

May 12, 2008

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Public Company Accounting Oversight Board  
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**RE: Request for Public Comment on PCAOB's Proposed Auditing Standard – Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Control Standards; PCAOB Rulemaking Docket Matter No. 025**

Dear Office of the Secretary:

The Center for Audit Quality (CAQ or the Center) is an autonomous public policy organization serving investors, public company auditors and the capital markets and is affiliated with the American Institute of Certified Public Accountants (AICPA). The CAQ's mission is to foster confidence in the audit process and aid investors and the markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. Based in Washington, D.C., the CAQ consists of nearly 800 member firms that audit or are interested in auditing public companies. We welcome the opportunity to share our views on the Public Company Accounting Oversight Board's (PCAOB or the Board) proposed auditing standard – *Engagement Quality Review (EQR) and Conforming Amendment to the Board's Interim Quality Control Standards* (the proposal or proposed standard).

We strongly support auditing standards that promote audit quality and believe that a robust and effective engagement quality review that focuses on significant judgments made and conclusions reached by the engagement team furthers that purpose. We also strongly support the Board's proposal that all registered public accounting firms – not just those that were members of the AICPA SEC Practice Section as of April 16, 2003 – be required to comply with the engagement quality review standard. We believe that requiring all firms to comply is consistent with the Board's

directive under Section 103 of the Sarbanes-Oxley Act of 2002 and is in the public interest.

However, we are concerned that the proposed standard goes well beyond international auditing standards promulgated by the International Auditing and Assurance Standards Board (as well as the Board's current interim standard),<sup>1</sup> and that the resulting incremental effort will not have a commensurate benefit to audit quality. Specifically, as discussed in greater detail below, our concerns are directed to the following fundamental aspects of the proposed standard and its divergence from international auditing standards:

- The standard does not contain an objective that articulates the purposes and objectives of the review;
- The standard establishes a new standard of performance for the engagement quality reviewer (“know or should know”) that is likely to result in the performance of substantial additional procedures and engagement quality reviewers being overly focused on being second-guessed as to what they should have known;
- The standard requires independent evaluations by the engagement quality reviewer, rather than reviews of evaluations made by the engagement team, even though the reviewer lacks access to the same information as the engagement team;
- The standard requires the reviewer to identify risks to the performance of the engagement team, rather than to focus on risks of material misstatement of the financial statements and material weaknesses in internal control over financial reporting that the engagement team might not have identified.

In our view, the focus of an engagement quality review standard should be on *reviewing* the significant judgments made and conclusions reached by the engagement team. Our analysis and basis for our views are set forth in detail below.

### **Objective of the Engagement Quality Review Standard**

We believe the final standard should state an objective in order to provide a clear, articulated understanding of the purpose of the standard. Having a common understanding of the overall

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<sup>1</sup> Proposed Redrafted ISA 220, *Quality Control for an Audit of Financial Statements* (ISA 220) and Proposed Redrafted ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* were proposed by the International Auditing and Assurance Standards Board in July 2007 and are scheduled to be considered for adoption by the International Auditing and Assurance Standards Board in September 2008.

purpose of the standard is important for two principal reasons. First, a statement of the objective will guide reviewers in satisfying themselves that, in doing their work, they understood and accomplished the requirements of the standard. Second, by putting the review in the proper perspective, the Board improves the likelihood that third parties -- including other regulators and the public -- will have a consistent understanding of the intent of the standard. Beyond these principal reasons for establishing an objective, we believe that doing so can also be beneficial to providing the appropriate framework for the standard-setting process itself.

We believe the objective should make clear that an engagement quality review should be just that—a review. The purpose of an engagement quality review is to provide an objective review of the engagement team’s significant auditing and accounting judgments, and the support for those judgments, by an experienced and objective colleague who, where appropriate, will question and challenge those judgments and reach a conclusion based on all relevant facts and circumstances of which he or she has knowledge. That review, properly conducted, enhances audit quality. To that end, we recommend that the Board adopt the following objective for the standard:

**The objective of the engagement quality review is to provide for an independent, objective review of significant auditing, accounting, and financial reporting matters including significant judgments made and conclusions reached by the engagement team, that results in a conclusion about whether the engagement quality reviewer concurs with the issuance of an engagement report.**

This language makes clear that the requirement is for a “review” of significant matters, not the performance of additional independent substantive procedures nor a complete evaluation of certain aspects of the engagement team’s work. It also serves to differentiate the function of the engagement quality reviewer from that of the engagement partner.

The engagement partner has overall and ultimate responsibility for the audit and the audit opinion. The engagement quality reviewer is an element of quality control. As such the reviewer is in the position to provide an objective review of significant auditing, accounting, and financial reporting matters, including significant judgments made and conclusions reached by the engagement team. Furthermore, the engagement quality reviewer is not, and could not as a practical matter be, responsible for the audit. Unlike the engagement team, the engagement quality reviewer's access to client records is generally limited to the audit documentation and discussion with the engagement team; he or she generally has limited, if any, interaction with client personnel.

