit documentation and discussions with engagement team members are among the procedures registered accounting firms perform in monitoring compliance with their quality control policies and procedures. While discussions with engagement team members are not a substitute for appropriate audit documentation, an experienced auditor with no previous connection with the engagement (even when he or she is knowledgeable of industry matters) generally will need to discuss the audit documentation with engagement team members to fully understand all of the team's conclusions.

We also are concerned that this paragraph creates an unconditional obligation regarding documentation in that it does not refer only to "significant" matters, unlike Paragraph 9, which refers to "significant findings or issues." The focus of the PCAOB's audit documentation standard should be on the performance of high-quality audits through documentation of the significant procedures performed and professional judgments made, and not on the volume of documentation.

Paragraph 6—We do not support the "rebuttable presumption" that failure to document work performed indicates that procedures were not applied, evidence was not obtained, and the conclusions reached were not suitably supported. This is particularly troublesome because the paragraph does not limit the documentation requirement to "significant" matters, unlike Paragraph 9, which refers to "significant findings or issues." Our concerns are still greater if the Board were to add another sentence to Paragraph 6 as "contemplated" in the Release – that "oral explanation alone would not constitute persuasive other evidence." Release at 4.

We are concerned that implementation of the proposed requirements would inappropriately focus the attention of auditors on the volume and clerical completeness of the audit documentation rather than the quality of the procedures, evidence and professional judgments made throughout the audit. Auditors literally make hundreds of inquiries in the course of performing an audit and, in doing so, continuously evaluate audit evidence and representations of client personnel that affect additional procedures that might need to be performed. The responses to inquiries, or the auditor's impressions of the quality of the audit evidence obtained, may cause the auditor to consider whether certain potential auditing, accounting, or financial reporting issues exist, which in turn might lead the auditor to perform additional procedures. Auditors should document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached during the audit process, as described in paragraph 9. But we are concerned that Paragraph 6 as drafted could be misinterpreted and misapplied, particularly in a hindsight challenge of the auditors' compliance with PCAOB standards.

We assume that it is not the Board's intent to require that the auditor document each and every inquiry or thought process during an audit, but we suggest the Board clarify this point. Such a requirement would be impossible to comply with and would set the auditor up for failure. Moreover, such a requirement would detract from the audit process by, in effect, forcing the auditor to allow documentation considerations drive the selection of procedures. This would result in the development of and reliance on standardized checklists and extremely detailed

forms for all aspects of the audit for fear that to do otherwise would result in insufficient documentation. Auditors currently use checklists to address matters common to all companies (*e.g.*, internal control and fraud consideration checklists, disclosure checklists). However, using a checklist approach in many other aspects of the audit would serve to make the audit too mechanical and would foster a form-over-substance audit approach, which would not facilitate the performance of higher quality audits.

For example, an auditor would typically ask many questions when obtaining an understanding of the flow of a particular type of transaction through the accounting system, and would document the individuals interviewed, documents examined, and the manner in which the transaction is processed based on the inquiries. The specific, question-by-question set of detailed questions would typically not be documented. Likewise, AU Section 316 states that the auditor should make inquiries of others throughout the entity but does not require that the auditor document each inquiry. The auditor is, however, required to document meaningful evidence from those inquiries that should be considered in assessing the risks of material misstatement due to fraud. We recommend that the PCAOB retain this concept of requiring that "significant" issues be recorded and make clear that every specific question or inquiry need not be documented unless it is "significant" to the audit.

In addition, the possible inclusion of a restriction on the use of an "oral explanation" would be a very harsh and unwarranted prohibition. It would essentially make the "rebuttable" presumption altogether "irrebuttable," because oral explanations are almost certainly necessary where the working papers lack a written explanation. This is particularly troublesome because the Board's standard is an auditing standard, so it would be applicable not only in regulatory investigations or inspections but also in private litigation.

Paragraph 7(b) — This paragraph includes the statement that "[audit documentation should] support the basis for the auditor's conclusions concerning every material financial statement assertion." Paragraph 9 of the Proposed Standard requires that the auditor document "significant [audit] findings or issues." We believe the language in paragraph 9 is consistent with the other references to the sufficiency of audit documentation throughout the Proposed Standard and recommend the Board delete the phrase "concerning every material financial statement assertion" from paragraph 7(b).

