



CENTER FOR CAPITAL MARKETS

C O M P E T I T I V E N E S S

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

**Re: Public Company Accounting Oversight Board Rulemaking Docket
Matter No. 025**

Dear Members and Staff of the Public Company Accounting Oversight Board:

The United States Chamber of Commerce (“Chamber”) is the world’s largest business federation representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

To achieve this objective, it is an important priority of the CCMC to promote an effective financial reporting policy. The CCMC recognizes the vital role of external audits in our markets and supports efforts to maintain and improve audit effectiveness, including by improving quality control and auditing standards. The concurring partner review (engagement quality review (“EQR”)) is a longstanding component of audit firms’ quality control systems and procedures, and so we appreciate the opportunity to comment on the Public Company Accounting Oversight Board (“the Board”) *Proposed Auditing Standard on Engagement Quality Review*. Our comments focus on several important issues raised by the Board’s standard-setting process in general, the approach used in developing the standard under consideration, and specific concerns related to the proposed standard.

Accordingly, the CCMC recommends that the above reference proposed standard be withdrawn and that significant reforms be undertaken to improve the Boards development and implementation of auditing standards.

Audit Standard Setting Process

The current draft is the second time that the Board has exposed an EQR standard for public comment. The Board's initial draft was proposed on February 28, 2008 ("2008 proposal"), and represented the Board's first new auditing standard, not involving documentation or Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX"). The Board received 38 comment letters on the 2008 proposal – many expressed concerns and confusion over the proposed guidance and the Board's intent as to the role of the EQR. The feedback led to substantive revisions and the need to re-expose the proposed guidance for public comment. However, the nature of the feedback highlights the need of the Board to reconsider its standard-setting approach.

The current standard-setting process lacks both transparency and a sufficient set of stakeholders that have the requisite expertise. As a result, the current process creates uncertainty and undermines clarity and meaning in any proposed standard. These factors complicate the consideration of a proposed standard during the comment process, as occurred with the 2008 proposal, and these complications would be compounded in the implementation of any final standard.

Unlike the Financial Accounting Standards Board ("FASB"), the International Accounting Standards Board ("IASB"), the International Auditing and Assurance Board ("IAASB"), and the Auditing Standards Board ("ASB"), the Board has *not* chosen to develop auditing standards through a transparent process. Outsiders can only observe the open meeting at which the Board votes to issue a proposed or final standard. No transparency exists with the Board's deliberative process for crafting standards. The Board's due process for auditing standards occurs through a formal comment period on a proposed standard. Such formal comment processes are likewise used by the other standard-setting bodies, although their comment processes have been informed by outsiders being able to observe and comment on the deliberations of the standard-setting body along the way.

Furthermore, because the Board appears to rely on an insular procedure without using task forces or other mechanisms to foster outreach, the Board process for developing and drafting auditing standards excludes meaningful contribution from outsiders with current, relevant expertise. Therefore, the Board, in developing new

standards, does not seek input from the most knowledgeable experts on any particular issue. Therefore, the Board, in developing new standards, does not seek input from a wide range of participants, or the most knowledgeable experts on any particular issue.

The Board has formed a Standing Advisory Group (“SAG”), which is tasked as its external source of advice on standards, including the current proposed EQR standard. SAG consists of thirty or so members, as representatives of various stakeholders in public company audits. While the SAG membership is made up of highly competent individuals, only a few – currently, less than a quarter – are associated with audit firms. Moreover, SAG meetings are limited in frequency and duration. The Board convenes SAG about twice a year for one-day public meetings. While SAG agendas have touched on a variety of issues, the discussions tend to be quite wide-ranging and general, without the focus needed to develop any consensus. Given these factors, SAG has little impact in the development and crafting of auditing standards.

Moreover, SAG meetings do not provide a meaningful forum for open dialogue and interaction with the Board and staff. During SAG meetings, the attending Board members and staff maintain a “listening mode,” based on Board instructions *not* to express views or comments. So, the SAG meetings provide little, if any, insight on the Board or staff thinking on a standard or its development. To illustrate, at the April 2, 2009 SAG meeting, during a discussion of the recently proposed EQR standard, SAG members requested clarification of the Board’s intent in revising the standard to reflect a “due professional care” requirement (par. 12), while the Board stated in the release text that “due professional care” equates to “the same requirement as the knows, or should know” (p. 24). The SAG request was met with silence – no Board or staff member in attendance would respond to this straightforward request.

To address these important issues, we encourage the Board to reconsider its entire approach to standard-setting. The Board is not composed of audit experts and it is unrealistic to expect it to hire a staff of permanent employees that can have or maintain the requisite expertise to formulate standards for *all aspects* of public company audits. Formulating standards requires a breadth and depth of current, relevant audit knowledge and experience. Outside expertise is vital, but the current SAG apparatus does not provide it. Task forces seem to be one of several ways to

contribute the necessary expertise and contribution of diverse viewpoints to the standard-setting process. Furthermore, we encourage the Board to develop a more transparent and open standard-setting process. For example, dedicated sessions for discussing issues, including sessions for staff education of the Board, could be public. In this way, the views and deliberations of the Board could be better understood by all market participants.