These limitations preclude the reviewer from independently forming the necessary judgments and conclusions required throughout the audit. Therefore, the purpose of the standard should not be to create an additional level of independent substantive auditing procedures, to engage in substantive

oversight over the audit engagement team, to substantively evaluate the performance of the engagement team, or to determine compliance with the audit documentation requirements. The objective recommended above would make that clear.

We believe the Board should not adopt an objective that could be interpreted to result in an engagement quality review that mirrors or overlaps with the engagement partner's responsibilities or other quality reviews such as a firm's internal quality control program and PCAOB inspections. The other firm-wide monitoring procedures and PCAOB inspections have distinct but different purposes and are generally conducted by teams of people, subsequent to the issuance of the engagement report and without timing constraints.

### **The Proposed Standard**

Measured against our suggested objective, we are concerned about certain aspects of the Board's proposal. First, as further described below, we believe that the proposed standard goes well beyond the requirements of international auditing standards. Second, we believe that the proposed changes and additions to what is required by the Board's current interim standard (as well as by international auditing standards) will significantly alter the nature of an engagement quality review and result in additional costs, which could be significant, without providing a commensurate benefit to audit quality. Incremental costs, in proportion to total audit fees, likely would be higher for smaller issuers than for larger issuers.

We believe that these concerns should be addressed by aligning the new standard with international standards, which we believe would create an appropriately focused and effective review standard. Moreover, doing so would be consistent with the growing demand for convergence of world-wide accounting and auditing standards and the recognition of the benefits of developing a single set of standards for world-wide use. We believe that further consideration should be given to the benefits of convergence and to avoiding the creation of unnecessary substantive differences in standards.

If, however, the Board does not believe convergence of this standard with international standards is appropriate, we urge the Board to, at minimum, consider and address the concerns about those provisions that differ significantly from international standards. We have recommended specific changes that we believe would appropriately support audit quality without the attendant costs of certain of the provisions in the Board's proposed standard. We believe that our recommended changes would result in a standard that is not only effective at meeting our proposed objective, but also one that can be implemented efficiently. We also have provided additional comments pertaining to certain other aspects of the proposed provisions in an Appendix to this letter.

More specifically and as more fully discussed below, we are concerned about the following incremental procedures in the proposal:

- A requirement that the engagement quality reviewer identify areas of “higher risk,” not of material misstatement, but rather areas where, regardless of materiality, the engagement team might have failed to obtain sufficient competent evidence or might have reached an inappropriate conclusion (paragraph 9);
- A requirement that the engagement quality reviewer independently evaluate the adequacy of audit documentation, particularly its compliance with Auditing Standard No. 3, *Audit Documentation* (paragraph 10);
- Procedures that require the engagement quality reviewer to make “evaluations” or “determinations” that, without clarification, might be interpreted to require efforts similar to those required of the engagement team in performing the work itself, rather than a review of the engagement team’s judgments and conclusions (paragraphs 7 and 8); and
- A new standard of performance for the engagement quality reviewer’s work and a conclusion that departs from the negative assurance in the interim standard and, as proposed, requires an affirmative conclusion. The proposal would require the reviewer to affirmatively conclude that there is nothing the reviewer “knows or *should know*” that would preclude concurrence in the engagement team’s issuance of the report (paragraph 12) (*italics added*).

These provisions, taken together, would impose substantial new burdens on the engagement quality reviewer without a commensurate benefit to audit quality. As discussed above, the objective of the review should be to enhance audit quality by providing an independent, objective review of the significant accounting and auditing judgments and the conclusions reached. The proposed standard, however, would redirect the focus of the engagement quality reviewer away from the work of the engagement team to the work performed to carry out the reviewer’s responsibilities. More specifically, in creating new standards of performance for the reviewer that require a “know or should know” level of assurance, these provisions become too focused on the adequacy of the engagement quality review itself, rather than on the quality of the work performed by the engagement team. For example, we believe that an engagement quality reviewer likely would interpret these provisions as a requirement for him or her to perform sufficient work to have a basis for separately forming his or her own independent determinations about such matters as whether appropriate consultations have taken place, whether appropriate matters have been communicated to the audit committee, whether there are areas that create a “higher risk” of non-compliance, and whether the engagement team complied with documentation standards.

Of course, issues should be raised by a reviewer if they are identified during the course of the procedures performed. However, by mandating separate determinations and judgments to be made



by the reviewer, the focus of the proposed standard is the reviewer's own basis for the determinations he or she makes in the engagement quality review, rather than the reviewer's consideration of the judgments and conclusions reached by the engagement team in the audit. The judgments the reviewer makes will likely be seen as wholly separate from, rather than enhancing or confirming, those of the engagement team.

We believe firms, clients, and investors should continue to expect engagement partners to make reasonable judgments. Engagement quality reviews, along with the other quality control processes, combine to provide a firm with reasonable assurance about the effectiveness of its system of quality control, as is required. However, we see neither a purpose nor benefit in the redirection of focus of the engagement quality review or from the additional costs that will undoubtedly be incurred.