Paragraph 8—The requirement that the audit documentation for each engagement contain a reference to the central repository regarding matters common to all audit engagements, such as auditor independence and staff training and proficiency, is unnecessary and would not enhance audit quality or audit documentation. The lead audit partner and other audit engagement team executives rely upon the firm's quality control standards and processes to determine that assigned staff have satisfied relevant training and other requirements. This is an essential element of a cohesive accounting firm partnership – the ability of a line audit partner to rely on the firm's common system of quality control. The proposed requirement would shift quality control responsibilities – that is, making sure that audit staff have the correct training, meet independence requirements, and so on – from the national offices to each individual partner.

That is not where such a responsibility should reside. And having a team member make standard, boilerplate cross-references in the engagement working papers to central repositories would not bring a sharper focus on such important quality controls with respect to the specific engagement. Accordingly, we recommend the Board simplify this paragraph and retain only the third sentence, which would require that the audit documentation include matters unique to the particular engagement.

Paragraph 12—We recommend that the Board clarify how "information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's final conclusions" differs from "information or data, relating to a significant matter that is inconsistent with the auditor's final conclusions regarding that matter or the audit or review" as set forth in SEC Rule 2-06(c). Because of the differing language, we are uncertain whether the Proposed Standard imposes a different definition for such information.

We also note a redundancy in that the requirement that the auditor retain documentation of consultations on, and resolution of, differences in professional opinion is addressed in item (d) of Paragraph 9 and is repeated in Paragraph 12.

Retention of and Subsequent Changes to Audit Documentation

Paragraphs 13 and 15—We recommend that the Board refer to the issuer's filing date in these paragraphs for determining the completion of the audit. We note that the SEC, to eliminate confusion about the commencement and completion dates of audit engagements in its "cooling off" rule adopted in 2003 as part of new auditor independence rules, decided to use the date that the issuer files its annual report with the Commission as the end of the audit engagement period. *See* Strengthening the Commission's Requirements Regarding Auditor Independence, 68 Fed. Reg 6006, 6009 (Feb. 5, 2003) (to be codified at 17 C.F.R. pt. 210).

Paragraph 13 establishes the "completion date" of an audit as the date of the auditor's report. Current practice is for the auditor to date the auditor's report as of the date when substantially all fieldwork has been completed. In some situations this date could be several weeks prior to the required filing date of the company's annual report with the SEC and the date when the auditor will need to grant permission to use the auditor's report in connection with the issuance of the company's financial statements. Often there are several necessary but routine auditing activities that take place after the date when fieldwork has been substantially completed but prior to the filing of the financial statements and issuance of the auditor's report. Paragraph 15 requires that the auditor follow the protocols of Paragraph 15 for adding, deleting, or discarding audit documentation after "completion." Accordingly, Paragraph 15, together with paragraph 13, would require that the auditor follow the procedures set forth in Paragraph 15 for any additions or deletions to the audit documentation after completion of the fieldwork (*e.g.*, identifying who made the changes, and explaining the reason for them), which seems unnecessary with respect to routine procedures that are performed during this intervening period. We recommend the Board establish the company's filing date as the completion date for the audit so as not to impose

additional procedural requirements with respect to routine audit procedures performed after the completion of fieldwork but prior to the client's filing of the audit report.

Paragraph 16—Paragraph 16 would require that "[a]udit 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." We submit that this Proposal would result in very significant changes to audits of major U.S. and foreign SEC registrants without a corresponding increase in audit quality. Moreover, certain aspects of the Proposal would be either unworkable or impractical; would add to the cost of the audit with little, if any, benefit to users of the financial statements; and would unreasonably and unjustifiably increase audit firm liability.

We strongly support measures by the Board to enhance the quality of audits and to hold auditors accountable for that quality. The Board's Proposed Standard, however, does not identify the deficiencies in audit quality that Paragraph 16 is intended to address or describe how the requirements of this paragraph otherwise enhance audit quality. It is not known whether the Board's intent is to facilitate its inspections by making all of the working papers of any particular audit available in one office within the U.S.; to improve the quality of audit performance outside the United States; to shift greater responsibility or liability to U.S. firms for work done outside the U.S.; or to achieve some other goal or goals. Before adopting requirements having such great significance, the Board should explain its objectives and why this change in auditing standards is necessary to meet those objectives.

