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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

January 12, 2004

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Subject: *PCAOB Rulemaking Docket Matter No.012—Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards*

This letter provides the U.S. General Accounting Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) November 21, 2003, proposed standard on audit documentation and the proposed amendment to the interim auditing standards dealing with cases where part of an audit is performed by other independent auditors.

We commend the PCAOB for giving these important issues priority. Overall, we support the proposed standard. We are especially pleased that the proposed standard adopts the substance of the audit documentation standard from *Government Auditing Standards*, which requires that "audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions."¹ Given PCAOB's responsibility for conducting inspections of registered public accounting firms, we believe the adoption of such a documentation standard is appropriate and necessary. We also support the PCAOB's "rebuttable presumption" standard, which states that the failure to document procedures performed, evidence obtained, and conclusions reached creates a presumption (rebuttable with persuasive evidence) that the procedures were not applied, the evidence was not obtained, and conclusions reached were not suitably supported.

GAO believes that any new standards on audit documentation should balance the desire to improve audit quality and value against the danger of becoming overly prescriptive, while adhering to the primary objective of audit documentation, which is providing sufficient, competent evidence to support the opinions in the auditor's report. Audit documentation is an essential element of audit quality.

Enclosure 1 contains GAO's comments on the following provisions of PCAOB's Proposed Auditing Standard on audit documentation:

¹ *Government Auditing Standards* (GAO-03-673G, June 2003), paragraph 4.22.

- Dating audit documentation
- Reference to documentation stored in a central repository
- Documentation of significant findings or issues
- Documentation of significant audit adjustments
- Requirement to prepare engagement completion memo
- Requirement to identify items tested
- Retention of audit documentation
- Open-ended retention requirement
- Implementation date

GAO's comments on the PCAOB's Proposed Amendment to Interim Auditing Standards on dealing with cases in which part of an audit is performed by other independent auditors are contained in Enclosure 2.

We thank you for considering our comments on this very important issue.

Sincerely yours,

A handwritten signature in black ink, appearing to read "D M Walker", followed by a horizontal line extending to the right.

David M. Walker
Comptroller General
of the United States

Enclosures

cc: The Honorable William H. Donaldson, Chairman
Securities and Exchange Commission

The Honorable William J. McDonough, Chairman
Public Company Accounting Oversight Board

GAO's Comments on the Proposed Auditing Standard on Audit Documentation

Dating audit documentation (paragraph 5.b.)

GAO believes that the requirements in paragraph 5.b. of the proposed standard for preparers and reviewers to date **all** audit documentation would be difficult to implement due to the continuous, ongoing nature of audit procedures. We believe that audit documentation should indicate who performed the work as well as the name of the person who reviewed the work. On the other hand, dating the documentation is more problematic because of the difficulty of determining when a working paper is actually completed and when a review is actually finished. We believe it is important to have preparation and review dates for **key** documentation, such as the audit completion checklist and the report or product clearance document, which demonstrate that the auditor's report is supported and reviewed. However, any requirement for dating other working papers should be left up to the individual audit organization.

Reference to documentation stored in a central repository (paragraph 8)

We recommend deleting from paragraph 8 the requirement for audit documentation to specifically refer to the central repository when applicable engagement information, such as independence and training records, is stored there. We believe that the best way to handle this situation is by looking to the firm's policies and procedures rather than requiring references in each engagement file.

Documentation of significant findings or issues (paragraph 9)

Paragraph 9 of the proposed standard includes types of significant findings that auditors must document. We recommend adding to this list all material weaknesses, significant deficiencies, fraud, illegal acts, and significant instances of noncompliance with applicable rules and regulations. We would also add to this list identification and resolution of potential finding in audits of internal control over financial reporting.

Documentation of significant audit adjustments (paragraph 9.c.)

We recommend clarifying paragraph 9.c. with the following changes:

Significant findings or issues include, but are not limited to, the following . . . **proposed and actual** 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 on the company's financial **statements 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.

