

**NOTICE:** This is an unofficial transcript of the portion of the Public Company Accounting Oversight Board's Standing Advisory Group meeting on April 2, 2009 that related to the Board's proposed auditing standard titled "Engagement Quality Review." The other topics discussed during the April 2, 2009 meeting, including audit confirmations, emerging issues, and going concern, were not related to the proposed auditing standard. Those discussions are not included in the transcript.

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1 PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD (PCAOB)

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STANDING ADVISORY GROUP MEETING

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8:32 a.m.

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Thursday, April 2, 2009

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National Association of Home Builders

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1201 15th Street, N.W.

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Washington, D.C.

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1           So with that, I'd like to move to the first  
2           item on the agenda, engagement quality review, and  
3           I'll turn that over to Greg Scates, who will lead that  
4           discussion.

5                     GREG SCATES: Thank you, Jennifer.

6           As you are aware, soon after the board's  
7           creation, the board adopted certain existing standards  
8           used by the auditing profession. One such standard  
9           was the concurring partner review requirement, which  
10          the board continued to apply on a transitional basis  
11          to register firms that were members of the SEC  
12          Practice Section of the AICPA as of April of 2003.

13          Registered accounting firms that were not  
14          members of the SEC Practice Section, those were  
15          generally non-U.S. firms and some smaller firms, are  
16          not subject to this existing requirement.

17          As part of the board's process of evaluating  
18          the existing concurring partner review requirement,  
19          the board sought the advice of the Standing Advisory  
20          Group on two separate occasions, in June of 2004 and  
21          October of 2005. In addition to input received at  
22          these SAG meetings, the board considered information  
23          on this topic from PCAOB inspections, SEC and PCAOB

1 enforcement cases, and other sources.

2           On February 26 of last year, of 2008, the  
3 board proposed to replace the existing requirement  
4 with a new auditing standard entitled Engagement  
5 Quality Review. The board received 38 comment letters  
6 on this proposal and, in response to the comments,  
7 made significant changes to the original proposal. On  
8 March 4th of this year, the board re-proposed the  
9 standard. The comment period for this re-proposal  
10 ends on April 20th.

11           A transcript of the discussion this morning  
12 will be available on our website, along with the  
13 comment letters that we received.

14           Today we'd like to discuss certain aspects  
15 of the proposed standard that generated significant  
16 feedback from commenters on the original proposal. In  
17 particular, the SAG will discuss questions from the  
18 release related to reviewer qualifications, the  
19 engagement quality review process, concurring approval  
20 of issuance, and documentation of the engagement  
21 quality review.

22           So first, let's turn to reviewer  
23 qualifications. The board originally proposed to

1 allow the engagement quality reviewer to be a partner  
2 or another individual in the firm or an individual  
3 outside the firm. In contrast, as described in the  
4 release on March 4th, the new proposal would require a  
5 reviewer from inside the firm to be a partner or a  
6 person in an equivalent position. Like the original  
7 proposal, the new proposal would allow a qualified  
8 person outside the firm to perform this review.

9 In addition, as under the original proposal,  
10 the reviewer must have independence, integrity, and  
11 objectivity, and must possess the level of knowledge  
12 and competence required to serve as the engagement  
13 partner for the same type of engagement.

14 The discussion questions on reviewer  
15 qualifications taken from the release are on the slide  
16 in front of you. These are the ones we'd like to talk  
17 about first. Is it appropriate to explicitly require  
18 a reviewer from within the firm to be a partner or an  
19 individual in an equivalent position? Should the  
20 standard allow qualified accountants who are not  
21 employed by the accounting firm to conduct the review?  
22 And then should the standard prohibit the engagement  
23 partner from serving as a reviewer for a period of

1 time following his or her last year as the engagement  
2 partner? And if so, is two years a sufficient time,  
3 or should it be extended?

4 So I'd like to go ahead and open up our  
5 discussion here on the reviewer qualifications for the  
6 engagement quality reviewer.

7 JENNIFER RAND: Just for the new members, if  
8 you're interested in making comments, we'll try to  
9 call on you in order. If you could just please put  
10 your name tent on the side, and we'll get to you.

11 GREG SCATES: I'm sorry. Wayne? Wayne  
12 Kolins?

13 WAYNE KOLINS: Yes. I'm just thinking on  
14 the first one, I think it is appropriate for the  
15 reviewer to be a partner, and I would just seek some  
16 clarification in terms of what "equivalent position"  
17 means. I assume that if the accounting firm is not  
18 organized as a partnership, then we're talking about a  
19 name other than a partner, but an equivalent to what a  
20 partner would be in a partnership.

21 GREG SCATES: Yes. We explain that in the  
22 release. Yes, you are correct, Wayne, that if it's  
23 structured like a corporation, then they're sometimes

1 referred to as members, and it would be someone in an  
2 equivalent position as a partner.

3 WAYNE KOLINS: And I do think it is  
4 appropriate for those that are not employed by the  
5 firm, and particularly with respect to smaller  
6 accounting firms. They may have a resource issue  
7 getting the number of partners to serve as a  
8 concurring reviewer, and it has been the experience  
9 for such firms to go outside the firm, perhaps getting  
10 an accounting professor, an audit professor, or  
11 somebody that is very experienced doing these reviews,  
12 and I think that's an appropriate objective and  
13 provision for the standard.

14 GREG SCATES: Thank you, Wayne.

15 Hal Schroeder?

16 HAROLD SCHROEDER: I was curious about the  
17 second requirement or applicability of hiring somebody  
18 from the outside. How do you handle the independence  
19 issue? It seems like if you find someone, as was just  
20 suggested, a professor or someone who develops I would  
21 say a specialty in being this reviewer, will they  
22 become dependent on that stream, and would they tend  
23 to shade their views to make sure they had that steady

1 stream of being the reviewer? They may be qualified,  
2 but their source of income may make them less than  
3 independent.

4 GREG SCATES: Good point. Thank you, Hal.  
5 Gaylen Hansen?

6 GAYLEN HANSEN: I would follow up with  
7 Wayne's comments. I agree that perhaps some  
8 clarification on what equivalent position within the  
9 firm means, what may be a little bit of color on that,  
10 if it were.

11 But at the same time, on the other question  
12 about the outside reviewer, I think the same standard  
13 should apply. I don't know how you have a lesser  
14 standard with outside individuals than what you would  
15 within the firm, and the follow-up with the last  
16 comment. I think the independence issue is typically  
17 resolved with respect to either that individual is  
18 with another registered firm and some sort of  
19 independence confirmation that there's independence,  
20 in fact, with that client.