By way of background, we believe it might be useful to review some elements of the approach to audits of multinational corporations by Ernst & Young and other major accounting firms.

Many large U.S. and foreign SEC registrants have worldwide operations and conduct business in dozens of countries. While these companies have highly sophisticated means of transmitting summarized financial information to their corporate headquarters to prepare consolidated financial statements and disclosures, the source documents are not routinely shipped to the company's corporate headquarters. Instead, they are retained at the subsidiary location. In the case of operations in foreign countries, the source documents are typically not written in English or translated into English.

Ernst & Young and other major auditing firms have developed methodologies, processes, and practices to summarize results of audit procedures performed at the various subsidiary locations and to transmit audit findings to the office issuing the auditor's report on the consolidated financial statements. Audit procedures carried out at the subsidiary locations are conducted by local auditors in the local language and, in the case of foreign locations where English is not the primary language, substantial portions of the work is not typically written in English or translated into English. This audit work (whether foreign or domestic) is subject to appropriate levels of review and other quality control procedures at the location where the work is performed, and it provides the basis for the summary audit findings that are transmitted in English to the office issuing the auditor's report.

To promote consistent quality in audits of large U.S. or foreign SEC registrants, the larger auditing firms have formed global networks of auditing firms. Members of these networks generally have adopted common audit methodologies and tools and similar quality control procedures, including quality assurance review programs. In addition, member firms frequently share communication networks, technical materials, and staff development and training programs.

Engagement teams for large U.S. or foreign SEC registrants design and utilize a variety of techniques to promote consistency and quality in each phase of the annual audit. These techniques have been refined over a number of years, principally in response to changes in the client environment and advancements in information technologies. Examples of these techniques include:

Engagement Planning—global planning meetings to establish worldwide audit scope; dissemination of detailed engagement planning instructions, time and resource planning templates, materiality thresholds, information concerning key business risks and significant accounting and auditing matters potentially affecting the company, and communication protocols; site visits by auditors from the headquarters engagement team to discuss and review audit planning documents at different locations; submission of audit planning documents to the headquarters office for review and comment.

Engagement Execution—dissemination of audit programs, electronic working paper templates, visitation by auditors from the headquarters engagement team to review audit programs and to discuss the audit procedures performed and the results of such procedures.

Engagement Results—common reporting packages and other communication protocols, visitation by auditors from the headquarters engagement team to review and discuss audit findings, submission of audit summarization documents (*e.g.*, engagement completion memorandums) to the headquarters office to enable the office issuing the auditor's report to understand and evaluate significant findings and issues at the locations.

To further promote consistency and quality in audits of large U.S. or foreign SEC registrants, the U.S. and other member firms in the global networks have relocated experienced auditors from the U.S. to major offices of their foreign, affiliated audit firms. These individuals are assigned to the audits of major U.S. or foreign SEC registrants, possess in-depth knowledge of U.S. accounting and auditing standards, and, among other things, assist the auditors from the headquarters engagement team in dealing with potential language barriers.

These and other audit techniques and practices employed by the global network provide the headquarters engagement team the ability to leverage the skills of auditors around the world to consistently perform a high-quality audit of a multinational SEC registrant's financial statements.

Rather than adopting the proposed requirements of Paragraph 16 for affiliated firms, we recommend that the PCAOB consider requirements for documentation of the supervision and control of the work performed by other affiliated firms that is to reside in the office issuing the auditor's report. Such requirements could include the scope of the affiliated firm's work deemed necessary in connection with the audit of the entity's consolidated financial statements, circumstances that caused the affiliated firm to depart from the scope of the work outlined by the issuing office, audit adjustments whether recorded or unrecorded, a description of significant accounting and auditing matters and conclusions reached, and a representation that the quality control procedures of the firm were followed. Likewise, we recommend that the PCAOB consider whether changes are needed to the quality control standards to provide better guidance regarding documentation that should be maintained by the U.S. firm pertaining to global issues such as independence and training in U.S. accounting and auditing standards applicable for auditors in affiliated firms who audit a subsidiary, an affiliate or a division of an SEC issuer. We would be pleased to work with the PCAOB in developing these proposals.

