

Office of the Secretary
PCAOB
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USA

By E-mail: comments@pcaobus.org

May 12, 2008

Dear Sir(s):

**Re.: PCAOB Rulemaking Docket Matter No. 025
PCAOB Release No. 2008-002
Proposed Auditing Standard – Engagement Quality Review and
Conforming Amendment to the Board’s Interim Quality Control
Standards**

The Institut der Wirtschaftsprüfer in Deutschland [Institute of Public Auditors in Germany], the professional organization representing public auditors in Germany, appreciates the opportunity to comment on the above-mentioned Proposed Auditing Standard – Engagement Quality Review and Conforming Amendment to the Board’s Interim Quality Control Standards (hereinafter referred to as the “proposed PCAOB auditing standard” or “proposed standard”).

We share the Board’s view that well-performed engagement quality control reviews are an important element in establishing a basis for investor reliance on audits and agree with the aims of the proposed PCAOB auditing standard. Subject to the issues raised below, we support the content of the proposed standard. We discuss our major concerns in detail below. In the Appendix to this letter, we respond to the questions posed by the Board and comment on the proposed effective date.

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Major concerns

The extent of engagement quality review procedures

We support the Board's statement on page 16 of the Release that the engagement quality reviewer's role is not to perform procedures amounting to a re-audit. We are, however, concerned that, contrary to this statement, certain requirements in paragraphs 8 and 9 of the proposed standard appear to require the engagement quality reviewer obtain an understanding of certain matters or knowledge, respectively, disproportionate to an engagement quality review. In this context, we refer to the Appendix to this letter in which we explain our concerns in relation to paragraphs 8 and 9 in more detail.

The source of an engagement quality reviewer's knowledge

In view of our comments relating to the extent of certain procedures required by paragraphs 8 and 9, we are concerned that the wording of the phrase "knows, or should know based on the requirements of this standard" in paragraph 12 may not be sufficiently clear. An engagement quality reviewer ought only be expected to know what he or she would reasonably be able to know as a result of having complied with the requirements of the proposed PCAOB auditing standard. It would be unreasonable and inappropriate for knowledge based on information gained with hindsight for example, to be included in this expectation. We therefore believe it is essential that the wording of paragraph 12 be unambiguous and also that each of the requirements of the proposed standard be worded such that they are not capable of misinterpretation.

We refer to the Appendix to this letter, in which we explain our concerns in respect of paragraph 12 in more detail.

Respective Authorities

The proposed standard does not clarify the respective responsibilities of the engagement partner and the engagement quality reviewer, nor does it stipulate how conflicting views between the engagement quality reviewer and the engagement partner are to be dealt with such that the firm will be in a position to grant permission to the client to use the engagement report.

According to our reading of paragraph 13, the engagement quality reviewer would assume a level of authority sufficient to block that of the engagement partner, because he or she can bind the firm by effectively vetoing the issuance

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of an engagement report. We are concerned that, given the different depth of knowledge that an engagement partner and an engagement quality reviewer can be expected to obtain, respectively in relation to the same engagement, it is not appropriate for the proposed standard to require the latter be able to block the engagement partner's authority without stipulating how such conflicts are to be resolved. The respective roles of an engagement quality reviewer and an engagement partner need to be clarified, such that the engagement partner's responsibility for the engagement is not diminished by the fact that an engagement quality review is performed.

In the Appendix to this letter we respond to question no. 9, further recommending that firms be required to establish procedures or measures to resolve any differences of opinion that may arise between the engagement partner and the engagement quality reviewer before a firm can issue an engagement report.

We would be very pleased to be of further assistance if you have any questions or comments about the content of our letter.

Yours truly,



Klaus-Peter Feld
Executive Director



Ulrich Schneiß
Director, Auditing

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Enclosed: Appendix

APPENDIX

Specific questions raised by the PCAOB in PCAOB Release No. 2008-002:

1. The proposed standard does not explicitly state an overall objective of an engagement quality review. Should this standard state such an objective? If so, what should be included in the objective?

We encourage the PCAOB to format its standards in a manner similar to that currently being adopted by the IAASB and the AICPA. Objectives are generally useful in focusing the public's expectation of what an auditor aims to achieve.

2. Should the engagement quality review be required for all engagements performed in accordance with the standards of the PCAOB? If not, when should an engagement quality review be required?

Whilst the IAASB's equivalent standards require an engagement quality control review for audit engagements of listed entities, it is for the firm however, to establish a policy for determining which engagements other than audits of the financial statements of listed entities are to be subject to a quality control review. Criteria to consider when determining which engagements other than audits of financial statements of listed entities are to be subject to an engagement quality control review include, for example the nature of the engagement, including the extent to which it involves a matter of public interest or the identification of unusual circumstances or risks in an engagement or class of engagements. We suggest the PCAOB adopt a similar approach for engagements performed in accordance with PCAOB standards.