Our concerns are compounded by the new "know or should know" standard that changes the basis upon which the reviewer can concur in the issuance of the report. Under the current interim standard, the reviewer could concur so long as "no matters have come to his or her attention that would cause the [reviewer] to believe" that the financial statements did not conform to GAAP in all material respects or that the audit was not performed in accordance with GAAS. This is a "negative assurance" standard. The proposed standard, in effect, requires the reviewer, like the engagement partner, to determine that he or she has sufficient grounds to positively concur with the issuance of the report. It converts the engagement quality reviewer's conclusion to one that requires an affirmative finding or representation that, by definition, must be based on the performance of sufficient procedures to support the finding or representation.

We have a number of concerns about the proposed change in approach to an engagement quality review. First, the requirement that the reviewer make a positive determination about whether the report should be issued is directly contrary to the objective of the review; it comes far too close to, or could even be said to replicate, the judgment made by the engagement partner. Second, because of the limitations on what a reviewer can do without impairing objectivity, the reviewer's conclusion by extension will be based on limited information. The information gap between what the engagement partner knows and the engagement quality reviewer knows, will necessarily -- but we suggest inappropriately -- raise the question about what the reviewer *should have known*. Third, the introduction of a "should know" standard would be likely to have unintended consequences given the focus it brings to the potential for being second-guessed, particularly in the absence of an objective standard or specific direction about what is required to comply. It is reasonable to assume that many reviewers will interpret the required procedures in such a way that results in significant additional work for the purpose of anticipating a defense to any subsequent challenge.

We do not believe that imposing these kinds of requirements directly on the engagement quality reviewer will result in commensurate benefit to audit quality. We believe that a reviewer, who



conscientiously performs the procedures outlined in paragraph 8, as amended by our proposed revisions below, will appropriately contribute to audit quality by focusing on the significant matters addressed by the engagement team and providing an independent review of the engagement team's judgments and support for those judgments.

In addition to the aforementioned concerns, based on discussions with various smaller member firms, we are concerned that the "should know" concept in the standard will result in a general inability for firms that need to engage a third-party engagement quality reviewer to find individuals willing to accept such a review engagement. A consequence to some smaller firms that seek to engage such a third-party engagement quality reviewer likely would be either to assign a less-qualified manager or director to perform the review or to conclude that they can no longer serve issuer clients.

The following sections explain in more detail our concerns with the particular sections of the standard and set forth our recommended changes to the Board's proposal to address our concerns. We believe that our recommended changes are consistent with the objective we proposed.

### **Scope of Review**

Paragraphs 7 and 8 prescribe general standards and specific procedures for conducting the engagement quality review. We generally agree with the nature of these procedures to be performed. However, we recommend a change to paragraph 7 and certain changes in the text of paragraph 8 (set forth below) to clarify what procedures will satisfy the reviewer's responsibility to make the requisite evaluation and to avoid any suggestion that the reviewer is required -- or indeed able -- to duplicate the work of the engagement team or to make independent judgments about matters that are the responsibility of the engagement team.

These recommended changes, included herein, would make the expected level of work more clear and avoid a fundamental change in the nature of the review function, which could otherwise potentially compromise the important principles of objectivity underlying the standard. The standard, we believe, should reinforce, not diffuse, the accountability of the engagement partner.

Based on the foregoing, we recommend that the Board consider revising paragraphs 7 and 8 of the proposed standard. In addition to changes to implement our comments above, we believe certain provisions in paragraph 8 should be clarified to provide more certainty about how to satisfy the presumptively mandatory requirements in each of these sections:

**7. The engagement quality reviewer should evaluate ~~include an evaluation of the significant judgments made by the engagement team and the significant conclusions reached by the engagement team in forming the overall conclusion on in conducting~~**

the engagement and in preparing the engagement report, if a report is to be issued. ~~To identify and evaluate the significant judgments and conclusions,~~ The evaluation should be conducted by the engagement quality reviewer should include through discussions with the person with overall responsibility for the engagement, discussions with other members of the engagement team as necessary appropriate, and other procedures, as described in paragraphs 8 and 9.

8. As part of performing the engagement quality review, the engagement quality reviewer should:

- a. ~~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~~ for the company.
- b. Obtain an understanding of the company's business, significant activities during the current year, and significant financial reporting issues and risks through discussions with the person with overall responsibility for the engagement, discussions with other members of the engagement team, as appropriate, and the performance of the procedures enumerated in the subparagraphs below.
- c. Review the engagement team's evaluation of the firm's independence in relation to the engagement (i.e., the communication with the audit committee required by Rule 3526, *Communication with Audit Committees Concerning Independence*, formerly Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*).
- d. ~~Evaluate~~ Review engagement planning, including (1) the judgments made about materiality and the effect of those judgments on the engagement strategy and (2) the identification of significant risks of material misstatement to the financial statements and the risks of material weakness in internal control over financial reporting, including fraud risks, and the plan for and performance of engagement procedures in response to those risks.
- e. ~~Evaluate~~ Review judgments made about (1) the materiality and disposition of corrected and uncorrected identified misstatements and (2) the severity and disposition of identified control deficiencies.
- f. ~~Determine if appropriate consultations have taken place on difficult or contentious matters.~~ Review the documentation, including conclusions, of such consultations that have taken place on significant difficult or contentious matters.





