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**COMMENT LETTER**

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

Date  
9 May, 2008

By email - comments@pcaobus.org

Dear Sirs,

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

We are pleased to have this opportunity to comment on the PCAOB’s proposed auditing standard, *Engagement Quality Review and Conforming Amendment to the Board’s Interim Quality Control Standards* (the Proposed Standard) on behalf of BDO International.<sup>1</sup>

We support the PCAOB’s efforts to strengthen the quality of the existing second partner review process. Such a process, when soundly implemented, provides an effective mechanism to enhance the quality of the audit and the consequent reliability of financial reporting. In that regard, we believe that the process would be further strengthened on a consistent global basis through convergence with the standards proposed by the International Accounting and Assurance Standards Board (“IAASB”) in this area, such as the Proposed Redrafted International Standard on Auditing (“ISA”) 220, *Quality Control for an Audit of Financial Statements*, and the Proposed Redrafted International Standard on Quality Control (“ISQC”) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*.

Our responses to the specific questions posed in the Release are set forth below. They are intended to promote greater clarity of the final standard.

**A. Engagements for Which an Engagement Quality Review is Required**

- 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 believe that the Proposed Standard would benefit from an explicitly stated overall objective of the engagement quality review. Providing such an overall objective supports the principles based audit approach, which requires the auditor to step back and evaluate whether the procedures performed were sufficient in meeting the objective, and serves to avoid a “checklist mentality.”

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<sup>1</sup>BDO International is a world wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country.

In determining the language for such objective, we recommend considering as a starting point paragraph 20 of Proposed Redrafted ISA 220, which states that a quality control review should provide:

*“...an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor’s report.”*

**2. Should an 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?**

We believe that an engagement quality review should be required for all engagements performed in accordance with the standards of the PCAOB based on the rationale expressed in the Proposed Standard that *well-performed engagement quality reviews are an important element in establishing a basis for investor reliance.*

**B. Qualifications of the Engagement Quality Reviewer**

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

One aspect of the qualifications of an engagement quality reviewer as described in the proposed standard is not clear to us, in that it states that an engagement quality reviewer may be a partner or *another individual in the firm or an individual outside the firm.* This seems to conflict with Section 103 of the Sarbanes-Oxley Act of 2002 (the “Act”), which requires the Board to include in the auditing standards a requirement that “each registered public accounting firm shall provide a concurring or second partner review...” (Emphasis added). There is similar language in Section 203 dealing with lead and concurring partner rotation. Our understanding of these provisions of the Act is that the engagement quality review must be performed by a partner. Rule 2-01 of Regulation S-X also uses the term “partner” when referring to the “concurring partner.” Regulation S-X uses the term “...partner or persons in an equivalent position...” when defining an audit partner. In practice, we believe that “principals” would be in an equivalent position within a firm, but only if they have authority to bind the firm. We do not believe that this equivalency would extend to those below a principal role, such as a senior manager. While we do not object to extending the capability to perform the engagement quality review beyond the pure partner role, provided that the individual has the requisite other qualifications, we suggest that the final standard reconcile the qualifications of the reviewer with the aforementioned provisions of the Act and Regulation S-X.

The Proposed Standard requires the engagement quality reviewers, including non-partners, to possess *the level of knowledge and competence related to accounting, auditing, and financial reporting to serve as the person who has overall responsibility for the same type of engagement.* Ordinarily, an individual possessing these characteristics would be a partner (or principal) or someone who has the *authority* to act as an audit engagement partner. This characteristic is included in Proposed Redrafted ISA 220 (paragraph A42) and, in our view, reflects a substantive factor in evaluating the ability of the engagement quality reviewer to stand up to the engagement partner when difficult issues arise. Assuming it is permissible under the Act and Regulation S-X for suitably qualified non-partners to perform an engagement quality review, it seems to us, therefore, that this Proposed Standard or the Quality Control Standards should provide that when a non-partner performs the review, the working papers should contain documentation about how the firm’s quality control standards

ensured that such person was appropriately qualified, considering criteria such as the independence and technical qualifications, experience, and authority of the reviewer.

To clarify the Board's intention regarding the meaning of the terms partner, engagement partner, practitioner-in-charge, and engagement quality reviewer, we suggest including a definition section within the standard. While these terms are used extensively within the accounting profession, they may have different meanings to different people. We suggest that, wherever possible, such definitions should be generally consistent with those set out in the proposed redrafted ISQC 1, included below.

*Engagement partner* – The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

*Engagement quality control reviewer* – A partner, or other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions they reached in formulating the report.