21 On the third question about the prohibition  
22 of becoming an engagement quality reviewer after  
23 serving as an engagement partner if you still have



1 years open within the five-year rotation period, I  
2 think some break is appropriate. I'm not sure where  
3 the two years came from or why it was thought that  
4 that would be appropriate. I would even ask, in the  
5 interest of smaller firms that have limited resources,  
6 whether a one-year break would be sufficient. I'm not  
7 sure that two years is necessary.

8 GREG SCATES: Bernard Jarvis?

9 BERNARD JARVIS: It's my view also that the  
10 engagement quality review is a very important part of  
11 the audit and ought to be assigned to a person who is  
12 a senior executive in the firm, and that would, in my  
13 opinion, be someone at the partner level. And I'd  
14 just address the third point. I agree with Gaylen  
15 that perhaps in the case of small firms, one year  
16 break. I do agree that some break is necessary, and  
17 I'd agree that about one year would be sufficient.

18 GREG SCATES: Other comments on the  
19 qualifications? Joe Carcello?

20 JOSEPH CARCELLO: I appreciate the sentiment  
21 on the one year. The one thing you probably need to  
22 think about carefully, though, since your purview is  
23 public companies, is two years of balance sheets and

1 three years of income statements and cash flow  
2 statements in the 10-K. And so if there's a one-year  
3 period after someone rolls off being the engagement  
4 partner and they come on and they're the engagement  
5 quality reviewer, at least some of the financial  
6 information and the financial statements that they're  
7 going to be reviewing were financial statements that  
8 they were responsible for auditing.

9 GREG SCATES: Any other comments on the  
10 reviewer qualifications? Arnold Schilder?

11 ARNOLD SCHILDER: Thank you. Just a brief  
12 comment for agreement with what you have done. If I  
13 compare it with what the IAAHB has done in the quality  
14 control standard, you've tried also to define a bit of  
15 a general principle which mentions more general  
16 principles, sufficient and appropriate technical  
17 expertise, experience, and authority, because you can  
18 never, let's say, regulate all detailed circumstances.  
19 So we thought it was helpful to have a bit of a  
20 broader criteria to which against you can judge the  
21 more specific criteria. And I would just offer that  
22 as a thought that might be helpful in the  
23 circumstances.

1           GREG SCATES: Thank you, Arnold.

2           If there are no other comments, we can move  
3 to the next topic. Let's turn to the engagement  
4 quality review process.

5           It's described in the release under the new  
6 proposal like the original proposal. It would require  
7 evaluation of significant judgments made and  
8 conclusions reached by the engagement team, and  
9 specify certain procedures that the reviewer should  
10 always perform. The new proposal provides that the  
11 reviewer should perform these procedures through  
12 discussions with the engagement team and through the  
13 review of documents.

14           Under the original proposal, after  
15 performing certain procedures, the reviewer was  
16 required to perform additional procedures in higher  
17 risk areas of the engagement. This provision is not  
18 included in the new proposal because the board  
19 believes that the required procedures are sufficient  
20 to focus the reviewer on the areas of higher risk.

21           The new proposal describes specific  
22 requirements for an engagement quality review of an  
23 interim review. These requirements are based on the

1 proposed requirements for an engagement quality review  
2 of an audit and are tailored to the different  
3 procedures performed in a review of interim financial  
4 information.

5 Now let's turn to the questions in the  
6 release on the engagement quality review process, as  
7 on the screen in front of you. Are the descriptions  
8 of the scope and extent of engagement quality review  
9 procedures contained in the re-proposed standard  
10 appropriate? Will the performance of these procedures  
11 result in a high-quality engagement quality review?  
12 If not, how should these procedures be revised? Are  
13 these specifically required procedures appropriately  
14 tailored to reflect the difference in scope between an  
15 audit and an interim review? And then lastly, do the  
16 specifically required procedures sufficiently focus  
17 the reviewer on areas of higher risk? Are there other  
18 procedures that should be required?

19 I'm going to open up the floor for  
20 discussion of the engagement quality review process  
21 itself.

22 Wayne Kolins?

23 WAYNE KOLINS: One process, part of the

1 process that I'd like to see put in there is some  
2 guidance or some principle regarding how any  
3 differences of opinion between the engagement quality  
4 reviewer and the engagement partner are worked out.

5 GREG SCATES: Okay. Gaylen Hansen?

6 GAYLEN HANSEN: Yes, I think that resolution  
7 process needs to be addressed that Wayne just brought  
8 up.

9 The other thing that I think would be  
10 helpful is some sort of distinction between  
11 materiality with respect to an audit and a 10-Q  
12 interim review would seem to be appropriate in the  
13 sense that materiality in an audit -- and we all  
14 struggled with that, and we've had those discussions  
15 around this table, but it involves planning and  
16 understanding of the system and internal controls,  
17 whereas I think there's a little bit different meaning  
18 of materiality on interim reviews, and there doesn't  
19 seem to be any kind of distinction with respect to  
20 that and how that is addressed. It talks about  
21 material modifications and the AU -- what is it? 722?  
22 -- and I think if a little bit more was said about  
23 that particular distinction, it would be helpful.

1           GREG SCATES: Randy Fletchall?

2           RANDY FLETCHALL: Greg, I would just like to  
3 comment, first to commend the board. I think the  
4 revisions that were made from the first version to  
5 this version went a long way in clarifying what I  
6 think were some concerns about what exactly is the  
7 process that the standard is articulating.

8           I think likewise the original version, an  
9 audit and interim review were kind of lumped together,  
10 and so now I think it's much clearer that those are  
11 different service levels and the level of the  
12 engagement review is different.

13           Undoubtedly, we will still have a few  
14 comments on a few words that we would suggest,  
15 probably Paragraphs 9 and 10, maybe an addition to  
16 that section that would give some additional  
17 clarification. But I guess I would just say I think  
18 this went a long way in solving what we thought were  
19 some of the concerns.

20           GREG SCATES: Thank you, Randy.

21           Greg Jonas?

22           GREGORY JONAS: I am a little surprised that  
23 the document doesn't give more attention to the issue

1 of timing of the review. In my experience, a key  
2 differentiating factor between substantive concurring  
3 partner reviews and non-substantive, often the root  
4 cause was the concurring partner was in late,  
5 particularly on larger engagements where audits are  
6 kind of like aircraft carriers. If you don't turn  
7 them on a dime, you don't turn them quickly. You've  
8 got to get a running start.

9           The concurring partner, looking at planning  
10 shortly after the planning is done, looking at the  
11 resolution of major issues as they occur throughout  
12 the year, is really an important factor to a quality  
13 review. Also, it helps the concurring partner get  
14 their head in the game, which is critically important,  
15 particularly in complex work.