We suggest these alternatives because of our serious concerns about Paragraph 16, which are as follows:

1. The proposed requirements of Paragraph 16 do not seem to take into account the global audit coordination and quality-control efforts of the major accounting firms or the nature of multinational audits and, in fact, could make them irrelevant. The office issuing the auditor's report should be able to rely on review and other quality control procedures performed by affiliated firms that subscribe to the quality control policies of a common global network and issue the auditor's report without redundant review.

We believe that requiring redundant reviews generally would not be feasible and would not contribute to improving audit quality. SEC reporting requirements make it necessary to complete the audit shortly after year-end. As a result, significant portions of the annual audit are conducted over a relatively short period of time. Therefore, quality control procedures necessarily must be performed on-site, as the audit procedures are being performed. The relevant quality control procedures (on-site supervision and review by experienced auditors) need to be performed by auditors from the other audit firms with oversight from the headquarters engagement team. It is not practical for the office issuing the auditor's report to subsequently "review in" quality after the audit procedures at the various other locations are performed and the audit documentation is forwarded to the issuing office. This would become even more of an issue as the SEC reporting deadlines are shortened from 75 to 60 days after year-end.

Further, in many situations the senior engagement team members from the office issuing the auditor's report will not be able to read the foreign audit documentation. Having possession of all audit working papers prepared at every location participating in the audit will not enhance quality when much of the documentation is not in English.

2. The proposal would increase audit costs. While it is a common perception that today's audit documentation is electronic, and therefore easily transferred and stored, a significant portion of

the audit documentation is in hard copy form, and will be for the foreseeable future. This is because the evidence gathered generally comes from external sources or from the issuer in hardcopy form. Examples include written confirmations received from third parties, copies of account statements obtained from the issuer's files, signed letters of representation, letters from attorneys, summary pages from computer print-outs, copies of contracts and other legal documents. The auditor often documents the audit procedures performed directly on the hardcopies and the hardcopies become part of the audit documentation.

Accordingly, the proposal would require that huge quantities of documents, many written in languages other than English, be shipped from foreign offices into the United States. Shipping and storage costs by themselves would be significant. In addition, we generally avoid sending original copies of working papers through the mail or delivery services because of the risk of loss or theft, so significant copying expenses also would be incurred. And the process of copying (for which outside copying services might be necessary in some countries), packaging, and shipping working papers would increase the likelihood of lost or misplaced documents.

3. The requirement of Paragraph 16 that audit documentation "must be retained by the office issuing the auditor's report" will raise significant liability issues both for U.S. and the non-U.S. firms irrespective of whether a quality audit was performed. The elimination of a privity requirement in shareholder lawsuits, the acceptance of the fraud on the market theory, and other legal developments in the federal courts have created an environment in which accounting firms are potentially exposed to billions of dollars of liability every time the firm signs an audit opinion on a large publicly traded company. As the Board is aware, the result of these developments is that massive damages claims can be, and routinely are, asserted against the major accounting firms. Even where they lack merit, such lawsuits often cost millions of dollars to defend. While the Board appropriately should adopt rules that further its ability to fulfill its regulatory obligations, we believe that the Board should be hesitant when those measures also would unjustifiably exacerbate private liability exposure.

Among other things, Paragraph 16 would facilitate the assertion of frivolous claims in the U.S. against foreign accounting firms (which typically are organized as separate partnerships from the U.S. firm), as well as against the international umbrella organizations of the major accounting firms, such as Ernst & Young Global. Naturally, our foreign firm affiliates are concerned about any proposal that might sweep them into the U.S. litigation environment – an environment that has no parallel elsewhere in the world. Yet the Paragraph 16 could do precisely that.