3. Are the qualifications of an engagement quality reviewer appropriately described in the proposed standard? If not, how should they be revised?

We support the proposal that suitably qualified persons both not necessarily at partner level and also external to the firm may perform engagement quality reviews. This allows more flexibility than current PCAOB's interim requirements, and is likely to be particularly helpful to smaller foreign registered firms seeking suitable engagement quality reviewers.

However, we note that the levels of knowledge and competence that an engagement quality reviewer must possess according to the proposed standard

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are more stringent than those stipulated in the PCAOB's interim requirements and by the IAASB in its counterpart standards¹. The proposals require the experience of the quality control reviewer to be sufficient to enable him or her to serve as engagement partner in the specialized industry (we refer to page 9 of the Release). This may be problematical for foreign audit firms, and in particular smaller firms, where the "pool" of potential engagement quality reviewers may be limited.

4. *Should the proposed standard allow the engagement team to consult with the engagement quality reviewer during the engagement? Would such consultation impair the reviewer's objectivity?*

We agree that consultation may certainly be useful at an early stage in the audit in some cases.

We support the proposal for consultation to be allowed, but at the same time, not so as to impair the engagement quality reviewer's objectivity. Nevertheless ultimate responsibility for the engagement should remain with the engagement partner.

5. *Are the descriptions of the scope and extent of engagement quality review procedures contained in the proposed standard appropriate? If not, how should they be changed?*

In our letter above, we have expressed concerns relating to specific paragraphs in the proposed standard. We comment further on these paragraphs as follows:

Paragraph 8:

As currently worded, subsections a and b of paragraph 8 requiring the engagement quality reviewer to "obtain an understanding of the firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process" and to "obtain an understanding of the company's business, significant activities during the current year, and significant financial reporting issues and risks", respectively may be interpreted to mean that the engagement quality reviewer should obtain the required under-

¹ [Proposed] ISQC 1 (Redrafted) paragraph A42 states that for an audit of a listed entity the engagement quality control reviewer "... would be an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities."

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standings, essentially by repeating engagement procedures independently. We appreciate that the Board does not intend this to be the case, and therefore suggest the standard clarify that the procedures required do not extend beyond a review of the engagement documentation supplemented by discussions with the engagement partner and, as necessary, other engagement team members.

Similarly, paragraph 8f needs to clarify that the difficult or contentious matters referred to therein means only those significant difficult or contentious matters identified by the engagement team rather than implying any “new” matters are to be identified by the engagement quality reviewer.

We note that other procedures in paragraph 8 make specific or implied reference to the engagement team’s or the firm’s findings or actions, but this is not clearly the case in respect of sections a, b and f.

Paragraph 9:

In our view the requirement of paragraph 9 is likewise unclear. Paragraph 9 requires the engagement quality reviewer “based on the procedures performed in accordance with paragraphs 7 and 8, **and other relevant knowledge** possessed by the engagement quality reviewer” to “assess whether there are areas within the engagement that pose a higher risk that the engagement team has failed to obtain sufficient competent evidence or reached an inappropriate conclusion”. We interpret the phrase “other relevant knowledge” to mean that knowledge the engagement quality reviewer is required to possess in accordance with paragraph 4 of the proposed standard, rather than inferring a requirement for the engagement quality reviewer to obtain further relevant information to supplement that obtained by the engagement team. It would be helpful if the PCAOB were to clarify this in the text of the proposed standard, for example, along the lines of the following text currently specified in the interim requirements: “The concurring partner reviewer is not responsible for searching for additional matters to be considered by the engagement team. However, significant matters not previously identified by the engagement team that come to the concurring partner reviewer’s attention should be referred to and resolved by the engagement team with the concurrence of the concurring partner reviewer.”

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Paragraph 12:

We would like to suggest that the requirement of paragraph 12 be reworded to clarify that the phrase “knows or should know” contained therein is to be understood only in the context of the engagement quality reviewer having complied with the requirements of the proposed PCAOB auditing standard, i.e., excluding any additional facts or matters that become known with hindsight. Furthermore, performing all the procedures required by the proposed standard can give reasonable but not absolute assurance that the engagement quality reviewer will know everything that could become known in so doing. This also needs to be reflected, along the lines of “... he or she knows, or should reasonably be expected to know, that...”.

We comment further on the issue of final approval by the engagement quality reviewer prior to issuance of an engagement report in our response to question 9 below, because we believe paragraph 12 needs further amendment in this respect.

Finally, we also note that the requirement states that the “...engagement quality control review *must not* provide concurring approval ...”. We would like to point out that, logically and grammatically speaking, the negation of “must” in this case does not mean that the engagement quality control reviewer is prohibited from providing concurring approval, but that the engagement quality control review is not required to provide concurring approval. We believe that this is not what the PCAOB had in mind. For this reason, the words “must not provide” should be replaced with “may not provide” or “is prohibited from providing”.