More importantly, SOX Section 103 gives the Board great flexibility in its approach to standard-setting. For example, rather than formulate its own standards, SOX allows the Board to adopt standards proposed by other professional groups of accountants (with or without modification). One logical group that could be tapped into would be the IAASB. And, it is noteworthy that the IAASB has an updated EQR standard.

Adopting standards proposed by the IAASB is likewise consistent with the spirit of convergence. As we have previously expressed,¹ we encourage the Board to embrace the convergence of auditing standards. In continuing to propose its own standards for audits of public companies in the United States, the Board once again fails to acknowledge the globalization of the economy and the unique needs these changes have imposed upon businesses and investors alike. Commonalities in the dissemination, reliability, and evaluation of financial information assist in the sound operation of markets. With this proposal, as currently constituted, the Board has missed an opportunity to advance the convergence of international auditing standards.

EQR Objective and the Standard of Care for Performing an EQR

As noted, the 2008 proposal generated a good deal of consternation and concern. The Board has revised the wording of the current proposed standard in an attempt to address the issues raised by previous commenter's. Nonetheless, in several important areas, the Board appears to temper its revisions within the standard and through the use of release text, actually modifies the standard and undermining its intent and meaning. Essentially, the Board appears to be maintaining its prior

¹ For example, see letter from the United States Chamber of Commerce's Center for Capital Markets Competitiveness on PCAOB rulemaking docket matter No. 026, *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (February 18, 2009).

positions as put forth in the 2008 proposal, in spite of the revisions set forth in the proposed standard under consideration. These inconsistencies will certainly create confusion in the implementation and enforcement of such a standard. For example, release text is often used to interpret the Board's standards as part of inspection, private litigation, and regulatory enforcement activities. Two important areas in which inconsistencies occur between the proposed standard and release text involve the objective of the EQR and the standard of care for performing an EQR.

A. *EQR Objective*

The proposed standard states that the objective of the EQR "is to perform an evaluation of the significant judgments made by the engagement team and the conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance" (par. 2). This seems a reasonable objective.

On the other hand, subsequent paragraphs in the proposed standard modify this objective by stating, for example, that: "[i]n an audit, the engagement reviewer may provide concurring approval of issuance only if, after performing with due professional care the review required by this standard, he or she is not aware of a significant engagement deficiency" (par. 12). This is followed by a note that explains a "significant engagement deficiency in an audit exists when (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the Board, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client" (par. 12). Furthermore, based on paragraph 12 (for an audit), due professional care applies to the EQR required by the standard as a whole, and is not limited to the conduct of the EQR requirements in paragraphs 9, 10, and 11. Thus, the language in paragraph 12 (including the note) appears to considerably broaden the original objective of the EQR, as stated in paragraph 2, from evaluating significant judgments by the engagement team to searching for possible engagement deficiencies.

To help address this issue for audits, we recommend that the Board revise paragraph 12, confine the conduct of the EQR to the requirements in paragraphs 9, 10, and 11, and eliminate the note (and make a similar revision to paragraph 17 for interim reviews, to confine the conduct of the EQR to the requirements in paragraphs 14, 15, and 16). For example, we suggest the following wording for paragraph 12: “In an audit, the engagement reviewer may provide concurring approval of issuance only if, after performing with due professional care the requirements in paragraphs 9, 10, and 11, he or she is not aware of any matters that would cause him or her to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects, or that the firm’s audit was not performed in accordance with the Board’s auditing standards.”

This suggested clarification is of added importance because the release text in several places does not reiterate paragraph 2, rather the release text states that the objective of the EQR is to detect any significant engagement deficiencies. For example, the release text says that the “[e]ngagement quality review (‘EQR’) is an opportunity for the auditor to discover any significant engagement deficiencies” (p. 2). Also, the release text says “...the Board continues to believe that in order to improve audit quality, the standard must require an EQR that serves as a meaningful way to identify significant engagement deficiencies in time to correct them” (p. 4).

It is noteworthy that identifying significant engagement deficiencies is an objective of the Board’s inspection. So, the question naturally arises, in spite of the stated objective in the proposed standard (par. 2), whether the Board continues to equate the EQR review with an inspection, albeit with the distinction that the EQR is performed prior to the release of the auditor’s report. Such a view would be consistent with the position expressed by one Board member at the 2008 open meeting, who said that “...a thoughtful engagement quality reviewer – who after all has access to the same information we do as part of our inspections – could have found and focused the firm on these deficiencies before we inspected the firm.”² But, of course, the EQR reviewer does not have the same information as a Board inspector. Not only does the available information change post-issuance of the audit

² Statement of Board Member Charles D. Niemeier at the PCAOB February 26, 2008 Open Meeting on the *Proposed Auditing Standard on Engagement Quality Review*.

report and with the passage of time, but the inspection process typically involves a team of people that follow different procedures and processes than an EQR reviewer. It is simply inappropriate to conflate Board inspections and EQRs.