- g. Read the financial statements, management's report on internal control over financial reporting, or other information that is the subject of the engagement and the engagement report (if an engagement report is to be issued) for the period covered by the engagement and for the prior comparative periods presented.**
- h. Read other information in periodic filings and offering documents, as applicable, containing financial statements that are the subject of the engagement and are to be filed with the SEC and evaluate whether the engagement team has taken appropriate action with respect to material inconsistencies with the financial statements or material misstatements of fact of which the engagement quality reviewer is aware.**
- i. ~~Determine if~~ Review whether appropriate matters of which the engagement quality reviewer is aware have been communicated, or identified for communication to the audit committee, management, and other parties, such as regulatory bodies.**
- j. Review the engagement completion document and confirm with the person with overall responsibility for the engagement that there are no significant unresolved matters.**

**Note: Matters of which the engagement reviewer is “aware” are those matters that have come to the attention of the reviewer during the course of performing the procedures required by this standard.**

### **Engagement Quality Reviewer Risk Assessment**

Paragraph 9 of the proposed standard requires the reviewer to identify areas within the engagement that pose a “higher risk.” The term “higher risk” in that paragraph is not, however, directed to the potential for material misstatements or any other objective standard. Rather, the standard focuses on the “higher risk” that the engagement team failed to obtain sufficient competent evidence or reached an inappropriate conclusion. For the areas that pose such “higher risk,” the engagement quality reviewer is required to evaluate whether the engagement team performed procedures that were responsive to those risks, whether the judgments made by the engagement team were reasonable in the circumstances, and whether the results of the procedures support the engagement team’s overall conclusion.

We believe it is important that the engagement quality reviewer understand and review the significant risks of material misstatement to the financial statements and the risks of material weakness in internal control over financial reporting identified by the engagement team and the

engagement team's response to such risks. We do not believe that requiring a separate assessment of the risk that the engagement team failed to obtain sufficient competent evidence or reached an inappropriate conclusion is workable or consistent with the objective of an engagement quality review.

First, we question how the engagement quality reviewer would make such a determination. For example, what considerations would be deemed sufficient to support this determination, particularly without the benefit of the information available in hindsight when his or her review is scrutinized? The standard does not articulate any procedures for making this determination, other than referring to the procedures in paragraphs 7 and 8 and "other relevant knowledge possessed by the engagement quality reviewer." Second, we note the Board's use of the term "higher risk." Being a relative term, it implies that there should always be some areas of higher risk, even though there might be no audit areas that pose a sufficiently high risk to justify further consideration or action. Third, we believe this requirement to be more concerned with having the reviewer make risk assessments separate from the engagement team, rather than reviewing the engagement team's own judgments for reasonableness. We question the focus of this requirement and the extent to which it will result in improvement to audit quality. Finally, we note that paragraph 12, both as proposed and consistent with our recommended revision, already contains a sufficient provision to prevent engagement quality reviewers from concurring with the issuance of the engagement report if, based upon the engagement quality review procedures performed, the reviewer believes that the engagement team failed to obtain sufficient competent evidence in accordance with PCAOB standards or reached an inappropriate conclusion about the subject matter of the engagement.

We recommend that the Board modify the proposed requirement in paragraph 9 to refocus it on whether important matters were identified during the engagement quality review that were not previously identified by the engagement team. Those matters should include the significant risks of material misstatement to the financial statements, significant risks of material weakness in internal control over financial reporting, and significant difficult or contentious matters that the engagement team might not have identified where consultation by the engagement team should be considered. If such matters are determined to exist, the engagement quality reviewer should be required to communicate these matters to the engagement team and assess whether the engagement team responds or has responded appropriately.

As such, we recommend that paragraph 9 be revised to read as follows:

**9. Based on the procedures performed in accordance with paragraphs 7 and 8, and the engagement quality reviewer's knowledge, the engagement quality reviewer should assess whether any of the following matters were not previously identified by the engagement team:**



- significant risks of material misstatement to the financial statements,
- significant risks of material weakness in internal control over financial reporting, or
- significant difficult or contentious matters where consultation should be considered by the engagement team.

If the engagement quality reviewer believes that there are such risks or matters, he or she should communicate that to the engagement team and then assess whether the engagement team has responded appropriately.

### Review of Engagement Documentation

Paragraph 10 of the proposed standard would require the engagement quality reviewer to evaluate the engagement documentation. In particular, it requires the reviewer to evaluate whether the documentation “is appropriate in the circumstances and consistent” with the Board’s Auditing Standard No. 3, *Audit Documentation* (AS 3).

We believe audit documentation is important and we support the Board’s proposed requirement for an engagement quality reviewer to assess whether the engagement documentation supports the conclusions reached by the engagement team with respect to the matters reviewed by the engagement quality reviewer. However, we believe that the proposed standard, if not modified, could impose substantial additional burdens on the engagement quality reviewer to review the adequacy of documentation rather than the appropriateness of the significant accounting and auditing judgments made by the engagement team, and that result would not meaningfully enhance audit quality. We therefore recommend that the standard be modified in the following respects.