6. Is the risk-based approach to the engagement quality review described by the proposed standard sufficient to identify significant engagement problems? If not, how should the proposed standard be changed?

We refer to the detailed comments explaining our major concerns in the accompanying letter as well as the comments relating to paragraphs 8 and 9 above. We do not believe that all the procedures of paragraph 8 sufficiently reflect a risk-based approach.

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7. Are the proposed requirements for the review of the engagement team's documentation appropriate? If not, how should they be changed?

We support a risk-based approach whereby the review of the engagement team's documentation does not extend beyond documentation of the matters subject to engagement quality review procedures.

Nevertheless, we believe that the requirements of paragraph 10a may not be practicable as regards the envisaged evaluation of consistency with the requirements of PCAOB AS-3. An engagement quality reviewer who only reviews selected parts of the engagement team's documentation may not be in a position to confirm that these parts are consistent with all the requirements of AS-3. For example, paragraph 5 of AS-3 requires in subsection a, that audit documentation "demonstrate that the engagement complied with the standards of the PCAOB"; unless a review of the complete documentation were performed this cannot be ascertained fully. In addition, unless the engagement quality reviewer were to re-audit, the engagement quality reviewer would potentially be unable to ascertain when the engagement team's documentation is incomplete. In such cases, evaluation of whether engagement documentation complies with paragraph 12 of AS-3 would likewise not be practicable.

8. Is the description of the timing of the engagement quality review, as proposed, appropriate? If not, how should it be changed?

In our opinion the flexibility as to timing of the engagement quality review envisaged in the proposed standard is appropriate.

We note the Board's belief (we refer to page 15 of the Release) that an engagement quality review "could be more effective if the review is performed shortly after the engagement team's resolution of significant issues", however, this may not be the case in all engagement circumstances. We would like to suggest the Board also recognize that in some engagements, particularly less complex or smaller companies, an engagement quality review performed towards the end of the engagement, as opposed to throughout that engagement, may also be effective.

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9. Is the standard for the engagement quality reviewer's concurring approval of issuance appropriate? If not, how should it be changed?

In the attached letter, we have expressed concerns as to the respective authority of the engagement partner and the engagement quality reviewer, and also suggested the PCAOB introduce a requirement for firms to establish procedures to resolve any differences of opinion that may arise:

We note that the current interim requirements address both issues as follows:

Organizational Structure and Functions of the SEC Practice 1027 Section.39, APPENDIX E - Concurring Partner Review Requirement states: "The concurring partner reviewer's responsibility is not the equivalent of the audit engagement partner's responsibilities. Without first-hand knowledge of the client's business environment, the benefit of discussions with management and other client personnel, the opportunity to review client documents or controls, or the ability to observe the client's actions or attitudes, a concurring partner reviewer generally is not in a position to make the informed judgments on significant issues expected of an audit engagement partner." and "If the concurring partner reviewer and the audit engagement partner of the engagement have conflicting views regarding important matters, the disagreement should be resolved in accordance with applicable firm policy."

The international auditing standard ISA 220 also contains similar requirements and also requires the engagement partner not date the auditor's report until the completion of the engagement quality control review, thus clarifying that the engagement partner retains responsibility for the engagement:

[Proposed] ISA 220 (Redrafted), paragraphs 23 "The engagement partner shall remain responsible for the audit engagement and its performance, notwithstanding involvement of the engagement quality control reviewer." and 24 "Where differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's procedures for dealing with and resolving differences of opinion."

In our opinion, similar requirements and statements need to be included in the proposed standard, such that the respective roles of engagement quality reviewer and engagement partner are clarified. It is important that the engage-

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ment partner retains full responsibility for the engagement and in no way relies on an engagement quality review as a safety net or corrective measure.

10. Are the documentation requirements for an engagement quality review appropriate? If not, how should they be changed?

In our opinion, the documentation requirements are reasonable.

12. Should the proposed standard require documentation of the engagement quality review to comply with other provisions contained in AS No. 3? If so, which provisions should be applicable?

No. We have not identified any further provisions that would be applicable.

The Board requests comment on the proposed effective date.

In our opinion, the proposed effective date is not appropriate, since until the SEC has given its approval to the proposed standard many engagements for which a report will be issued on or after December 15, 2008 may have advanced beyond their initial planning stages. Involvement of an engagement quality reviewer in accordance with the final version of this proposed standard at an early stage will no longer be possible. This is a particular problem for those firms not previously subject to the interim requirements or for which changes from those requirements may require adaptation of their previous practices.

In our opinion, a more reasonable approach would be to state that the auditing standard is applicable for fiscal years beginning on or after December 15, 2008.