*Partner* – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

**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?**

While we agree that it is important for the engagement quality reviewer to maintain his or her objectivity, we believe that recognition should be given to practical circumstances that would make it reasonable to permit engagement teams to consult with the engagement quality reviewer at the time issues arise. This is particularly the case for smaller firms where technical experts are limited in number and most also perform client service roles, such as serving as engagement quality reviewers.

We understand the concept that for an engagement quality reviewer to remain objective, the engagement team should ordinarily develop a view on issues prior to consultation. However, we believe that in practice there may be some situations, either because of timing or resource constraints, where the engagement team may not form a view on a highly specialized or technical issue prior to consultation with the engagement quality reviewer. In our view, sporadic consultations in this fashion would not ordinarily impair the reviewer's objectivity with respect to the overall engagement, or necessitate his or her replacement on the engagement.

**C. The Engagement Quality Review Process**

**1. Scope of Review**

**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?**

Generally, we agree that the descriptions of the scope and extent of engagement quality review procedures are appropriate. However, there are some areas where we believe additional clarification is needed as to the nature and extent of the review, as follows:

#### *Review of working papers*

We believe the Proposed Standard is unclear as to whether or not the review ordinarily would extend to the detailed working papers supporting the judgments made and conclusions reached in the higher risk areas, or whether this evaluation can be achieved through review of the top memorandum, discussions with engagement teams, and performing the specific procedures in paragraph 8.

We believe that the requirement set out in paragraph 10.a. that requires the reviewer to evaluate the engagement documentation of the matters that were subject to the review should ordinarily require the reviewers to review the important detailed working papers in the areas subject to significant judgment. However, we believe this requirement as presently worded could be read as meaning that the reviewer need only ensure that the items specified in paragraph 8, rather than the underlying working papers themselves, are documented in accordance with Auditing Standard No. 3 (“AS No. 3”).

As such, we recommend clarifying the intended extent of the engagement quality review, and specifically stating that ordinarily a review of selected working papers evidencing the procedures performed and conclusions reached for the higher risk areas is required, although the extent of such review would vary based on an assessment of risk. This approach is consistent with the proposed redrafted ISQC 1, which provides for such a review of selected working papers relating to the significant judgments made and conclusions reached. (Refer to paragraphs 44 and 45 of proposed redrafted ISQC 1.)

#### *Significant Risks*

The term “significant risk” is used in the Proposed Standard to refer to a matter the reviewer should assess as part of the evaluation of engagement planning. This term has a specific meaning within the AICPA Statements on Auditing Standards (“SAS”) 109, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement* (which is similar to the ISA equivalent standard) and is defined as follows:

*As part of the risk assessment described in paragraph 102, the auditor should determine which of the risks identified are, in the auditor’s judgment, risks that require special audit consideration (such risks are defined as “significant risks”). Paragraphs 45 and 53 of SAS No. 110 describe the consequences for further audit procedures of identifying a risk as significant.*

However, this term, “significant,” which in the AICPA standard is not necessarily synonymous with “high” or “higher,” is not defined in the PCAOB’s auditing standards, and for clarity purposes, we suggest that a different term be used.

#### *Review of Interim Financial Information*

We agree that an engagement quality review and concurring approval of issuance are appropriate for each engagement performed and completed in accordance with PCAOB standards, including reviews of interim financial information where an engagement report may not be issued. However, we believe that certain of the required procedures set out in the Proposed Standard may not be applicable to a review of interim financial information in

accordance with AU section 722. For example, paragraph 8.d. (2) requires the engagement quality reviewer to evaluate engagement planning, including the identification of significant risks, including fraud risks, and the plan for and performance of engagement procedures in response to those risks, but this evaluation is not applicable to an interim review. As such, we recommend identifying those procedures that may not be applicable to such a review.

- 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 support a risk based approach to the engagement quality review. However, the Proposed Standard does not clearly define the meaning of the phrase “areas within the engagement that pose a higher risk.” As such, we recommend that the focus of the engagement quality review be on those areas that pose a higher risk of material misstatement to the financial statements or, where applicable, a risk of material weakness in internal control over financial reporting.

### *2. Review Engagement Documentation*

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

As described in our response to question 5, we believe the proposed requirements should be clarified with respect to the depth of the working paper review and, as such, we recommend providing additional guidance on this matter based on the suggestions contained in that response. In that regard, it is also not clear whether (1) the reviewer is simply required to evaluate the procedures performed by the engagement team based on what they have documented in the working papers and consider whether that documentation complies with the provisions of AS No. 3 (which we believe is the appropriate approach) or (2) in any review of analyses in detailed working papers, the engagement quality reviewer is expected to re-perform any procedures documented on such working paper and/or tie information back to underlying accounting records or other documents.

