



May 12, 2008

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

Via e-mail: comments@pcaobus.org

Audit - Tax - Advisory

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687

T 312.856.0200
F 312.565.4719
www.GrantThornton.com

Re: PCAOB Rulemaking Docket Matter No. 025, *Engagement Quality Review*

Dear Board Members and Staff,

We appreciate the opportunity to comment on the proposed auditing standard, *Engagement Quality Review*. We support the Public Company Accounting Oversight Board's ("Board" or "PCAOB") mission to develop auditing standards that promote audit quality, and we believe that a robust and effective engagement quality review enhances audit quality. In our opinion, an objective engagement quality review that focuses on a review of significant matters, including significant judgments made and conclusions reached by the engagement team, will accomplish that purpose. We believe that the proposed standard does not clearly articulate the objectives of the quality review and that the proposed requirements will result in additional audit time and costs that will not have a commensurate benefit to audit quality.

Objective of the engagement

We believe that a carefully crafted objective would enable the engagement quality reviewer to know when he or she has fulfilled the objective of the standard. The objective would also help define who would be qualified to perform an engagement quality review in that the person qualified to perform the review would need to have the skills to meet the objective. The objective also would clarify expectations of third parties, for example, financial statement users and regulators, with respect to what an engagement quality review is and is not.

We believe that an objective based on the existing standard is appropriate. We suggest:

The objective of the engagement quality reviewer is:

- a To review the documentation of those significant auditing, accounting, and financial reporting matters, including significant judgments made and conclusions reached by the engagement team as a result of the procedures performed.

- b On the basis of the review of audit documentation and discussions with the engagement team, to conclude whether matters that have come to his or her attention would cause the engagement quality control reviewer to believe that the audit was not performed in accordance with the standards of the PCAOB or that the financial statements are not in conformity with generally accepted accounting principles.

We believe it is important that the objective maintain the separation between the engagement partner and the engagement quality reviewer. That is, the objective should reflect that the requirement is to review significant matters, and not to perform a separate audit risk assessment or substantive procedures to obtain audit evidence.

The engagement quality review process

We have concerns that the proposed standard fundamentally changes the role of the engagement quality reviewer. Our first concern is with the “knows or should know” standard. We believe that the engagement quality reviewer will have to perform substantial work before being comfortable that he or she knows everything that he or she *should* know – especially since what should have been known will inevitably be judged with hindsight.

The concern is exacerbated by the lack of boundaries around some of the procedures that the engagement quality reviewer is required to perform. For example, paragraphs 8(a) and 8(b) require the engagement quality reviewer to obtain an understanding of the firm’s recent engagement experience with the company, risks identified in connection with the firm’s client acceptance and retention process, the company’s business, significant activities, and significant reporting issues and risks. The proposal, as drafted, appears to require the engagement quality reviewer to obtain his or her own understanding, rather than to obtain such an understanding through inquiries of the engagement team and the review of the audit documentation.

Paragraph 8(c) requires the engagement quality reviewer to review the engagement team’s evaluation of the firm’s independence in relation to the engagement. We note that engagement teams rely on the firm’s systems in this area. We believe that the engagement quality reviewer’s review should be limited to the engagement team’s evaluation of threats to independence and safeguards put in place to protect against those threats. The review also should cover the engagement team’s required communications with the audit committee concerning independence.

We also believe that paragraph 9 requires an independent risk assessment by the engagement quality reviewer rather than a review of the engagement team’s risk assessment. We do not believe that an engagement quality reviewer can perform a risk assessment that is equivalent to that of the engagement team without incurring unnecessary costs, since such a risk assessment would be duplicative.

We believe that the requirement in paragraph 10 to “evaluate whether the engagement documentation of the *matters* that were subject to the engagement quality review procedures... is consistent with the requirements of PCAOB Auditing Standard No. 3”, goes beyond what should be required of the engagement quality reviewer. First, it is the responsibility of the

engagement partner to determine that the engagement documentation is consistent with the requirements of Auditing Standard No. (AS) 3. Second, the entire engagement is “subject to the engagement quality review procedures.” Finally, the documentation associated with any particular *matter* might be quite voluminous. We question how far the engagement quality reviewer would have to look for missing documentation. If the requirement remains, we believe that it should be to evaluate whether the documentation that the engagement quality reviewer has reviewed is consistent with the requirements of PCAOB AS 3.

We believe that the extent of these requirements, when considered in conjunction with the statement in paragraph 12 that “[t]he engagement quality reviewer must not provide concurring approval of issuance if he or she *knows, or should know* based on the requirements of the standard...”, means that the engagement quality reviewer must obtain a level of knowledge to be able to provide assurance at a level comparable to that of the engagement partner (and in some cases, for example, in the case of a review of interim financial information, greater than the engagement partner). We believe that the additional communication between the engagement quality reviewer and the company that would be necessary for the engagement quality reviewer to obtain this level of knowledge will make it difficult for the engagement quality reviewer to perform the review without conflicting with the requirement to maintain objectivity, as set out in paragraphs 5-6. This will add significant cost and may raise concerns about the ability of the engagement quality reviewer to maintain his or her objectivity.