4. The proposed requirements raise significant conflict of law concerns. As the PCAOB is aware from comment letters, roundtables, and meetings with foreign regulators, many foreign countries have data privacy, bank secrecy and other laws that would prohibit the disclosure of certain information to the PCAOB and to others. Certain of these legal protections can be waived by the audit client, and, pursuant to Section 102 and 106 of the Sarbanes-Oxley Act, our firm and other large accounting firms are currently in the process of seeking appropriate client consents and waivers. (We note in this regard that we will be filing a comment letter on the Board's proposal with respect to oversight of non-U.S. firms within the next week, and in that letter we will be describing the waivers/consents in some detail.) However, waivers and

consents are not a universal solution – their effectiveness varies from jurisdiction to jurisdiction. Accordingly, even if we are successful in obtaining waivers and consents from relevant non-U.S. accounting firms and audit clients, we still could not comply with the proposed standard – which is very broad with respect to the type of documentation that must be sent to the issuing firm's office – without potentially violating the laws of many foreign countries. The Proposal does not address this issue.

In order to provide the PCAOB with a more detailed discussion of foreign conflict of law issues, the major accounting firms have retained the law firm of Linklaters, headquartered in London, England, to submit a legal memorandum to the Board. Linklaters submitted a similar letter on behalf of the major firms as part of the commenting process on the Board's rule on registration of foreign accounting firms, and we expect that the Board will find their legal analysis helpful. The Linklaters letter describes conflict of law issues stemming from the European Union directive on data privacy. We suggest that, although the law relating to that directive is still developing and its precise effects are not yet known, the Linklaters analysis provides guidance to potential legal impediments.

It is also important to note the apparent inconsistency between the Board's proposed requirements in Paragraph 16 and other current proposals and activities of the Board. The Board has previously acknowledged the foreign conflict of law issue and has sought solutions so that the Board can properly fulfill its statutory mandate with respect to the regulation of both U.S. and foreign accounting firms. Thus, the Board attempted to accommodate foreign legal conflicts by including Rule 2105 in its registration rules. That rule permits a foreign registering firm to obtain a legal opinion describing legal conflicts that exist in its jurisdiction and that thereby preclude the firm from providing certain information that is required by the Board's registration rules. Likewise, the Board has described its efforts to establish a "partnership" and "cooperative relationships" with foreign regulators in order to solve foreign legal conflicts and in order to work together on inspections and investigations of foreign accounting firms. *See* PCAOB Release 2003-024 – Proposed Rules Relating to the Oversight of Non-U.S. Accounting Firms (Dec. 10, 2003).

Paragraph 16 seems to bypass all of these other efforts being made by the Board. It would simply require that all foreign audit working papers be shipped into the United States, where they presumably would be available for inspection or review by the PCAOB, without regard to any foreign law issues. This would be at odds with the PCAOB's other efforts in the international context and would require the registered accounting firms to choose either to risk violating many foreign laws or to violate the PCAOB's auditing standard.

5. The Board's Release does not describe the reasons or rationale for the requirements proposed in Paragraph 16, but it would appear they are intended at least in part to facilitate the Board's inspection and investigative processes. But under Section 102 of the Act and the Board's rules, a registered U.S. accounting firm must obtain agreements from foreign accounting firms that participate in the audit that the firm will cooperate with the Board in an inspection or investigation. In addition, under Section 106(a) of the Act and the Board's rules, foreign firms

that sign reports on issuers, or that play a "substantial role" in the audits of issuers, must themselves register. Finally, Section 106(b) of the Act requires consents for the production of working papers from foreign firms that issue audit opinions or that perform "material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report."

Because of these several, and redundant, statutory provisions, foreign firm audit working papers must be made available to the Board by the foreign accounting firm (consistent, of course, with the foreign conflict of law issues discussed previously). Thus, the Board need not require that working papers be shipped into the U.S. pursuant to an auditing standard to facilitate its inspection and investigation of audits of multinational issuers.

Implementation Date

Paragraph 18—The Proposed Standard would apply to "engagements completed on or after June 15, 2004." Audits of certain engagements that will be completed on or after June 15, 2004 have already commenced, and many engagements will have commenced prior to the time when the PCAOB adopts a final standard that is approved by the SEC. Thus, to the extent the Proposed Standard would change existing audit documentation standards, auditors may not be in compliance with the Proposed Standard. It is not practical to apply these new requirements retroactively. We therefore suggest that the Board make the implementation date of the final standard prospective (*e.g.*, for audits of financial statements for periods beginning on or after June 15, 2004, which would likely provide sufficient time for the Board to issue a final standard and for the SEC to approve the standard).