### *3. Timing of the Review*

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

We agree with the description of the timing of the engagement quality review, as set forth in the Proposed Standard.

## **D. Concurring Approval of Issuance**

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

We believe that the requirement in the Proposed Standard for an engagement quality reviewer’s concurring approval of issuance is appropriate and we support the PCAOB’s focus on strengthening the provisions within the standard to ensure that those matters that must be corrected before an audit report is issued, or before an engagement conclusion is communicated to the client (if no engagement report is issued), are handled appropriately.

However, the form of such approval should recognize that the engagement quality reviewer's responsibility is not the equivalent of the engagement partner. 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, an engagement quality reviewer generally is not in the same position to make informed judgments on significant issues as would be expected of the engagement partner. Therefore, to avoid any confusion, we believe the standard should provide a clear distinction between the roles and responsibilities of each such that it clearly states that notwithstanding the procedures performed by the engagement quality reviewer, the engagement partner has final responsibility for the audit engagement, including whether the auditor's report is appropriate in the circumstances. This different level of responsibility of the engagement quality reviewer caused by the inherent limitation of his or her breadth of knowledge about the issuer seems more appropriately suited to negative assurance. This form of assurance is already included in Interim Standard AU722, *Interim Financial Information*, in which less than full assurance is contemplated.

In contrast, we believe that the phrase "should know based on the requirements of this standard" may have unintended consequences. This is primarily because this term is not defined within the professional standards, and outside parties may attribute a higher level of assurance to this than is warranted by the application of the procedures provided for in the Proposed Standard. As a result, reviewers who are concerned about being second guessed as to what they "should know" may feel compelled to perform additional procedures that are not contemplated by the Proposed Standard.

We therefore suggest that the Proposed Standard adopt terminology already available in the professional standards that will also more closely align with the International Standards in this area. Suggested wording is as follows:

*"The engagement quality reviewer should perform the procedures set out in this standard. The reviewer should not provide concurring approval if, as a result of these procedures, anything comes to his/her attention [or he/she is aware of anything] that would cause him/her to believe that ...."*

We further recommend providing additional guidance with respect to a mechanism for the resolution of disagreements between the engagement partner and the engagement quality reviewer. This guidance should require any conclusions reached to be documented in accordance with the provisions of AS No. 3, paragraph 8, and that the report not be issued until the matter is resolved in accordance with a firm established framework for the resolution of such differences that reflects an ultimate decision by a suitable technically qualified partner within the firm.

Additionally, we note that paragraph 13 of the Proposed Standard provides guidance to a firm in fulfilling its responsibility to ensure that reports issued are appropriate in the circumstances and, as such, this guidance would seem better placed within the quality control standards. However, footnote 5 to this paragraph remains appropriate, and we therefore suggest that the current wording of paragraph 13 be replaced with wording based on the information in footnote 5, as the footnote information is more pertinent to procedures a reviewer should perform.

## E. Documentation of an Engagement Quality Review

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

Generally, we believe that the documentation requirements for an engagement quality review are appropriate. However, we suggest clarification of the nature and extent of the documentation of procedures performed by the engagement quality reviewer to ensure consistency in practice. For instance, item 14.c. requires documentation of the procedures performed, but the form of that documentation is not clear and without additional clarity, the level of documentation may be excessive. Given the guidance in the Proposed Standard, documentation could range from a simple sign off on the working paper (which we believe is the appropriate approach) to something much more in depth, such as the preparation of a summary memo describing exactly what the reviewer looked at on the working paper. Additionally, item 14.e. requires the results of the review procedures to be documented; however, once again the nature of the required documentation is not apparent. It is not clear whether this documentation requirement could be satisfied simply by providing concurring approval of issuance (which we believe is the appropriate approach), or whether something more is contemplated.

We also suggest that guidance be provided along the lines of AS No. 3, paragraph 6, which indicates that the identification of who performed the review and when that review took place may necessitate having the reviewer initial and date specific working papers rather than include a general description of the areas covered by the review.

### 11. 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?

As noted in our response to Question 9 above, we believe that the Proposed Standard should require documentation of the resolution of any disagreements between the engagement partner and the engagement quality reviewer.

## Effective Date

To allow all registered public accounting firms sufficient time to incorporate the guidance included within the final standard into their engagement quality reviews, we recommend that the effective date be no earlier than for periods *beginning* on or after six months after the standard is approved by the Securities and Exchange Commission.

We would be pleased to discuss any questions you may have about our comments. Please contact Helen Thomson at +32 (0)2 778 0130 or via electronic mail at [hthomson@bdoglobal.com](mailto:hthomson@bdoglobal.com) with any questions.

Yours faithfully,

BDO Global Coordination B.V.

