

May 2, 2008

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 025

Dear Mr. Scates, Ms. Campbell, PCAOB Board Members and Staff:

Thank you for the opportunity to comment on the Board's Proposed Auditing Standard, "Engagement Quality Review." On balance, I think this is an excellent proposed standard. I will briefly highlight what I view as the strengths of the proposal, and make a few limited suggestions as to how the proposed standard might be improved.

The proposed standard has three noteworthy features. First, the proposed standard requires that an engagement quality review be performed on all engagements performed under the standards of the PCAOB. Currently, engagement quality reviews are only performed for audits performed by SECPS member firms as of 2003. In addition to requiring engagement quality reviews for audits performed by registered firms that were not members of the SECPS (presumably a limited number), the proposed standard would require that an engagement quality review be performed for all auditor reviews of quarterly information filed on a Form 10-Q. The academic literature documents that quarterly information is relevant to the capital markets and that quarterly financial information is generally less reliable. Therefore, efforts by the Board to increase the quality of quarterly reviews performed by auditors will benefit the investing public. Requiring an engagement quality review on quarterly reviews performed by the auditor should increase the quality of this work. Second, the proposed standard is informed by PCAOB inspection findings and by recent PCAOB enforcement cases. Unlike other standard setters, the PCAOB can tailor standards to address deficiencies identified during inspections and enforcement cases. Third, prohibiting the firm from issuing the report until the engagement quality reviewer gives his or her concurrence provides the quality reviewer with leverage if he or she disagrees with the engagement partner.

I believe that the proposed standard could be improved in three ways. First, I believe the proposed standard should state an overall objective for the engagement quality review. In

my view, the overall objective of the proposed standard should be, “The engagement quality reviewer is to perform the review to evaluate whether the engagement has been planned and performed to provide reasonable assurance that material misstatements will be detected, whether caused by error or fraud.”<sup>1</sup> This is what financial statement users care about. Second, the firm should be required to document its conclusion as to why the quality reviewer has the qualifications needed “... to serve as the person who has overall responsibility for the same type of engagement.” This is particularly important where someone other than another partner from the firm performs the review (e.g., a non-partner employee of the firm, a partner from another registered firm, an outside consultant, etc.). Moreover, to continue to build important feedback loops between different PCAOB divisions, the firm’s evaluation of the qualifications of the engagement quality reviewer should be carefully evaluated by the PCAOB’s inspection staff, especially in the early years that this standard is effective. Third, the engagement quality reviewer (to the extent practicable) should not be included in the same office-level profit pool as the engagement partner. For example, if Firm ABC audits Company XYZ out of the Atlanta office and if Firm ABC partially compensates partners based on local-office profitability, the engagement partner should not be from the Atlanta office.<sup>2</sup>

In my view, the proposed standard, Engagement Quality Review, has the potential to improve audit practice. I encourage the Board to move expeditiously to approve it.

Sincerely,

Joseph V. Carcello  
Ernst & Young Professor  
Director of Research – Corporate Governance Center

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<sup>1</sup> This proposed objective applies to engagement quality reviews of audit engagements. Appropriately-modified language could be developed for engagement reviews of quarterly auditor reviews and attest engagements.

<sup>2</sup> This recommendation obviously would not apply to single-office firms, but it may be efficacious for audits performed by the largest six firms and these firms audit companies comprise the overwhelming majority of U.S. stock market capitalization.