16           I certainly understand the board's desire  
17 not to be too prescriptive about timing. I appreciate  
18 that timing, best timing practices differ dramatically  
19 from job to job. But I am surprised that it almost --  
20 it walks away from the issue and abdicates any counsel  
21 in a standard in what, in my experience, has been  
22 mission critical to a quality concurring partner  
23 review.

1           JENNIFER RAND: Greg, can I just ask you to  
2 expand on what you might think would be appropriate to  
3 include, recognizing the standard would be to be  
4 applied for all public company audits to have an  
5 engagement quality review? So kind of what in your  
6 view in the timing would you like to see mentioned, if  
7 you have any more thoughts specifically?

8           GREGORY JONAS: Well, if the document at  
9 least talked about the importance of timing, the  
10 importance of concurring partners to get in early,  
11 where desirable, the advantages of doing this, and  
12 simply observe that one of the factors that one  
13 considers when deciding whether a concurring review  
14 was substantive in part relates to the timing. I  
15 wasn't thinking more than that.

16           JENNIFER RAND: Thank you.

17           GREG SCATES: Liz Fender.

18           ELIZABETH FENDER: I'm not sure I'm reading  
19 it correctly, but I was questioning the differences  
20 between the procedures required for an interim review  
21 versus an annual review, and I think the wording was  
22 trying to make it clear that if you're doing an  
23 interim review, you don't have to look at the prior



1 year's disclosures about internal control for the  
2 annual review report. One, is that correct? And two,  
3 would you really do that? Would you really review  
4 somebody's interims and not take a look at what  
5 somebody raised in the prior annual review?

6 GREG SCATES: Liz, are you talking about the  
7 prior -- a review of a prior quarter, or are you  
8 talking about the annual audit?

9 ELIZABETH FENDER: I think the wording says  
10 you only have to look at the prior interim  
11 information. So I didn't know if that was meant to  
12 say you don't have to look at the prior year's annual  
13 audit reports.

14 GREG SCATES: Well, the engagement quality  
15 reviewer would be looking at it if he or she is not  
16 already familiar with the engagement and what happened  
17 in the prior year's audit. If he or she was new to  
18 the engagement, then they would obviously look at  
19 prior year's audit and see what the issues were, what  
20 the audit issues were. In carrying out the interim  
21 review, they would look at the prior quarter. If  
22 there's a prior quarter they looked at, then they  
23 would look at that to see what the issues are, because

1 they want to keep current with the issues and know  
2 what they are going into that review.

3 ELIZABETH FENDER: I agree with the  
4 sentiment. I'm just not sure the words are clear  
5 about that. But obviously, you do have to familiarize  
6 yourself with the engagement. But when it was trying  
7 to describe the differences between what you're  
8 required to do in an interim versus an annual, it sort  
9 of said you only have to look at the prior interim.

10 GREG SCATES: Okay. We'll look at that and  
11 make sure that's clearer. Thank you.

12 Doug Anderson?

13 DOUGLAS ANDERSON: I had a concern on how  
14 the objective is worded and how the procedures in  
15 Paragraph 10 and Paragraph 9 are described. As I read  
16 the objective, which I think is a great idea to have a  
17 clearly stated objective for the standard in Paragraph  
18 2, it seems pretty broad. It looks like we want to  
19 make sure that there's a good evaluation of judgment,  
20 a good evaluation of conclusions received. As I look  
21 at Paragraph 10, it talks about, in Part B, that the  
22 reviewer should evaluate the risk assessments, the  
23 audit responses, the scope of the work. Those all

1        seem pretty broad. As I go back up, though, to  
2        Paragraph 9, it says you're supposed to do that merely  
3        by holding discussions with the engagement team,  
4        effectively, in reviewing documentation.

5                Those, to me, seem to be inconsistent. The  
6        objective and what we're trying to get out of this  
7        review seem very broad and comprehensive, but then  
8        we've limited the procedures, and my concern is those  
9        two things could be considered in conflict, that the  
10       external auditing firms will then revert back to what  
11       they think the objective is driving as opposed to what  
12       Paragraph 9 is saying.

13               So as I look at this, it just seems  
14       inconsistent, those two directions in the standard  
15       looking consistent, and either needing more  
16       clarification back up in Paragraph 2 as to what the  
17       objective is, or maybe more clarification in 10(b)  
18       about that.

19               GREG SCATES: Thank you, Doug. We'll take  
20       another look at that and make sure that they are  
21       consistent and clear and concise.

22               Bob Dacey?

23               ROBERT DACEY: Thanks, Greg. We, too,

1 appreciate the changes that were made in response to  
2 the comments on the earlier draft but still have some  
3 concerns about -- at least it's our perception that  
4 some of the other standards, particularly the IAASB,  
5 are at a more general principle level than what this  
6 would provide in the PCAOB. And again, in this area  
7 as well as other areas, we just have the concern as to  
8 whether or not there's a perception that the general  
9 principle stated in some of these other standards are  
10 consistent with where you are going or different  
11 because of the different terminology that you're  
12 using.

13 So we just want to, again, raise that point  
14 of concern in this area in particular as to whether or  
15 not that will create any conflict in application.

16 Thanks.

17 GREG SCATES: Hal Schroeder?

18 HAROLD SCHROEDER: Echoing some comments  
19 that were made earlier, I am curious myself as to why  
20 LISI, signing off on the engagement planning portion,  
21 it's not encouraged or recommended that it's done  
22 concurrent at the same time the partner has signed off  
23 on it. The reviewing partner should be signing off on

1 the planning before anything substantive is done,  
2 because as I read through the requirements, you don't  
3 have any opportunity to make any recommendations or  
4 changes. The game is over by the time you get  
5 involved, and I would strongly recommend that at least  
6 there be two segments to a reviewer's involvement,  
7 early in the process, and then at the end of the  
8 process.

9 GREG SCATES: Thank you, Hal.

10 Kurt Schact?

11 KURT SCHACT: A quick question for those of  
12 us not in the profession. I'm curious how often does  
13 the EQR result in a material change, and does the  
14 PCAOB, or should it, keep statistics on that so that  
15 you have some statistical evidence of how often  
16 problems should be found in a particular company's  
17 audits?

18 GREG SCATES: You can look at some of our --  
19 our inspection reports have cited some findings with  
20 respect to the performance or lack of performance,  
21 aggregate performance in the engagement quality  
22 review, but we don't have any statistics on it. But  
23 I'd be interested in hearing from the profession,

1 anyone that wants to.