Proposed Amendment to AU Section 543.12

Along with the proposed changes in audit documentation standards, the Board is proposing to amend AU Section 543.12, which, similar to the proposed requirements set forth in Paragraph 16, would result in very significant changes to audits of major U.S. and foreign SEC registrants and, we submit, would not improve audit quality. We also are concerned that the Proposed Amendment would, in many instances, be unworkable.

AU Section 543.04 describes the situation under which the principal auditor may rely on the work of other auditors without referring to the other auditors in the audit report. It states, "If the principal auditor is able to satisfy himself as to the independence and professional reputation of the other auditor and takes steps he considers appropriate to satisfy himself as to the audit performed by the other auditor, he may be able to express an opinion on the financial statements taken as a whole without making reference in his report to the audit of the other auditor. If the principal auditor decides to take this position, he should not state in his report that part of the audit was made by another auditor because to do so may cause a reader to misinterpret the degree of responsibility being assumed."

Audits of large, multinational SEC registrants generally are conducted by global networks of auditing firms. In these situations, the principal auditor "satisfies himself as to the independence and professional reputation of the other auditor" with the knowledge gained from member firm activities, including sharing common audit methodologies, similar quality control procedures, and other activities described previously in this letter. The principal auditor "takes steps he considers appropriate to satisfy himself as to the audit performed by the other auditor" by considering whether to perform one or more of the procedures described in existing paragraph AU Section 543.12.

We have the following specific comments on this proposal:

1. The Proposed Amendment would require the principal auditor to review the work of the other auditors in all instances, and in more detail, regardless of the principal auditor's satisfaction as to the independence and professional reputation of the other auditors or the nature and extent of the other procedures the principal auditor might choose to perform to satisfy himself as to the audit performed by the other auditors. Reviewing the working papers of the other auditors is one of the considerations currently described in AU Section 543.12; however, it does not require the principal auditor to review the audit documentation of the other auditors "to the same extent and in the same manner [as] the audit work of all those who participated in the engagement is reviewed," which the proposed amendment would require. Auditors generally elect to review the work of the other auditors in such a manner when the work is significant to the overall audit or presents unusual risks, the principal auditor is less familiar with the professional reputation of the other auditors, or the other procedures currently described in AU 543.12 do not provide the necessary evidence. We believe the principal auditor should be permitted to continue to exercise professional judgment in determining the nature and extent of procedures necessary to rely on the work of other auditors.

2. For many of the same reasons discussed above with respect to Paragraph 16, the Proposal would be impractical and unworkable. It does not adequately recognize how large, multinational engagements are conducted or issues relating to increasingly shorter year-end audit periods and considerable language difficulties.

3. The "review" proposal would essentially deny the principal auditor the ability to place any reliance on the quality control procedures of other auditors because it would require the principal auditor to review the audit documentation of the other auditor to the same extent and in the same manner as the audit work of all those who participated in the engagement is reviewed. This would have the effect of subjecting the work of other auditors to quality control procedures of both the principal auditor and the other auditors, resulting in higher audit costs without any corresponding benefit. Where practical, SEC issuers and their principal auditors would likely elect not to engage other auditors to avoid these higher costs. This outcome potentially would weaken audit quality in that it would serve to limit the choices of issuers as to the auditing firms they might engage on a global basis. Issuers frequently engage other auditors to audit segments of their business due to industry expertise or service capabilities in geographic locations. The added cost of requiring the principal auditor to review the audit documentation of the other

auditors to the same extent and in the same manner that the audit work of all those who participated in the engagement is reviewed would have a dampening effect on such arrangements.

We note that the PCAOB might appropriately consider less far-reaching alternatives that could have a positive effect on audit quality and could be implemented without practical difficulty. One possibility is to impose the "review" requirement on situations where the other auditor is not a registered accounting firm subject to inspection by the PCAOB, or is not an affiliated firm that subscribes to the quality control policies of a common global network.