

FEBRUARY 26, 2008 OPEN MEETING

PROPOSED AUDITING STANDARD ON ENGAGEMENT QUALITY REVIEW

Statement of Board Member Daniel L. Goelzer

The engagement quality review standard that the Board is considering today would fulfill an important part of the Board's statutory mandate. Congress expressly directed the Board to include in its standards a requirement for a qualified person to perform a concurring or second partner review of every audit report to be filed with the SEC. For the past five years, we have been relying on concurring partner requirements that were developed during the era of self-regulation, before the Board's creation. Those requirements are not applicable to all firms that prepare audit reports filed with the Commission, since only firms that were in existence in 2003 and members of the AICPA's SEC Practice Section need to comply. Today's proposal begins the process of bringing the Board's concurring review standards in line with Congress's directive.

More importantly, the proposed standard would focus renewed attention on what is probably the most common quality control deficiency cited in PCAOB inspection reports. Time and again, the Board's staff identifies audit deficiencies that a properly performed concurring partner review should have detected and caused to be corrected before the audit report was issued. Based on four years of inspections experience, it seems clear that engagement quality reviews have a real potential to reduce the number of after-the-fact audit failure discoveries. Unlike PCAOB inspections, and unlike the internal inspections that the major firms perform, the purpose of these reviews is to backstop the engagement team and to identify problems before the audit report is publicly released, while they can still be addressed. That obviously protects investors in a way that no after-the-fact review or inspection can.

While it is intended to strengthen concurring reviews, the proposed standard is not an exercise in re-inventing the wheel. It builds on, rather than discards, the existing requirements. In my view, the proposal would make four key changes:

- First, the proposal calls more explicitly than the current standard for a risk-based approach. The reviewer would be required to assess whether there are engagement areas that pose higher risks, and to evaluate whether the engagement team performed procedures responsive to those risks.
- Second, consistent with Congress' direction, the proposed standard would require the reviewer to approve the issuance of the audit report. The

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interim standard merely requires completion of a review, not explicit reviewer approval.

- Third, under the proposal, the reviewer could not approve issuance of the audit report if he or she “knows, or should know” that the report is inappropriate. At present, the reviewer only determines that “nothing has come to his or her attention” suggesting that the audit was performed improperly.
- Fourth, the documentation requirements applicable to the concurring review would become more detailed. Currently, the work papers need only “contain evidence that the firm’s policies and procedures with respect to the concurring partner review requirements were complied with.”

Despite these changes, it bears repeating that, for most registered firms, concurring reviews would not be new. The proposal should not have a radical effect on the basic nature of these reviews or on the cost of public company auditing. Many registered firms, including the largest, already have sophisticated concurring review programs. I assume these firms would not have to make fundamental changes in the design of their programs if the proposed standard is adopted. The accuracy of that assumption is, however, something that I hope will be fully explored as part of the comment process.

Finally, it is also important that, before the proposal is finalized, the Board fully understands how the new standard will affect smaller audit firms, especially those where the reviewer is more likely to be outside the firm, rather than a colleague. The potential benefits of a strengthened engagement quality standard are substantial for these firms. We need to make sure, however, that the standard is workable for firms of all sizes and practice types, and that it will not have unintended effects on smaller firm practice. To help us understand these issues, I hope the Board will receive a wide range of robust and candid public comments.