First, we believe the requirement to evaluate documentation should be limited to assessing that which is reviewed in connection with the procedures required by paragraphs 7 - 9 of the proposed standard. Absent such a limitation, the proposed standard might be interpreted to extend the engagement quality reviewer’s responsibilities to require him or her to conduct a separate review of all or much of the engagement documentation.

Second, we believe that the final standard should omit the requirement that the engagement quality reviewer evaluate whether the audit documentation is consistent with AS 3. We do not believe that this specific requirement is consistent with the overall objective of the engagement quality review, nor do we think it will meaningfully enhance audit quality. The engagement partner has primary responsibility for performance of the audit, including performing a review of the documentation for compliance with AS 3. It is not, and should not be, the engagement quality reviewer’s responsibility to duplicate that evaluation. Furthermore, we do not believe it is appropriate or necessary to single out any particular auditing standard for this type of compliance check by the reviewer.

We believe requirements in paragraphs 9 and 10 of the proposed standard potentially duplicate other requirements of AS 3. In addition, paragraph 13 of AS 3 requires that the engagement team “identify all significant findings or issues in an engagement completion document.” Paragraph 13 further states that “this document, along with any documents cross-referenced, should collectively be as specific as necessary in the circumstances for a reviewer to gain a thorough understanding of the significant findings or issues.” In our view, a qualified engagement quality reviewer should be able to achieve the objectives for the engagement quality review by performing the procedures outlined in paragraphs 7 and 8 of the proposed standard, as amended by our proposed revisions above, which reflect existing requirements and would include reviewing the engagement completion document.

Third, we recommend that the Board revise paragraph 10 to make it clear that the scope of the engagement quality review is to assess whether the documentation that the reviewer selected for review supports the conclusions that were reached by the engagement team. That assessment will include considering significant risks of material misstatement to the financial statements and the risks of material weakness in internal control over financial reporting and significant judgments by the audit team. Our recommended change, however, eliminates an implication that paragraph 10 creates a more general requirement to assess matters that are not encompassed by the procedures set forth in paragraphs 7 - 9.

Accordingly, we recommend that paragraph 10 of the proposed standard should be revised to read as follows:

**10. Engagement Documentation. Based upon the procedures performed in accordance with paragraphs 7, 8, and 9, the reviewer should assess whether the engagement documentation reviewed during the course of the engagement quality review supports the significant conclusions reached by the engagement team.**

#### **Concurring Approval of Issuance**

Paragraph 12 of the proposed standard provides that the engagement quality reviewer cannot provide “concurring approval” of the issuance of an engagement report if he or she “knows or should know” that any of four enumerated conditions exist.

We believe that the engagement quality reviewer’s concurrence is an important contribution to audit quality. We agree with the Board’s enumeration of the four conditions that, if present, would preclude the engagement quality reviewer from concurring with the issuance of the engagement report. We also support the requirement that the engagement quality reviewer consider the knowledge obtained in performing the review in accordance with the standard. However, we believe that the inclusion of the legalistic “knows or should know” formulation for approval in auditing



standards is neither necessary nor appropriate. The terminology would likely lead to misunderstanding and inconsistent application of the standard. For example, referring to what the reviewer “knows, or should know based upon the requirements of this standard” implies that the reviewer must perform sufficient procedures under the requirements of the standard to “know” that the four specified conditions do not exist. This would likely lead engagement quality reviewers to engage in substantial procedures to conclude that they do not know that any of the specified conditions are present. The term “should know” is even more troubling. It inherently creates a potential for post-hoc questioning of whether an engagement quality reviewer should have identified a condition that would have precluded him or her from concurring in the issuance of the engagement report. Accordingly, we believe that engagement quality reviewers will be overly focused on being second-guessed as to what they should have known, if a problem with the audit is later identified, rather than on assisting the engagement team by reviewing significant judgments and conclusions.

As a result, the engagement quality reviewer would likely spend substantially more time, perform substantially more procedures and incur more costs than the reviewer would otherwise consider necessary, or we believe appropriate, in connection with a review. We strongly believe that the cost-effective improvement to audit quality should be the primary objective. We do not believe that inclusion of a “know or should know” standard of performance for the engagement quality reviewer furthers that objective. We recommend that paragraph 12 of the proposed standard be revised to remove the words “knows, or should know” by either conforming to the language used in ISA 220<sup>2</sup>, or alternatively, as follows:

**12. The engagement quality reviewer must not ~~provide concurring approval of~~ concur with the issuance of an engagement report if, ~~he or she knows, or should know based upon his or her review in accordance with the requirements of this standard,~~ the reviewer believes that (1) the engagement team failed to obtain sufficient competent evidence in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the firm's report, if a report is to be issued, is not appropriate in the circumstances, or (4) the firm is not independent of its client.**

We believe that the proposed language retains the essence of the standard—that the reviewer cannot concur if he or she believes, based on the review, that any of the four enumerated conditions are present. However, it eliminates the inappropriate “knows or should know” standard.