2 Vin Colman?

3 VINCENT COLMAN: I'll certainly be brief.

4 That kind of statistic would be very difficult if your  
5 objective is a good engagement quality review. I do  
6 engagement quality reviews now, and to say did you  
7 catch something, if you're doing it well from the  
8 planning through the execution to the final and you  
9 are engaged with the engagement team, you're both  
10 independent, but yet you're understanding issues as  
11 they arise. So the objective is to avoid looking for  
12 the statistic that you're asking for, because the  
13 objective is to get it right before you even would get  
14 into that position, if you're doing your job right,  
15 correctly.

16 GREG SCATES: Paul Sobel?

17 PAUL SOBEL: Thinking through the 302  
18 disclosure requirements, I do see -- and I'm thinking  
19 of interim reviews. I think it was covered well for  
20 the annual review. There is mention about changes.  
21 Presumably that's material changes and internal  
22 control over financial reporting. I didn't see any  
23 specific mention about any frauds that might be

1 identified, committed by management or those involved  
2 in the financial reporting process. Is that just  
3 considered to be intuitively covered by one of the  
4 other items?

5 GREG SCATES: Paul, can you explain that --  
6 can you go over that discussion again? I'm not sure I  
7 understand what you were saying.

8 PAUL SOBEL: Okay. If there is an incident  
9 of fraud committed by a member of management or those  
10 integrally involved in the financial reporting  
11 process, it has to be disclosed to the audit committee  
12 and the independent outside auditor. I presume, even  
13 with interim financial statements, that might raise  
14 questions by the engagement partner, and I wasn't sure  
15 how that would be covered, then, in the EQR in terms  
16 of the resolution or conclusions about the impact such  
17 a fraud may have on the interim information.

18 GREG SCATES: The auditor is clearly under  
19 an obligation, a professional obligation, that if  
20 something comes to their attention, that they have to  
21 resolve it. They cannot have some information before  
22 them and because it has serious consequences with  
23 respect to not only the interim financial statements

1 but also the annual, so they have to resolve any  
2 particular issue that might be a fraud indicator.

3 PAUL SOBEL: I understand that, and I guess  
4 my question was, as I say, it may be subsumed in one  
5 of these bullet points, is how does the concurring  
6 partner get comfortable with the conclusions of the  
7 engagement team with regards to that resolution?

8 GREG SCATES: Well, the engagement quality  
9 reviewer would have to use his or her professional  
10 judgment, and that's what that individual's duty is,  
11 is to challenge what the team has done. So he or she  
12 would be challenging the team's conclusion on any  
13 matter, whether it's a matter that you brought up or  
14 any other matter.

15 Any audit or accounting issue that they are  
16 confronted with, that person is charged with that and  
17 has that obligation to make sure that they are  
18 concurring with the resolution, because if they're  
19 not, then they need to have a further discussion.  
20 They may have to -- he or she may have to have  
21 additional evidence before he or she concurs.

22 PAUL SOBEL: Yes, I understand that side.  
23 I'm either way off base or not making myself clear. I



1 understand what the process should be. The interim  
2 procedures are silent with regards to that. So what  
3 I'm hearing you saying is that that would just go  
4 along with any of the other judgments, material  
5 judgments that are made and doesn't need to be  
6 specifically identified as something that should be on  
7 the radar screen of the concurring partner, because  
8 again, material changes and internal control are  
9 mentioned as one of the items, but fraud is not.

10 GREG SCATES: Okay. Well, we'll take  
11 another look at that.

12 JENNIFER RAND: Paul, I see fraud mentioned  
13 in Paragraph 15 regarding interim. I don't know, it's  
14 one of the -- under 15(a). "Engagement quality  
15 reviewer should evaluate the nature of identified risk  
16 and material misstatement due to fraud." Does that --

17 PAUL SOBEL: It may. I saw that particular  
18 point, and to me that was more forward looking, what  
19 are the risks, what are the potentials, and I was  
20 referring to something that was known and identified.

21 GREG SCATES: Gary Kabureck?

22 GARY KABURECK: Thank you. This question I  
23 thought of when Kurt had raised his question about

1 tracking statistics, if you will, when the engagement  
2 reviewer overrules the -- excuse me -- the quality  
3 reviewer overrules the engagement partner.

4 My question: Did the board consider, or  
5 should you consider if you didn't, if there really is  
6 a significant override by the concurring partner and a  
7 decision is changed, whether it's audit scope or  
8 accounting or disclosure decisions, should there be a  
9 requirement for communication with the audit  
10 committee, or at least the audit committee chairman,  
11 of that event?

12 Again, I appreciate a lot of this stuff.  
13 We'll eventually agree, and eventually we'll get the  
14 evidence, but there's going to be times, presumably  
15 when the engagement team is overruled on something  
16 that's important, and from a client service point of  
17 view, should there be a requirement for at least the  
18 audit committee or the audit committee chairman to be  
19 advised of that? I don't know if that's -- I don't  
20 know if you considered it and rejected it. I'm not  
21 even suggesting that that should be the answer, but I  
22 think it should be considered.

23 GREG SCATES: So any instance, then, you're

1 saying, in which the engagement team arrived at a  
2 conclusion and then the engagement quality reviewer  
3 would disagree, and then the ultimate conclusion is in  
4 the favor of the way the engagement quality reviewer  
5 wanted to go, so he or she overrides what the  
6 engagement team did?

7 GARY KABURECK: Yes, correct. And  
8 presumably, anything they would override them on would  
9 be something material to the engagement, whether it's  
10 on the audit scope or an accounting conclusion,  
11 because this is supposed to be risk focused. Again,  
12 I'm not saying that should be the answer, to advise  
13 the audit committee or the committee chair. I'm just  
14 asking did you consider it, and if you didn't, maybe  
15 you could before you finalize it.

16 GREG SCATES: Would anyone else like to  
17 weigh in on that? Yes, Gaylen Hansen?

18 GAYLEN HANSEN: I would be very cautious  
19 about using the word "override." We -- I think  
20 ultimately the engagement partner has to be  
21 responsible for the opinion that is issued. He's the  
22 final person on the line there, but that doesn't mean  
23 to say that that engagement quality reviewer, the

1       concurring reviewer, doesn't take that further to the  
2       firm's quality control partner, to the director of  
3       audit services, whatever the structure is within that  
4       firm to try to get resolution.

5                But I think that resolution aspect is a  
6       little bit lacking in the standard.  But I'm a little  
7       bit antsy about this idea that one person can override  
8       another person in its entirety.

9                GREG SCATES:  Thank you, Gaylen, and thank  
10       you, Gary.

11               Wayne?  Wayne Kolins?

12               WAYNE KOLINS:  On that point, I would also  
13       be cautious, and even if the word "override" is not  
14       used and it's a different word, like maybe if there's  
15       a disagreement and the engagement quality reviewer's  
16       position is the ultimate position, then you'd have to  
17       get involved with defining disagreements again, which  
18       is now in the literature between the issuer and the  
19       audit firm, and there's a whole different reason for  
20       that in terms of the pressure that might be put to  
21       bear, which I don't think exists on the engagement  
22       team.

