



12 May 2008

Our ref: ICAEW Rep 65/08

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

By email: *PCAOB Rulemaking Docket No. 025*

Dear Sir

**PCAOB RELEASE NO 2008- 002 PROPOSED AUDITING STANDARD:  
ENGAGEMENT QUALITY REVIEWS**

The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the proposed auditing standard *Engagement Quality Review*.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

Our comments have been prepared with the help of our many members working around the world who have detailed knowledge and practical experience of US, EC and other regulatory regimes. We set out our main comments and answers to the PCAOB's specific questions below.

- 1. We are concerned by the introduction of a new standard of performance for Engagement Quality Reviewers (EQRs), requiring them to consider not merely what they know, but also what they 'should know'. This departure is critical and its effect should not be underestimated. We expect EQRs to significantly increase the scope and extent of their work to protect themselves, and for confusion to arise as to who is ultimately responsible for the audit opinion, We do not see additional value in these proposals and expect considerable increased cost to arise from this standard of performance, without corresponding benefit.**
- 2. The proposed implementation date makes the standard applicable for 2008 calendar-year end audits. This timetable is too aggressive since planning for many 2008 audits is already underway, involving EQRs in the review of planning. We recommend a more measured approach to implementation of the proposed standard.**



THE INSTITUTE  
OF CHARTERED  
ACCOUNTANTS

IN ENGLAND AND WALES

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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## **Main Comments**

### **1 The role of EQRs and what they 'should have known'**

Current requirements in both US GAAS and ISAs require the EQR to consider judgements presented to them by the engagement team. Furthermore, ISA 220 *Quality Control for Audits of Historical Financial Information* is currently being redrafted and proposes that the EQR's role is, among other things, to provide an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report, emphasising that it is the engagement team's determination of what is significant that sets the agenda for engagement quality review.

The proposed PCAOB standard departs significantly from current international practice since the EQR is directed not merely required to consider what is known, but also those matters the EQR 'should have known', possibly to levels approaching those currently applied by the engagement team, to avoid being second-guessed after the fact by those who have the benefit of hindsight, including PCAOB inspectors.

### **2 Timing of implementation**

The proposed standard seeks implementation for 2008 calendar audits. This is unrealistic for a standard which cannot be approved by the SEC until relatively late in 2008 and raises the prospect of quality review work being performed under existing rules and then re-performed once the final standard is known. A more measured approach to implementing the new standard should be adopted.

### **3 Interaction between the engagement team and the EQR**

The standard creates a requirement for the EQR to balance on the one hand a need to retain objectivity through separation from the engagement team, and by implication the audit client, and on the other hand to have a strong understanding of the issues involved in the audit. Very little is provided by way of guidance on how this balance should be achieved without compromising either objectivity or the quality of the review. We recommend that the PCAOB enhance the explanation of how EQRs can achieve such a balance. These proposals will also lead to confusion as to who has ultimate responsibility for the issuance of the audit opinion.

### **4 Applicability**

We recommend that the PCAOB give further consideration to the applicability of this standard in three particular circumstances:

#### *Foreign private issuer audits*

PCAOB rules currently require certain review procedures to be made available to networked audit firms which are not members of the AICPA. This is commonly known as 'designated review' and focuses on the application of US accounting audit, disclosure and independence requirements where these are not the usual framework for the reporting audit firm. We are concerned that there is overlap between the role

of the EQR and the designated review. In the interests of efficiency, we recommend that the PCAOB consider and explain how these two requirements can fit together without creating unnecessary duplication.

#### *Referred reporting engagements*

Referred reporting engagements often involve the component auditor confirming that their work has been conducted in accordance with PCAOB standards. The introduction of the proposed standard would prompt the introduction of EQRs for component audits. However, in such circumstances, second-sight judgements are best provided by instructing offices rather than by involving new partners at the component level by the reporting office. We recommend that the proposed standard should not apply to component audits.

#### *Non-audit assurance*

The proposed standard seems drafted with audits in mind and we think that it would be difficult to comply with some of the requirements in a non-audit context, such as a review of interim financial information. We recommend that the PCAOB revisit this in finalising the standard and either provide additional guidance on application in non-audit contexts or specify that the standard solely applies to audits.

## **5 External sourcing of EQRs**

We welcome the proposed standard's recognition that EQR arrangements can be sourced outside the firm. This is wholly beneficial for audit choice.

### **RESPONSES TO SPECIFIC QUESTIONS**

**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?**

**This standard should not state an objective.** It is important that objectives in auditing standards are properly thought out within a proper framework, and that their role and status are crystal clear. While auditing standards are generally improved by the inclusion of a clear objective, the development of objectives on an *ad hoc* basis is not appropriate.

**If an objective is considered necessary, the PCAOB should consider aligning it with the IAASB's proposed objective for their equivalent standard, ISQC 1:**

*The objective of the auditor is to obtain reasonable assurance that the audit complies with professional standards and regulatory and legal requirements, through the implementation of appropriate quality control procedures at the engagement level.*

**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?**

**No**, as our comments above indicate.

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

We have not identified any particular problems with the description proposed, however, we recommend that the PCAOB consider whether its requirements in this area are significantly different to those required by the IAASB.

**4. Should the proposed standard allow the engagement team to consult with the engagement quality reviewer during the engagement?**

**Yes**, consultation should take place. Timely consultation is central to the role of the EQR. Further guidance on how this should occur would be welcome as our comments above indicate.

**Would such consultation impair the reviewer's objectivity?** The need for and benefits of consultation outweigh any potential actual or perceived impairment of the reviewer's objectivity.

**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?**

**No**, as our comments above indicate.

**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?**

**No**. The identification of significant engagement problems depends primarily on the quality of the *implementation* of the requirements of the standard. Requirements of standards alone cannot be expected to deliver audit quality. Adherence to the spirit, as well as the letter of the risk-based approach by both auditors and PCAOB inspectors will be necessary to achieve the desired outcomes.

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

**No**. The requirement for the EQR to consider what he or she 'should have known' is inappropriate as our comments above indicate.

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

We have not identified any particular problems with the timing proposed.

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

**No**. The proposed standard suffers from a lack of clarity as to who has ultimate responsibility for the issuance of the audit opinion. The standard should set out the

process for dealing with the rare circumstances in which the audit engagement partner and the EQR are unable to agree.

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

As drafted, the documentation requirements seem excessive, although the problem does not stem from the documentation requirement *per se*, but rather from the inappropriate requirements of the standard itself, as set out elsewhere in this letter. If the proposed standard is redrafted as suggested elsewhere in this letter, documentation problems will be less likely.

**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?**

We have not identified any other relevant provisions in AS No. 3.