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<sup>2</sup> Paragraph 22(c) of Proposed and Redrafted ISA 220 requires the reviewer to document that “the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.”

**Effective Date**

As proposed, the standard would be effective for reports issued on or after December 15, 2008. We are concerned that the proposed effective date would not permit sufficient time for registered public accounting firms to implement the new engagement quality review requirements. The effective date should provide all registered public accounting firms with sufficient time to (1) adopt policies and procedures consistent with the new standard, (2) train their personnel in the requirements of the new standard, and (3) assign qualified engagement quality reviewers consistent with their system of quality control.

We also believe that the effective date should be linked to the beginning of an engagement period. By linking the effective date to the beginning of the engagement period rather than the report issuance date, the new requirements would (1) be known and anticipated as of the beginning of the engagement period, (2) allow the assigned engagement quality reviewer to comply with the requirements throughout engagement planning and execution, and (3) be in place for each quarterly review conducted under AU section 722, *Interim Financial Information*.<sup>3</sup> In this manner, adoption of the new standard would be more effective and efficient.

To the extent that the new standard contains more extensive requirements than the Board's interim standard, the PCAOB should delay the effective date to annual periods beginning no earlier than twelve months after SEC approval to provide adequate time for firms to prepare for adoption.

**Potential Effect on Ability to Complete Review Timely**

In the event that the Board does not make significant modifications to the proposed standard to address the matters raised in our comment letter, we question whether some issuers and auditors would be able to meet the SEC's accelerated filing deadlines, given the fact that a significant portion of engagement quality review work must be performed near the end of the engagement. Accordingly, absent significant modifications, we recommend that the PCAOB discuss with the SEC, the effect of the standard on issuers' ability to meet SEC filing deadlines and whether such deadlines would need to be modified.

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We appreciate the opportunity to comment on the proposed standard and would welcome the opportunity to meet with you to discuss any of our comments.

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<sup>3</sup> Our concerns regarding the requirements of the proposed standard relative to reviews of interim financial information are included in the Appendix to this letter under "Scope of Proposed Standard."



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Public Company Accounting Oversight Board  
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Sincerely,



Cynthia M. Fornelli  
Executive Director  
Center for Audit Quality

Cc: PCAOB  
Mark W. Olson, Chairman  
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Conrad Hewitt, Chief Accountant  
Dr. Zoe-Vonna Palmrose, Deputy Chief Accountant for Professional Practice  
John W. White, Director of Division of Corporation Finance

## Appendix

Set forth below are additional comments pertaining to certain other aspects of the proposed standard.

### Scope of Proposed Standard

While we acknowledge the Board's desire for the engagement quality review standard to apply to all engagements performed in accordance with the standards of the PCAOB, the requirements in the proposed standard are so specifically tailored to financial statement audits and integrated audits that it would be difficult to apply certain requirements to other types of engagements with appropriate consistency. For some engagements, it might be appropriate to presume that certain requirements do not apply (for example, reading management's report on internal control would not apply in a review of interim financial statements). However, in other situations, the Board's intent is less clear. For example:

- Would the engagement quality reviewer be expected to obtain an understanding of significant financial reporting issues and risks (paragraph 8(b)) when reviewing an attestation engagement on the assessment of compliance with servicing criteria under the SEC's Regulation AB?
- What is the "prior period" (paragraph 8(g)) in the case of a third-quarter review of interim financial information?

Furthermore, with respect to the evidence required to be assessed ("sufficient competent evidence"), and the nature of the affirmative conclusion, the proposed standard appears to place the engagement quality reviewer in a position of having to obtain more evidence and, consequently, to provide a higher level of assurance than the engagement team for certain engagements – for example, a review of interim financial information or a comfort letter for underwriters.

More specifically regarding a review of interim financial information, we are concerned that the requirements of the proposed standard are not consistent with the objective of a review of interim financial information. The objective of a review of interim financial information is "to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles."<sup>4</sup> Toward that objective, a review consists principally of analytical procedures and inquiries of management. Some examples of what we believe to be inconsistencies between the requirements of the proposed standard and a review of interim financial information follow:

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<sup>4</sup> AU 722.07

- Paragraphs 8d and 10 of the proposed standard include requirements for the engagement quality reviewer to evaluate the engagement team's identification of, and responses to, significant risks. While a review of interim financial information involves assessment of risk in designing appropriate analytical and inquiry procedures, the terminology used in the proposed standard relates to an audit engagement, and we ordinarily would not expect an engagement team's documentation in a review of interim financial information to include explicit risk assessments. Accordingly, the Board's expectation of the engagement quality reviewer concerning risk assessment in a review of interim financial information is unclear.
- Paragraph 9 would require the engagement quality reviewer to assess whether there are areas within the engagement that pose a higher risk that the engagement team failed to obtain sufficient competent evidence or to reach an appropriate conclusion. As obtaining sufficient competent evidence is not a part of a review of interim financial information, we believe paragraph 9 will result in confusion and inconsistent practice in a review of interim financial information, notwithstanding the phrase "or to reach an appropriate conclusion." Paragraph 12 also refers to sufficient competent evidence
- Paragraph 12, as proposed, requires the engagement quality reviewer to provide an affirmative conclusion. Given that the objective of a review of interim financial information is to provide negative assurance, we do not believe it is appropriate for the engagement quality reviewer to reach a conclusion that is different than and goes beyond that which is required of the engagement team.