B. *Standard of Care for Performing the EQR*

Further compounding the confusion about the Board's intent with respect to the role of the EQR is the inconsistency between the proposed guidance and the release text as to the standard of care for performing an EQR. As previously noted, the proposed standard refers to "due professional care" and references AU Section 230, *Due Professional Care in the Performance of Work*. However, in the release text, the Board undermines the use of "due professional care" and alters its current meaning in the professional literature by stating: "While auditors should be more familiar with 'due professional care' than the concurring approval standard in the original proposal, the requirement to exercise due professional care imposes on a reviewer essentially the same requirement as the 'knows, or should know based on the requirements of this standard' formulation in the Board's original proposal" (p. 24).

A standard of "knows, or should know" is akin to a strict liability requirement for engagement deficiencies. The proposal not only would impose a new legal standard, but does so through the backdoor of release text and contravenes both audit standards and the legislative process. Moreover, it imposes this new standard on all auditors – not just EQR reviewers – because the release text will be used by plaintiff attorneys, Board inspectors, and other regulators as indicative of the Board's definition of due care, in spite of AU Section 230. As such, the "knows, or should know" definition of due care in the release text significantly exacerbates litigation risk and sustainability concerns for public company auditors. In both concept and application, this is simply unacceptable and the entire first paragraph on page 24 of the release text should be deleted.

Other Comments

We have two additional comments on the specifics of the proposed standard related to the qualifications of the EQR reviewer and the effective date of the proposed standard. The proposed standard responds to a good deal of feedback that

the Board received on these two matters. However issues still remain in the latest proposal.

A. *Qualifications of an Engagement Quality Reviewer*

The *existing* quality control requirements call for partners to conduct EQRs, although the Boards Rule 3400T allows that audit firms may seek a waiver to engage an academic or other experienced accountant to perform the EQR. Setting aside whether academics generally would have the requisite experience and expertise to serve as EQR reviewers, the Board has provided no information on how many audit firms have sought or been granted such waivers. However, given the lessons we are learning from the Madoff fraud, the Board should be cautious about promulgating a standard that retrenches on any existing requirements for EQR reviewers with respect to smaller firms.

The proposed standard has a general competence requirement and otherwise requires independence, integrity, and objectivity. However, it does not appear to sufficiently appreciate that competence comes from experience for all EQR reviewers. And, it does not appreciate the necessity of ensuring requisite authority for reviewers from outside the firm. In regards to these two issues, and consistent with our comments on the need for the Board to embrace the convergence of auditing standards, it would be worthwhile for the Board to consider the requirements of the IAASB in International Standards on Auditing (“ISA”) 220. ISA 220, which has been through due process, explicitly recognizes the need for both experience and authority by defining the engagement quality control reviewer as “a partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the auditor’s report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the auditor’s report.” As such, ISA 220 provides a *higher threshold* for serving as an EQR reviewer than that in the Board’s proposed standard.

B. *Effective Date of the Proposed Standard*

The Board intends to make a final standard effective, subject to approval by the Securities and Exchange Commission (“SEC”), for fiscal years *beginning* after December 15, 2009 for EQRs of interim reviews. However, for EQRs of audits, the Board intends to make a final standard effective, subject to SEC approval, for audits of fiscal years *ending* on or after December 15, 2009. The Board expressed sympathy for concerns expressed by commenter’s on the 2008 proposal that implementing any new EQR requirements in the middle of an engagement could be disruptive. Nonetheless, the Board concluded that “it is important to strengthen the existing requirements as soon as practicable” (p. 27).

The CCMC respectfully disagrees that the proposed standard is a strengthening of the existing requirements. In addition, it is not practicable to implement a final standard in 2009. Given the time required for the Board to consider comments, prepare, and approve a standard and then for SEC to consider the Board’s standard, including the requisite SEC public comment process and vote by the Commission, implementation in 2009 is not feasible. It should simply be abandoned as a goal.

Responsibility for any delays in promulgating a new EQR standard resides with the Board. The Board should not impose hardships on audit firms and EQR reviewers because of problems with the Board’s standard-setting process.

Conclusion

In conclusion, we appreciate the opportunity to comment on the Board’s *Proposed Auditing Standard on Engagement Quality Review*. It is important to ensure that the Board gets the guidance right. Likewise, it is important to ensure that the Board avoids confusing or undermining any guidance through inconsistent statements; in particular in the release text that accompanies any final standard.

However, given the substantive nature of our comments, the CCMC remains concerned that the proposed standard represents a step backward. Accordingly, it is respectfully submitted that the Board should withdraw the proposed standard and

Office of the Secretary
April 20, 2009
Page Ten

extend the current EQR requirements to all registered audit firms,³ while it deliberates its next steps.

Finally and most importantly, it is apparent that the Board's standard setting process needs to be reformed. The CCMC strongly encourages the Board to address this challenge, and stands ready to assist the Board in any manner.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard Murray". The signature is fluid and cursive, with a long, sweeping tail on the final letter.

Richard Murray
Chairman
U.S. Chamber of Commerce
Center for Capital Markets Competitiveness

³ See Statement of Board Member Bill Gradison at the March 4, 2009 Open Meeting on *Proposed Auditing Standard on Engagement Quality Review*.