23               I'd also be concerned about, in terms of

1       considering this, what that would do to the mindset of  
2       the engagement partner in helping to resolve this  
3       disagreement. It may make the engagement partner more  
4       obstinate in terms of the resolution.

5               GREG SCATES: Jim Cox? Oh, I'm sorry.  
6       Jamie Miller. Sorry.

7               JAMIE MILLER: I think Gary's point is a  
8       good one, and it's really a question to me as to how  
9       the governance structure works between the auditor and  
10      the preparer. I think the key question is how to  
11      determine what would get communicated, and I think  
12      perhaps one way to think about it would be to consider  
13      whether audit committee communication would be  
14      required in situations where a formal resolution  
15      process had to be invoked to resolve the disagreement,  
16      as opposed to those matters that are resolved in the  
17      normal course, through additional audit procedures or  
18      additional discussion between the concurring review  
19      partner and the audit partner. But I think it is  
20      something that ought to receive some level of debate.

21              GREG SCATES: Thank you, Jamie.  
22              Jim Cox?

23              JAMES COX: I'm sort of struck by the

1 opacity of the second paragraph. It states the  
2 objective. And I think if we had less opacity, we  
3 would deal with a lot of questions which were started  
4 off by Harold's comment about what we really want to  
5 have happen here.

6           You can think of a wide range of objectives  
7 that could be served within this language, and I think  
8 we ought to specify which one of it is we want. One  
9 would be make this year's audit better. Another one  
10 would be make next year's audit better. A third one  
11 could possibly be an internal evaluation of your own  
12 staff doing this. A fourth one could be an external  
13 evaluation by the audit committee.

14           I mean, what exactly is the objective of the  
15 external quality review? I think if you come to grips  
16 with that, many of these questions on this session  
17 would shake out from that. But currently, I think  
18 that, again, just to repeat myself here, I'm struck by  
19 what I perceive as the opacity of the second paragraph  
20 stating what the objectives are. I think it's fairly  
21 -- it's too generalized to be very helpful to somebody  
22 who is going to have to govern their conduct as an  
23 external reviewer, or what to make of the external

1 review going forward.

2 GREG SCATES: Thank you, Jim.

3 Joe Carcello?

4 JOSEPH CARCELLO: As some of you know, I've  
5 spent a lot of time over the years working with  
6 accounting and auditing enforcement releases, and one  
7 of the things we've seen in some of those, certainly  
8 not the majority but in some situations where  
9 obviously there is ultimately a fraud, and people  
10 lower on the engagement team had come across issues  
11 that were problematic and were dissuaded from being  
12 overly concerned about those issues by people higher  
13 on the engagement team. And so my concern ties into  
14 Paragraph 9, where the last sentence in that paragraph  
15 talks about holding discussions with the person with  
16 overall responsibility for the engagement, holding  
17 discussions with other members of the engagement team,  
18 as necessary.

19 I guess I would encourage the board to at  
20 least think about eliminating the words "as  
21 necessary." In today's world, with the ubiquity of  
22 cell phones, you would not have to have this  
23 discussion face to face. By the time the second

1 partner review is happening, often members of the  
2 engagement team are on to the next job. But you could  
3 easily pick up a cell phone and just touch base with  
4 everybody on the engagement team to just make sure  
5 there wasn't an issue that really troubled them, that  
6 they maybe were dissuaded from pushing too hard by  
7 others higher up in the chain.

8 GREG SCATES: Thank you, Joe.

9 Bob Dacey?

10 ROBERT DACEY: I just wanted to add a point.

11 In terms of our government auditing standards, we  
12 wanted to clarify in our latest release that, in fact,  
13 the firm ought to have procedures in evaluating or  
14 monitoring the quality review process, both in terms  
15 of identifying any systemic issues that were  
16 identified through quality reviews, as well as where  
17 the quality review function is being carried out  
18 properly in terms of a monitoring procedure.

19 So I'd just offer that in terms of what  
20 we've also addressed to deal with the issues of  
21 differences and whether or not things caught in a  
22 quality review, how they were dealt with, and again  
23 whether that's a systemic issue in the firm.



1                   GREG SCATES: Greg Jonas?

2                   GREGORY JONAS: Greg, I'm about to betray my  
3                   ignorance, so apologies in advance. Does the new  
4                   quality control requirement apply to review of work  
5                   supporting the 404 report on internal control?

6                   GREG SCATES: Yes.

7                   GREGORY JONAS: And that is quite a change  
8                   in practice relative to current practice or concurring  
9                   partner reviewers?

10                  GREG SCATES: No. They currently perform  
11                  that review of the internal control as well as the  
12                  audited financial statements.

13                  GREGORY JONAS: Is it worth making crystal  
14                  clear in the final document that if the auditor has an  
15                  integrated audit, that these requirements apply to  
16                  that 404 work as well, or was I the only person in the  
17                  room who was left wondering whether it does or  
18                  doesn't?

19                  GREG SCATES: Well, I'll go back and look at  
20                  it again. I thought it was clear, but maybe -- we'll  
21                  make sure it is.

22                  GREGORY JONAS: It could be my fault. It  
23                  very well could be my fault. Thank you.

1           GREG SCATES: That's fine.

2           Jeff Mahoney?

3           JEFF MAHONEY: I just wanted to follow up on  
4 Kurt's question earlier, and Professor Cox's comments  
5 about the objective. In connection with the PCAOB's  
6 inspection process, have you identified any issues or  
7 concerns regarding the EQR process, and can you tell  
8 me what two or three of the main issues or concerns  
9 were?

10          GREG SCATES: One of the issues is apparent  
11 when you look at some of the inspection reports. The  
12 question that presents itself is once you see the  
13 deficiencies that are identified, then you obviously  
14 ask yourself why didn't the engagement quality  
15 reviewer detect some of these deficiencies. I mean,  
16 that's paramount. With not all the inspection  
17 findings but some of them, you'll see that, and we  
18 make that clear in some of the reports.

19          Another issue that comes up is the  
20 documentation of the engagement quality review  
21 process. We have noted that in the reports that it's  
22 not sufficient to indicate what the person did and  
23 what the person reviewed and what conclusion they

1 arrived at, because it's hard to tell if they did  
2 anything at all. So those are just a couple of  
3 findings I would note.