The Board therefore should identify the engagement quality review procedures required for interim reviews, provide clarity regarding the applicability of the procedures, and modify the conclusion to be reached by the engagement quality reviewer in connection with interim reviews. Specifically, the Board should include in the final standard an additional section, analogous to paragraph 7, that requires the engagement quality reviewer, in a review of interim financial information, to "discuss significant matters identified and addressed in connection with the review." Similarly, the final standard should require that only a subset of procedures set forth in paragraph 8 (specifically those set forth in subparagraphs 8(g), 8(h), 8(i), and 8(j), as revised pursuant to the suggestions herein) be completed for interim reviews. Finally, the final standard should clarify that the engagement quality reviewer is required to provide only negative assurance of concurring approval in the context of an interim review, consistent with the overall conclusion of such a review.<sup>5</sup>

We also recommend that the Board reconsider the practicality of applying the proposed standard to engagements other than financial statement audits, integrated audits, and reviews of interim financial information. If the Board believes engagement quality reviews are desirable for such engagements,

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<sup>5</sup> Our concerns regarding the proposed requirement for an affirmative conclusion by the engagement quality reviewer in an audit engagement are included in this letter under "Concurring Approval of Issuance."

we believe that the Board should develop a separate standard that allow the procedures to be tailored appropriately to the engagement circumstances. For example, we believe that a requirement to apply an auditing standard to an engagement performed in accordance with attestation standards would result in confusion and inconsistent practice. Accordingly, we believe any engagement quality review requirement for attestation engagements should be provided for in the attestation standards rather than the auditing standards.

## **Qualifications of the Engagement Quality Reviewer**

### Competence

The proposed standard, in paragraph 2, indicates that the engagement quality reviewer may be a partner in the engagement partner's firm or another individual in the firm (or an individual outside the firm). Paragraph 4 of the proposed standard then states that "the engagement quality reviewer must possess the level of knowledge and competence related to accounting, auditing, and financial or other reporting required to serve as the person who has overall responsibility for the same type of engagement." While these statements are not necessarily contradictory, considered together, they are confusing. For example, one could argue that a senior manager cannot meet the definition of "competent," as a senior manager could not, by virtue of his or her title, be an engagement partner who has "*overall responsibility for the same type of engagement.*" Similarly, a person outside of the firm would have the same issue. We recommend that the Board reemphasize for clarity, in paragraph 4, that the engagement quality reviewer need not be a partner, notwithstanding the requirement to "possess the level of knowledge and competence related to accounting, auditing, and financial or other reporting required to serve" as the engagement partner.

Page 9 of the proposing release provides, as an example of the appropriate knowledge and competence of an engagement quality reviewer, a statement that a person assigned to perform the engagement quality review for an audit of a company involved in "oil and gas exploration" should have experience sufficient to serve as the engagement partner in this specialized industry. We are concerned that this example places too much focus on specialized industry expertise and again suggests that the engagement quality reviewer in all instances should be a partner. We recommend removing this example from the release, and including a statement in paragraph 4 of the standard that "considerations in evaluating competence include, but are not limited to, technical expertise, experience, knowledge of SEC rules and regulations pertinent to the engagement, and industry knowledge."

Footnote 18 of the Board's proposing release states, "The determination of what constitutes the appropriate level of knowledge and competence should be based on the circumstances of the engagement, including the size or complexity of the business." We believe this statement is useful guidance and reflects the concept of judgment necessary when assigning an engagement quality reviewer to an engagement, and we recommend that it be added to the standard.

*Independence, Integrity, and Objectivity*

We are concerned that the language in paragraphs 5 and 6 of the proposed standard redefines the notion of objectivity as it is currently explained in the PCAOB professional standards, and that this language, which is written very broadly, might be misinterpreted in a way that could negatively affect audit quality. Our specific comments regarding objectivity as it relates to communication between the engagement quality reviewer and the engagement team and communication between the engagement quality reviewer and the audit committee or management are set forth below.

*Communication between the Engagement Quality Reviewer and the Engagement Team*

Paragraph 5 of the proposed standard explains that “The engagement quality reviewer must be independent of the company, perform the engagement quality review with integrity and maintain objectivity with respect to the engagement and the engagement team” (emphasis added). While we agree the engagement quality reviewer must maintain objectivity, paragraph 5 could be interpreted to suggest that the Board is changing the definition of the word “objectivity.” Historically, “objectivity” has been defined with respect to the audit; that is, the engagement team and the concurring review partner are required to perform their procedures with skepticism and objectivity.