Notwithstanding the PCAOB’s stated beliefs that the proposal should not have a radical effect on the basic nature of reviews or on the cost of public company auditing, we believe that, if adopted as proposed, this standard will fundamentally change the nature of engagement quality reviews. We believe it will impose substantial unnecessary additional costs on public company audits, and increase the time needed to perform the engagement quality review such that it may significantly affect the ability of accelerated filers to make timely filings with the U.S. Securities and Exchange Commission (“SEC”).

We believe that an engagement quality reviewer who performs the review using due professional care and appropriate professional judgment would have an adequate basis to determine if something came to his or her attention to indicate that one of the four conditions in paragraph 12 exists. PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations*, would appear to address this issue. To avoid the unintended consequence of engagement quality reviewers spending inordinate amounts of time searching for what they “should know,” we suggest that the PCAOB rely on the concepts of due professional care, professional judgment, and lack of recklessness that already exist in the literature.

Engagements for which an engagement quality review is required

We commend the PCAOB for the proposal to require that all registered public accounting firms – not just those that were members of the American Institute of Certified Public Accountant’s SEC Practice Section in April 2003 – be required to comply with the final standard. We believe that this certainly is in the public interest.

We note that the proposed standard would apply to all engagements performed in accordance with the standards of the PCAOB. We recommend that the applicability of the requirements, and of the standard itself, to engagements other than audits, for example, attestation engagements, letters for underwriters, reports on the application of accounting principles, and interim reviews, be carefully considered. While it may be appropriate to require an engagement quality review for these other engagements, we found that the requirements in this proposal were so specifically tailored to audits, that it would be difficult to apply the proposed standard to these other types of engagements. For example:

- We do not believe that it would be necessary for the engagement quality reviewer 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, *Asset-Backed Securities*.
- There is misunderstanding and disagreement on the period of time that the "prior period" (paragraph 8(g)) covers in the case of a third-quarter review of interim financial information or a report on the application of accounting principles. Some believe it is the previous quarter. Others believe it is the prior year's audited financial statements.
- We do not believe that it would be necessary for the engagement quality reviewer to read other information in documents containing an attestation report on the assessment of compliance with servicing criteria under the SEC's Regulation AB (paragraph 8(h)), in those circumstances where the practitioner performing the attestation engagement is not required to read such information.
- Paragraph 9 requires the engagement quality reviewer to assess whether there are areas that pose a higher risk that the engagement team has failed to obtain "sufficient competent evidence." In the case of a review of interim financial information or letters for underwriters, "sufficient competent evidence" goes beyond the evidence that the engagement team would be required to obtain.
- Paragraph 10(a) implies that the requirements of AS 3 now apply to attest engagements, which goes beyond the stated scope of AS 3.

Furthermore, in the case of a review of interim financial information, it appears that the proposed standard puts the engagement quality reviewer in the position of having to obtain more evidence, and a higher level of assurance, than the engagement team. For example:

- An engagement team's documentation in a review ordinarily does not include explicit risk assessments (paragraph 8(d) and paragraph 10).
- A review does not ordinarily contemplate obtaining "sufficient competent evidence" (paragraph 9 and 12).
- In a review, the affirmative conclusion that the engagement quality reviewer must reach in paragraph 12 goes beyond the negative assurance required of the engagement team.

We believe that, in order to maintain the specificity in this proposed standard, it would be helpful to keep it focused on audits of financial statements, and at some time in the future, draft other standards that apply to other types of engagements. This approach would have the added benefit of keeping the auditing standards and the attestation standards clearly delineated.

Qualifications of the engagement quality reviewer

We agree with the proposal to allow an engagement quality reviewer to be a partner of the firm, another individual in the firm, or an individual outside the firm. We believe that this is important to smaller registered firms, and will allow the firms to appoint appropriate engagement quality reviewers while also helping to alleviate some of the challenges associated with work compression, the five-year rotation requirement, and the limited number of available qualified resources. We also fully support the provision that an engagement quality reviewer should be an associated person of a registered public accounting firm, and that he or she should have competence, independence, integrity and objectivity.

With respect to the description of what constitutes a competent engagement quality reviewer, we note an apparent inconsistency between the proposal in paragraph 2, which allows the engagement quality reviewer to be another individual in the firm, and the requirement in paragraph 4 that the engagement quality reviewer possess the level of knowledge and competence relating to accounting, auditing, and financial or other reporting required *to serve as the person who has the overall responsibility for the same type of engagement*. We read the emphasized phrase to mean that a competent senior manager would not be qualified to serve as the engagement quality reviewer since this person was not a partner. In addition, the portion of this phrase that states “for the same type of engagement” indicates that, if the reviewer had not been a person with overall responsibility for an engagement of the same size, complexity, etc., then that person could not qualify as an engagement quality reviewer, even if that person were a partner.

