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

PCAOB Rule Making Docket Matter No. 025 – Engagement Quality
Reviews

Dear Sirs:

The purpose of this letter is to expand upon the comments I and others made at the Standing Advisory Group (SAG) meeting of April 2, 2009 on the subject of Engagement Quality Reviews (EQR), and in doing so to express the views of Xerox Corporation on this subject. Xerox Corporation is a multinational technology and document services organization with operations in over 130 countries. Our audit fees, exclusive of non-recurring items and non audit services, have approximated \$20 million in recent years. Xerox is a calendar year reporting entity and in recent years we have traditionally been a very early filer of our interim and annual reports on Forms 10-Q and 10-K respectively. For example, our 2008 Form 10-K was filed on February 13, 2009 – 43 days after year end and 17 days earlier than required. Accordingly, any regulatory rule making proposal that potentially affects the aggregate cost of audit services and/or the timing of the completion of interim and annual audit procedures is of interest to us.

Before I provide detailed comments in several areas, let me begin by commending the PCAOB (the "Board), the Chief Auditor and staff for the improvements made to the original EQR proposal issued on February 26, 2008. The current EQR proposal dated March 4, 2009 in general represents a very readable and operational document and clearly demonstrates professional responsiveness to the issues raised during the comment letter process associated with the original EQR proposal.

My specific comments on scope, concurring review and documentation follow and in general build upon discussions at the April SAG meeting.

Scope

With one exception, I concur with limiting the scope of EQRs to regular interim reviews and annual audits. Most other types of audit and audit related engagements either: do not rise to same level of importance as audits or interim reviews; are not by their nature intended to directly benefit or be relied upon current or future shareholders; or due to the time is of the essence nature of certain services (such as a long form M&A due diligence report) it is not normally practical to involve a concurring review partner. The one exception – the one that I raised at the SAG meeting – is for the Board to consider including SAS 70 engagements, in particular SAS 70 Type 2 engagements, on internal controls for service providers, within the scope of the final standard. For many corporations today, large portions of transaction processing and record keeping are outsourced and off-shored. A large multinational company may receive a score or more of SAS 70 Type 2 reports each year. These reports are critical to the receiving company and its auditors particularly with respect to the annual audit of internal controls. If these functions were kept in house the audit procedures necessary to attest to the internal controls and resultant balances would clearly be subject to an EQR. The fact that these functions are no longer under the direct control of a company does not relieve the company (or its auditors) from responsibility in the event that an error therein results in a material error in the consolidated financial statements.

Accordingly, I recommend that if the engagement to be performed is to prepare a SAS 70 Type 2 report that the underlying engagement also be included within the scope of any final EQR standard.

Concurring Approval

My comments in this section relate to the interaction of the phrases 'due professional care' and 'knows or should have known'. The Board is to be commended for addressing the concerns raised by commentators in response to the original EQR proposal by removing the phrase 'knows or should have known' from the revised EQR Exposure Draft. You will recall, however, at the April SAG meeting much discussion centered around the observation that the covering Release to the Exposure Draft left intact the phrase 'knows or should have known' in the explanatory sections of the document. The Release went on to state such phrase essentially imposes the same requirements as the long standing requirement for an auditor to exercise 'due professional care'. The purpose of this comment letter is not to express a view as to whether or not these phrases are synonymous. It appears to this SAG member that the room was extremely divided on the subject in that the Board and staff believed the phrases were essentially equal in meaning whereas most, if not all, of the

accounting firms present believed they meant very different things. I have two specific comments.

- First, the needs of both proponents and opponents can be achieved by using only the phrase ‘due professional care’ in any document (the final Standard, covering Release, etc.) plus related follow on communications such as staff speeches. If the phrases in fact mean the same thing then there is no need for the redundancy. Conversely if they do in fact mean different things then limiting the final Release and Standard to referencing only ‘due professional care’ will clearly address the concerns arising from the original EQR proposal.
- Second, as I observed at the meeting it is important to keep in mind that while an official accounting or auditing standard may be the literal requirement(s) it is frequently the collateral materials that are critical – whether it be the ‘Basis for Conclusions’ or “Background Information’ in FASB pronouncements or in the covering PCAOB and SEC Releases for new regulatory requirements – to an understanding of what the authors believe the issues to be, what problems were trying to be solved, how the interpretation of the requirements will likely evolve, etc. Consequently, I can understand why the SAG members from the public accounting firms are concerned about leaving the phrase ‘knows or should have known’ in the covering Release and I recommend it be removed from the entirety of any final documents on EQR requirements.

Should the Board conclude the final Standard (or covering Release and related documents, etc.) needs to include the phrase ‘knows or should have known’, I recommend the context be clarified to the effect that: “...knows or should have known is intended by the Board to apply only to *matters brought by the engagement team to the attention of the engagement quality reviewer or in response to inquires of the engagement team by the engagement quality reviewer...*” (emphasis added). I believe phraseology to this effect will address the concern that ‘knows or should have known’ is not intended to be a second audit.

Documentation

At the SAG meeting there was considerable discussion about the documentation requirements of an EQR with most of it centered on paragraph 19.c of the Exposure Draft. After reflection it does appear that the requirements of paragraph 19.c will frequently be excessive of what is necessary in the normal circumstance. Accordingly I recommend the Board and staff re-visit this section prior to finalizing the EQR requirements – particularly with respect to the requirement to document ‘each discussion’ – and consider if there is a way the documentation burden can be reduced. Since the purpose of an EQR is to improve an

audit I believe it should be left to the judgment of the engagement team and the engagement quality reviewer to determine the extent to which documentation is needed with respect to the items considered by the reviewer. Obviously some form of EQR documentation is critical. Whether it is in the form of a discrete package of potentially extensive material prepared by the reviewer or, alternatively, it is prepared by the engagement team and distributed throughout the engagement's overall documentation is not critical. The important objective is for a high quality EQR to enhance the overall audit performance and the documentation requirements should be drafted consistent with this objective.

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In summary, I believe the current Exposure Draft represents a significant improvement over the original proposal of February 2008 and reflects a serious effort by the Board and staff to address constituent concerns arising from the comment letter process. Before the EQR Standard is finalized, I recommend: (1) the Board deliberate the inclusion of SAS 70 Type 2 engagements within the scope of services subject to the standard; (2) the phrase 'knows or should have known' be removed from any covering Release or related communications distributing the new EQR Standard (which presumably will continue to omit such language as well) and (3) the Board reconsider the documentation requirements of paragraph 19.c which a number of SAG members observed appeared to be excessive in normal situations.

Please do not hesitate to contact me at 203-849-2630 if you have any questions or comments about the contents of this letter.

Yours very truly,



Gary R. Kabureck