4 Any other comments on the engagement -- yes,  
5 Tom?

6 THOMAS TEFFT: I've just given some more  
7 thought to the question about whether there should be  
8 a requirement for communication to the audit committee  
9 if there's disagreements or, again, I understand the  
10 word "override" is probably a little inflammatory, but  
11 for lack of a better word right now.

12 I just think you'd need to really consider  
13 what the objective of that communication would be  
14 because, as I think more about it, if an auditor in a  
15 firm is carrying out the work outlined in the  
16 standards such that the reviewing individual can issue  
17 the concurring report, then from an audit committee  
18 standpoint, the audit committee should be satisfied  
19 that the work was done and not be concerned about the  
20 inner workings within the audit firm that led to that  
21 conclusion.

22 Not any different than for a preparer if  
23 there are debates and dialogues within a company as

1 it's preparing its financial statements. I just think  
2 to the extent the board considers a requirement, you  
3 would be very explicit as to what the objective would  
4 be because, otherwise, you could get into a very  
5 inefficient process and a very slippery slope there in  
6 terms of what's coming back to the audit committee.

7 GREG SCATES: Gaylen Hansen?

8 GAYLEN HANSEN: Just following up a little  
9 bit on that, in that respect, I wonder to what extent  
10 the board considered the interaction of the concurring  
11 reviewer with the client itself? And this has come up  
12 from time to time. Do they have the same level of  
13 discussion access as the engagement partner? Do they  
14 meet as regularly? Do they meet in person? Do they  
15 call independently? To what level is that  
16 independence of the concurring reviewer?

17 I've seen this done both ways, where the  
18 firm wants as much insulation and independence as  
19 possible of the reviewer, and others that say, well,  
20 if they know the client better, they'll understand  
21 where they're coming from and so forth. But to what  
22 extent was that considered?

23 GREG SCATES: We did have some discussions

1 of that, particularly with respect for the engagement  
2 quality reviewer to maintain his or her objectivity.

3 And one of the issues, obviously, has to do  
4 with when you do have some accounting and auditing  
5 issues or contentious issues that come up, but most  
6 importantly here is that the engagement team has  
7 identified the issue. They gathered the evidence, and  
8 they've come to a conclusion. At that time, then the  
9 engagement quality reviewer, it would be appropriate  
10 for him or her to step in and take a look at it.

11 But most importantly here is that the  
12 engagement quality reviewer cannot be a part of the  
13 initial process of gathering the facts and gathering  
14 the evidence. That's not their job. And they need to  
15 stay outside and look in when the issue has been --  
16 when the team has come to an initial conclusion. Then  
17 it's appropriate for that person to come and step in  
18 and take a look at it.

19 So objectivity here is very important  
20 because this person does not play -- is not going to  
21 fill the shoes of the engagement partner. And so,  
22 it's very important -- it was very important to the  
23 staff when we were developing and drafting the

1 standard to make sure that this person stays outside  
2 and looks in and maintains that objectivity.

3 JENNIFER RAND: Gaylen, as just to kind of  
4 follow up, I'd be interested if you have any  
5 experiences at your firm or other firms kind of  
6 regarding the engagement quality reviewer's  
7 communications with the client or preparers have any  
8 observations on how things are handled, that  
9 experience and how that's been helpful or not helpful?

10 GAYLEN HANSEN: I think some level of  
11 insular or compartmentalization of that individual  
12 makes some sense to at least consider that, and we  
13 kind of do that within our firm. We don't want that  
14 individual calling the CFO and having these  
15 discussions independently. We think that should go  
16 through the engagement partner, except for when  
17 they're involved in, say, an audit committee meeting.

18 GREG SCATES: Thank you, Gaylen.

19 Sam Ranzilla?

20 SAM RANZILLA: Well, having listened to the  
21 better part of the last 20 minutes, just a couple of  
22 observations. One, I think it's important that we  
23 keep in mind the objective, and then I understand some

1 think that the standard could be improved. And I  
2 don't know that I disagree with that.

3 But the objective here is to improve audit  
4 quality and improve financial reporting, and having --  
5 I hear sort of a sentiment around turning the  
6 engagement quality control reviewer into another  
7 policeman where statistics are kept on what they found  
8 or communications made to the audit committee about  
9 where they overrode somebody. I don't think that's  
10 actually going to improve the situation.

11 From the perspective that the engagement  
12 quality review is just one element of the firm's  
13 overall system of quality control, and there are  
14 plenty of policemen at the firms with respect to  
15 internal inspections and other parts of the quality  
16 control system where there is a vetting and a "second-  
17 guessing" of that engagement partner, I think this  
18 role should be more in line with getting it right the  
19 first time, improving the quality of audit, and that  
20 client's financial reporting and communication to  
21 investors.

22 So I think it's a balancing act. I just --  
23 I caution you against turning this role more into a

1 policeman than what would be appropriate.

2 GREG SCATES: Thank you, Sam.

3 Any other comments on the engagement quality  
4 review process?

5 VINCENT COLMAN: You know, I do want to  
6 follow up on I guess Sam and Gaylen's point. I do  
7 think you need to strike the right balance between  
8 objectivity and independence that you do already have  
9 in the standard.

10 But to do engagement quality, to get it  
11 right the first time, as Sam just said, there does  
12 need to be a certain level of interaction to make sure  
13 that you have a deep enough understanding of what  
14 those critical decisions and issues are. And if you  
15 go too far away, as I think that was just suggested,  
16 perhaps you cannot get it right the first time, and  
17 that's the objective.

18 GREG SCATES: Thank you, Vin.

19 Larry Salva?

20 LAWRENCE SALVA: Thanks. Two points. I  
21 guess on the interaction with the concurring partner -  
22 - between the concurring partner and the client  
23 interaction, I think the firms may take different



1 approaches and at times may have taken different  
2 approaches as to how much exposure concurring partners  
3 were giving to clients. I think that can really be  
4 left up to them in terms of what works best.

5 My current experience that I do with the  
6 firm that I'm working with now, there was a point in  
7 time that I knew the name of the concurring partner  
8 but had no interaction with the concurring partner at  
9 all. And more recently, I've had some interaction,  
10 but limited. And I don't think engagement quality has  
11 suffered in either of those cases. It's an internal  
12 working for the firm in terms of what works best for  
13 them.

14 The other point I'd make is in terms of  
15 communication with the audit committee. If that is  
16 considered by the board, I think it should stay out of  
17 this standard. There is a whole slew of things that  
18 should get communicated to audit committees, and I  
19 think about the audit committee communication that I  
20 have in terms of kind of a standard question from my  
21 audit committee chair is what close calls may have  
22 been debated within our disclosure committee, our  
23 internal management committee that discusses issues

1 and resolution?