Furthermore, the note to paragraph 6 of the proposed standard and footnote 19 of the proposing release also could be interpreted to limit the discussions between the engagement team and the engagement quality reviewer. The note to paragraph 6 states the following: “The engagement team may consult with the engagement quality reviewer on matters during the course of the engagement. When participating in such consultations, the engagement quality reviewer should not participate in a manner that would compromise his or her objectivity with regard to the engagement” (emphasis added). We believe that consultation is an important element of audit quality and that the standard should encourage consultation with the engagement quality reviewer.

To avoid the unintended consequence of limiting communications between the engagement team and the engagement quality reviewer that we do not believe compromise objectivity, we recommend:

- Replacing the language in paragraph 5 with language similar to that of QC Section 20, so that it states the following: “Engagement quality reviewers must be independent of the company and perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities.”<sup>6</sup>

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<sup>6</sup> See PCAOB Interim Standards, QC 20.09.

- Removing the second sentence of the note to paragraph 6. If the Board is concerned about the engagement quality review partner making an objective assessment, the standard could include language similar to that in the Board's interim standard on concurring reviews as follows:

“When discussion occurs with the concurring partner reviewer on an accounting, auditing, or financial reporting matter during the engagement, the audit engagement partner ordinarily should develop an initial resolution to the matter before discussion with the concurring partner reviewer.”

We note this language appears on page 11 of the Board's proposing release. Incorporating this language in the standard will make it clear that the Board is not intending to limit communications between the engagement quality reviewer and the engagement team or change the manner in which the two interact.

#### *Communications between the Engagement Quality Reviewer and the Audit Committee or Management*

We note that the standard is silent with respect to appropriate communications between the engagement quality reviewer and the audit committee or management. Without guidance on this topic, the proposed standard could be read to discourage such communications.

To address this concern, we recommend that the standard include guidance that communications between the engagement quality reviewer and management or the audit committee would not necessarily compromise objectivity. In addition, we recommend that the standard adopt the language that is in footnote 3 of the PCAOB's interim standard on concurring reviews: “A client may contact the concurring partner reviewer with respect to matters requiring immediate attention when the audit engagement partner is not available because of illness, extended travel or other reasons. When a concurring partner reviewer is thus required to deal with an accounting, auditing or financial reporting matter, he or she should advise the audit engagement partner of the facts and circumstances so that the audit engagement partner can review the matter and take full responsibility for its resolution.”

#### **Documentation of an Engagement Quality Review**

Paragraph 14 of the proposed standard, regarding documentation of an engagement quality review, is unclear in some respects and could lead to significant divergence in practice. To add clarity, we recommend that the Board consider including a requirement consistent with paragraph 27 of the International Auditing and Assurance Standards Board's Proposed Redrafted International Standard on Auditing (“ISA”) 220, *Quality Control for an Audit of Financial Statements*, which states:

The engagement quality control reviewer shall document, for the audit engagement reviewed, that:



- (a) The procedures required by the firm's policies on engagement quality control review have been performed;
- (b) The engagement quality control review has been completed before the date of the auditor's report; and
- (c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.<sup>7</sup>

In case the Board decides to retain documentation requirements along the lines of paragraph 14 of the proposed standard, we are concerned specifically that the Board's intent in paragraphs 14(b), (d), and (e) is unclear as described in the following paragraphs.

Paragraph 14(b) requires that the areas of the engagement subject to the engagement quality review be documented. In our view, an entire engagement is subject to the engagement quality review. However, if that interpretation is what the Board intended, it would not seem necessary to document that the engagement was subject to an engagement quality review, as that point would be self-evident from the engagement quality reviewer's concurring approval of issuance of the auditor's report. If the Board's intention is for the documentation to reflect which individual work papers were reviewed or something else, we recommend that the Board clarify that point.

Paragraph 14(d) requires that the engagement documentation reflect "when the review procedures were performed." An engagement quality review involves a variety of procedures, including review of individual work papers, review of draft financial statements and SEC filings, and discussion with the engagement partner and other engagement team members. If the Board's intent is that the engagement quality reviewer document when he or she reviews individual work papers, we recommend that this point be clarified. We do not believe, however, that it is appropriate for there to be a higher standard for documentation for engagement quality reviewers than for members of the engagement team or that such a standard would provide a benefit commensurate with the significant effort.

Paragraph 14(e) requires that the results of the review procedures be documented. We believe some auditors may view "the results of the review procedures" to be whether issuance of the auditor's report is approved. If this interpretation is correct, this requirement is redundant with paragraph 14(f), which requires documentation of whether the engagement quality reviewer provided concurring approval of issuance. We believe others may view "the results of the review procedures" to denote a detailed record of considerations made by the engagement quality reviewer, questions asked of the engagement team (e.g., review notes) with documentation of the engagement team's

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<sup>7</sup> Our concerns regarding the proposed requirement for an affirmative conclusion by the engagement quality reviewer in an audit engagement are included in this letter under "Concurring Approval of Issuance."

responses, etc. The latter interpretation would result in an effort substantially incremental to practice under the Board's interim standard and the need for a significant increase in engagement quality reviewer resources, with minimal benefit. We recommend that the Board eliminate paragraph 14(e) to avoid confusion and unnecessary effort.