GAO's Comments on the Proposed Auditing Standard on Audit DocumentationRequirement to prepare engagement completion memo (paragraph 10)

Paragraph 10 of the proposed standard would require an engagement completion memo for all engagements. Instead, we recommend requiring important information to be included in a format and location that will assure review by the principal auditor who will sign the audit report. The key concern is to assure that the report signer is informed of significant findings and issues. The format and location of the information within the audit documentation are details that can be handled by firm policies and procedures.

Requirement to identify items tested (paragraph 11)

We recommend clarifying the wording of footnote 2 to indicate that the auditor is not required to make copies of all documents examined. Without clarification, the wording of paragraph 11 and footnote 2 could lead auditors to believe that this type of detailed documentation is needed as identification of items tested.

Retention of audit documentation (paragraph 13)

We recommend adding to paragraph 13 of the proposed standard a requirement for documentation to be stored in retrievable form. This is especially important in light of the new 7-year retention requirement and the evolving nature of audit software, and could also be relevant in situations where part of the audit work was performed at different offices of the audit organization or by other auditors.

Open-ended retention requirement (paragraph 17)

We recommend revising paragraph 17 of the proposed standard in order to clarify the Board's intent in this paragraph. The transcript of the PCAOB's September 29, 2003, Audit Documentation Roundtable indicates that retention requirements for other audit-related documentation have caused significant confusion. Footnote 4 to paragraph 17 provides guidance on what constitutes audit-related documentation; however, the reason for including this paragraph in the standard is unclear.

Implementation date (paragraph 18)

We believe that the provisions of paragraph 18 of the proposed standard, which would apply it to engagements completed on or after June 15, 2004, would be difficult for audit organizations to implement because it would affect engagements that are already underway. We recommend that the PCAOB adopt an implementation date for engagements beginning on or after June 15, 2004, or the date that the final standard is issued, whichever is earlier.

GAO's Comments on the Proposed Amendment to Interim Auditing Standards on Part of an Audit Performed by Other Independent Auditors

We believe that confusion could result from the requirement in the proposed standard that “sufficient documentation of the work performed by the other auditor should be incorporated in the audit documentation of the principal auditor to meet all the requirements of PCAOB Auditing and Related Professional Practice Standards No. X, **as if the principal auditor had performed the work himself or herself**” [our emphasis added]. We are unsure of what this requirement means in that it is not specific enough and could cause firms to go to varying lengths in trying to adhere to it. This could result in burden and unintended consequences if firms go too far. We believe that the guidance provided in the GAO/PCIE *Financial Audit Manual* (FAM)² provides balanced and specific guidance for handling reviews of other auditors' work.

The FAM includes guidelines for the principal auditor's review of other auditors' documentation and uses a risk-based approach in which the principal auditor would consider the independence and qualifications of the other auditors as well as audit risk and materiality in determining the extent of the review. The FAM also provides guidelines for documenting the principal auditor's review when the principal auditor does not make reference to the work of the other auditors. After the principal auditor has completed reviewing the other auditors' work, the FAM requires the principal auditor to determine whether their work is sufficient and acceptable for the principal auditor's use and to document this determination in the audit file. We recommend that, in order to improve the quality of audit documentation and auditor practice in these situations, the PCAOB should adopt requirements similar to those in the FAM.

The FAM also notes the importance of distinguishing between the principal auditor's responsibilities to review the documentation of other auditors versus the principal auditor's responsibilities to document the procedures performed and the results of the review of other auditors' documentation. The FAM cautions the principal auditor to use judgment in deciding which of the other auditors' documents to copy and retain, and notes that copies of documents readily available from the other auditors or the auditee (such as invoices and contracts) need not be retained.

²General Accounting Office / President's Council on Integrity & Efficiency, *Financial Audit Manual* (GAO-03-466G, April 2003), pages 650-18 to 650 A-3.