2 And if the audit committee chair is so  
3 inclined to ask the engagement partner or the  
4 engagement team were there issues that were resolved  
5 through involvement of the engagement quality reviewer  
6 that would have been resolved differently had that  
7 review not occurred, fine. Let the audit committee  
8 chair be interested in that or put that into the mix  
9 of all of the communications that the auditor should  
10 have with the audit committee.

11 But I think it should stay out of the  
12 specific standard. It shouldn't be called out as a  
13 requirement here.

14 GREG SCATES: Okay. Thank you, Larry.

15 Any other comments on this particular topic,  
16 on the engagement quality review process?

17 [No Response.]

18 GREG SCATES: Okay, let's turn to the next  
19 topic, to the concurring approval of issuance. The  
20 original proposal provided that the reviewer must not  
21 provide concurring approval of issuance if he or she  
22 knows or should know, based upon the requirements of  
23 the standard, of certain engagement deficiencies.

1           In response to concerns expressed by  
2           commenters, the board revised this provision so that  
3           it relies instead on the auditor's existing duty to  
4           exercise due professional care rather than using the  
5           phrase "knows or should know, based on the  
6           requirements of the standard."

7           Like the formulation in the original  
8           proposal, the revised provision makes clear that a  
9           reviewer cannot evade responsibility because as a  
10          result of an inadequate review, he or she did not  
11          discover a problem that a reasonably careful and  
12          diligent review, a review performed with due  
13          professional care, would have revealed.

14          For our discussion this morning, let's  
15          discuss the questions from the release that addressed  
16          concurring approval of issuance. In front of you on  
17          the screen is the standard for the engagement quality  
18          reviewer's concurring approval of issuance  
19          appropriately described in the repropoed standard.  
20          Is the first edition appropriately tailored to reflect  
21          the difference in scope between an audit and an  
22          interim review?

23                   Jim Schnurr?

1                   JAMES SCHNURR: Thank you.

2                   We viewed the removal of "know and should  
3 know" as a positive step but are a little bit confused  
4 by the fact that in the discussion in the fore part of  
5 the standard, they define "due professional care" as  
6 the same as "know or should know." So it seemed to me  
7 that while in one instance, they changed the language,  
8 they made it clear that they thought the standard was  
9 still the same. And I don't think that addresses the  
10 concerns that we and others have expressed around  
11 that.

12                   The second point I would make is it seems  
13 odd to me that an individual auditing standard would  
14 specifically point out a requirement for due  
15 professional care when there is an overall standard,  
16 auditing standard that deals with due professional  
17 care, which applies to all standards. And so, it  
18 seems very odd to me that we would have a separate  
19 standard, which is then if you want to call it  
20 somewhat defined in the fore part of the standard.

21                   GREG SCATES: Other comments? Gary?

22                   GARY KABURECK: Picking up where Jim was  
23 just talking, looking at the way at least I read,

1 whether it's auditing releases or accounting  
2 standards, there is the standard, and then there is  
3 the backup material, in this case the release, you  
4 know, the basis of conclusions and FASBs.

5           So usually the standards are pretty clear in  
6 what they say, accounting or auditing or whatever.  
7 Then you go, "What do you mean?" I mean, you tend to  
8 go to the releases and the issuing cover memos and  
9 stuff where you get a little bit more free form in the  
10 words. And I mean, I've found over 25 years or so is  
11 those are often more useful in terms of communicating  
12 intent than the final standard itself.

13           So I can empathize where what Jim is saying  
14 with as a preparer, it doesn't matter all that much to  
15 me. The preparers, I think, when they commented,  
16 worried about does this become a second audit? I  
17 think you were trying to address that, but I can see  
18 where they would read that there's a conflict between  
19 the release and the standard. Maybe they're reading  
20 it wrong. Maybe it's unintentional. Maybe it's just  
21 a draft -- choice of words and drafting.

22           But seriously, the covering documents' basic  
23 conclusion stuff get read very heavily on any

1 assessment or interpretation of standards.

2 GREG SCATES: Other comments on concurring  
3 approval of issuance? Okay --

4 GAYLEN HANSEN: Greg, I think it's a great  
5 idea.

6 [Laughter.]

7 GAYLEN HANSEN: I think it should happen.  
8 So --

9 JENNIFER RAND: So you're supportive of it?  
10 This is an area we did receive a lot of comments. So  
11 interested in views in what we've done.

12 Gaylen, I thought I heard you say --

13 GAYLEN HANSEN: Yes, I mean, I think it all  
14 ties back into the timeliness that we've had of prior  
15 discussion about whether they're involved or whether  
16 this review is taking some -- is being wrapped up, and  
17 there are points that are open after the filing has  
18 been made.

19 I just can't imagine that there wouldn't be  
20 some level of formal signoff on the concurring review.  
21 And after the fact doesn't do anybody any good.  
22 Unless you're talking about next year's audit, Jim.

23 GREG SCATES: Vin Colman?

1           VINCENT COLMAN: Yes, I just wanted to  
2     reiterate. You don't want to repeat, but I also don't  
3     want the silence in this room to make the point that  
4     Jim and Gary have just made, that it's not a  
5     significant point.

6           I mean, you've got -- I think that the  
7     standard from a year ago has been significantly  
8     improved, as Randy said, and really appreciate that.  
9     But by far, this was the biggest issue with respect to  
10    the "known or should have known." And it seems that  
11    it's been taken out of the standard, but yet used as a  
12    synonym to "due professional care."

13           There is another standard that's out there  
14    on due professional care. I think we know what it is.  
15    And then to have something in there that basically  
16    almost redefines "due professional care" to be "known  
17    or should have known," I really question whether or  
18    not you address the issue. And it's now done in a  
19    way, as Gary pointed out, it's in the back somewhere.

20           I'm not sure it was a drafting error. Is  
21    that what we are saying or not? And I'm a little bit  
22    concerned, did we address it or not? I think we all  
23    felt like we did, but yet when you really read it, the

1 answer is maybe we didn't. And I think it does need  
2 to be addressed. As was discussed many, many times  
3 with the unintended consequences if you were to go in  
4 that direction, there's a real concern around it.

5 GREG SCATES: Thank you, Vin.

6 Doug Anderson?

7 DOUGLAS ANDERSON: Not to pile on, but just  
8 to emphasize a point that I was trying to make  
9 earlier. This whole issue of "known or should have  
10 known," when you marry that together with the  
11 objective that's very broad, I don't know how it's  
12 possible to accomplish that objective, especially the  
13 standard of "known or should have known" based on what  
14 it says in paragraph 9. And I get back to that's why  
15 I think the standard is inconsistent.

16 It holds the auditor to a high level of  
17 performance but then says you're only supposed to do  
18 that with these limited steps. And I worry that the  
19 objective and the expectation far exceeds what we're  
20 saying they're supposed to do, and that's the primary  
21 conflict I see in the standard.