Assuming that an objective of the proposed standard is developed, we believe that the following edit to paragraph 4 would help (1) eliminate this apparent inconsistency, and (2) properly cast the skills necessary to perform the engagement quality review as those technical skills necessary to perform the review, and not necessarily all of the skills required to be an engagement partner:

The engagement quality reviewer must possess the level of **technical** knowledge and competence relating to accounting, auditing and financial or other reporting required to **fulfill the objective of this standard** ~~serve as the person who has overall responsibility for the same type of engagement.~~

Footnote 18 of the release states that, “The determination of what constitutes the appropriate level of **technical** knowledge and competence should be based on the circumstances of the engagement, including the size or complexity of the business.” We believe that this would be helpful guidance to be included in the body of the standard, perhaps as a note to paragraph 4.

Concurring approval of issuance

The proposed standard requires the engagement quality reviewer to provide concurring approval of issuance of each audit report, and that such approval cannot be granted if certain conditions are present. On page 16 of the release, it is acknowledged that differences of opinion could occur between the engagement team and the engagement quality reviewer, and that, if those differences have not been satisfactorily resolved, the engagement quality reviewer must not provide concurring approval. We believe that this resolution of differences is an important contributor to audit quality, but the concept is not addressed in the proposed standard. We suggest that the standard state that, if one of the four conditions in paragraph 12 exists, *and those differences have not been satisfactorily resolved*, the engagement quality reviewer must not provide concurring approval.

Documentation of an engagement quality review

We believe that some of the requirements in paragraph 14 are not clear, or go beyond existing documentation requirements. For example:

- Paragraph 14(b) requires documentation of the *areas* of the engagement *subject to the* engagement quality review. Since all areas are subject to the engagement quality review, this requirement is not clear. If the Board means that the areas reviewed by the engagement quality reviewer should be documented, that should be clarified. Even then, how, and to what level of detail, one documents an “area” is not clear.
- Paragraph 14(d) requires the documentation of when the 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. The requirement to document when each of these procedures was performed would be a higher standard for the documentation of engagement quality reviews than for the engagement team. Compliance with this requirement will result in multiple signoff dates for each procedure performed.
- Paragraph 14(e) requires the documentation of the results of the review procedures. We believe that this could be read as requiring a detailed record of procedures performed and considerations made by the engagement quality reviewer, questions asked of the engagement team (e.g., review notes) with documentation of the engagement team’s responses, etc. This would result in a significant change in practice, without an improvement in audit quality.

We recommend that the Board eliminate paragraph 14(e), since the results of the review procedures will be clear when the engagement quality reviewer concurs with the issuance of the report. We further recommend that the documentation requirements in this standard parallel the documentation requirements in paragraph 6 of AS 3, as follows:

Documentation of an engagement quality review must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement:

- a To understand the nature, timing, extent and results of the review procedures performed, and conclusions reached, and

- b To determine who performed the review procedures and the date such review procedures were completed.

Tone at the top

The proposed standard does not include a discussion of the importance of the firm's tone at the top in ensuring the objectivity and independence of the engagement quality reviewer. This matter is included in the interim standards and should not be omitted.

Engagement partner movement to engagement quality reviewer

The Board's interim standards state, "... a prior audit engagement partner should not serve as the concurring partner reviewer for at least two annual audits following his or her last year as the audit engagement partner." We believe that this requirement is appropriate and should be retained in the final standard.

Paragraph-level comments

The following offers paragraph-level comments for your consideration.

Paragraph	Comment
3	The note to this paragraph deals with a matter that is a component of a firm's quality control system and therefore, it is not appropriate to include it in an auditing standard.
5	The proposal indicates that the engagement quality reviewer may seek assistance from others to complete the review, but the overall responsibility remains with the engagement quality reviewer. We believe it would be appropriate to indicate that those who assist the engagement quality reviewer also must be independent, have integrity, maintain objectivity <i>and be competent</i> .
6	Paragraph 6 appears to prohibit communications between the engagement quality reviewer and management or those charged with governance. We recommend that the standard adopt language that is in Footnote 3 of the PCAOB's interim standard on concurring reviews: "It is not unusual for clients to be aware of the existence of a concurring partner reviewer. 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."
8(i)	"Appropriate" communication, particularly with management, occurs throughout the course of the audit, is often verbal, and usually not in the presence of the engagement quality reviewer. We believe that the engagement quality reviewer should review whether specific communications, for example, those regarding audit adjustments and control deficiencies, are appropriately documented.
9	The proposed standard requires the engagement quality reviewer to assess whether there are areas within the engagement that pose a "higher risk" that the engagement team has failed to obtain sufficient competent evidence or reached an inappropriate conclusion. This seems to focus the risk on the engagement team, and not on the risk of material misstatement of the financial statements. We believe that it would be more effective to consider areas of significant risk of material misstatement of the financial statements, and whether the engagement team appropriately addressed them. Otherwise, there is a risk that the engagement quality reviewer may focus on areas where there is a higher risk that the engagement team has failed to obtain sufficient competent evidence or reached an inappropriate conclusion, but in an area where there is not a significant risk of material misstatement of the financial statements.

We would be pleased to discuss any of our comments with you. If you have any questions, please contact Mr. John L. Archambault, Managing Partner of Professional Standards, at (312) 602-8701.

Sincerely,



Grant Thornton LLP