22 You put the external auditor in a very  
23 difficult situation of holding him to a high result,



1 but saying they have to get there by doing limited  
2 procedures. And if that comes to fore, I think the  
3 objective will win out over what paragraph 9 says.

4 GREG SCATES: Other comments before we leave  
5 this area? Any other comments? Paul Beswick, SEC.

6 PAUL BESWICK: Well, Greg, I think it would  
7 be helpful if the staff did provide some views to the  
8 questions that Vin and Jim and others have raised as  
9 through the release, have you redefined "due  
10 professional care," or are we relying on the existing  
11 standard?

12 It seems to be a question that was posed,  
13 and I think it would be helpful to people who are  
14 providing comments if there is some clarification  
15 provided.

16 GREG SCATES: Any other comments?

17 [No Response.]

18 GREG SCATES: Okay, let's move to the last  
19 topic for discussion with respect to engagement  
20 quality review. Let's talk about the documentation I  
21 alluded to earlier.

22 Under the new proposal, documentation of the  
23 engagement quality review should contain sufficient

1 information to identify who performed the review, the  
2 documents reviewed, and significant discussions held  
3 during the review and the date that the reviewer  
4 provided concurring approval of issuance.

5 If the reviewer did not provide concurring  
6 approval of issuance, the proposal would require  
7 documentation of the reviewer's reasons for not  
8 providing concurring approval of issuance. The final  
9 question then states before you on the slide, are the  
10 documentation requirements in the repropoed standard  
11 appropriate? If not, how should they be changed?

12 Gaylen Hansen?

13 GAYLEN HANSEN: Paragraph 19 says, "If no  
14 concurring approval of issuance is provided, the  
15 reasons for not providing the approval need to be  
16 documented." And maybe you can help me out with this,  
17 but if the review is required in order to be issued in  
18 accordance with paragraphs 12 and 13, I don't know --  
19 it seems contradictory.

20 How can you issue the financial statements  
21 without the review? But if you don't have the review,  
22 you have to document why you didn't have the review?  
23 It just seems a little bit strange.

1           GREG SCATES: You are correct. I mean,  
2 obviously, Gaylen, if there is no concurring approval  
3 of issuance, then the firm cannot issue the report.  
4 You're right. We thought you should just close the  
5 gap and explain what happened, and the work papers can  
6 be -- because the report may never be issued. The  
7 work papers can be archived as is.

8           Then you can plead there may have been some  
9 discussion. I'm sure there were a lot of discussions,  
10 but the concurring partner or the engagement quality  
11 reviewer can close the gap, can close down what he or  
12 she was responsible for, here's what happened, and  
13 then they're finished. They're complete.

14           But you're right. You're right. There is  
15 obviously not going to be a report issued until there  
16 is an engagement quality review performed and they  
17 concur.

18           Jim Schnurr?

19           JAMES SCHNURR: In looking at the  
20 documentation in 19(c), which requires the reviewer to  
21 document discussions with the engagement team,  
22 significant discussions, going back to some of the  
23 comments we had earlier about Vin's comments around

1 the process or the interaction between the reviewer  
2 and the engagement team, I don't see -- and Sam's  
3 comments earlier about what the objective is here. I  
4 don't see how the documentation improves audit  
5 quality.

6 The engagement team has already documented  
7 in the work papers their conclusions about whatever  
8 the particular either financial reporting or auditing  
9 issue was. So this looks more like, as Sam talked,  
10 police or a cop coming in and having to document the  
11 discussions. It doesn't seem to add to audit quality,  
12 and it seems to be -- I'm not sure what the purpose of  
13 it is. It's not really described as to what the  
14 purpose of that is.

15 So I don't see any incremental benefit, and  
16 it would potentially add a lot of time to the process.

17 GREG SCATES: Jim, looking at it from the  
18 perspective of let's look at the engagement team  
19 first. But doesn't documentation, hard documentation  
20 drive good audit quality?

21 JAMES SCHNURR: I agree with that, but the  
22 engagement team under the auditing standards already  
23 has a requirement to document their significant

1 conclusions. And what we're asking the reviewer to do  
2 is simply concur on those conclusions.

3 So I don't know why that the reviewer would  
4 then have to document in the detail that seems to be  
5 here their discussions with the engagement team. I  
6 mean, there is already the overall requirement that in  
7 terms of issuing the report, he essentially or she has  
8 to be comfortable with those conclusions before they  
9 give their approval.

10 So an incremental documentation -- and given  
11 the number of discussions that potentially are held, I  
12 mean, if you think of a large multinational  
13 engagement, concurring reviewer may spend hundreds of  
14 hours on that engagement. If they have to document  
15 every time they have a conversation around a  
16 significant judgment, again, it's unwieldy, and I  
17 don't see the benefit to the overall audit quality.

18 GREG SCATES: Sam Ranzilla?

19 SAM RANZILLA: I totally agree with Jim, and  
20 the only point that I will add is looking at the  
21 purpose of that -- what I might envision to be the  
22 purpose of adding that requirement based on the  
23 proposing release. That requirement almost looks to

1 me like an inspection, that that requirement is  
2 focused on your inspection process.

3 And I can appreciate that, but again, I  
4 would caution the board on writing auditing standards  
5 in order to improve their ability to inspect auditors.

6 GREG SCATES: Thank you, Sam.

7 Joe Carcello?

8 JOSEPH CARCELLO: Greg, if you forgive me, I  
9 want to go back and revisit the last discussion  
10 briefly. I'm sorry I didn't comment on it, but I  
11 needed a little bit of time to formulate my thoughts.

12 My friends in the profession express a lot  
13 of concern about this due care issue and as it ties  
14 into "know or should have known." And so, maybe  
15 there's an issue there that I don't fully understand,  
16 and if there is, I'd like them to articulate it.

17 But I guess from an investor perspective, to  
18 me, the way that that standard -- the proposed  
19 standard is written is essentially it says if you  
20 review the documentation that the standard requires  
21 you to review, if you have the discussions that the  
22 standard requires you to have, using due care, which  
23 includes professional skepticism, then if there is a

1 problem that's obvious from doing that, you either  
2 know it, but you can't know someone's state of mind.  
3 Or you should have known it, which allows for the fact  
4 that you can't know someone's state of mind.

5           And I'll give an example of why I think this  
6 is important. I've done some expert witness work for  
7 the Securities and Exchange Commission. And in one of  
8 the cases that I did, they were seriously thinking  
9 about bringing an enforcement action against the  
10 second partner, and they decided not to bring the  
11 enforcement action because the existing standard was  
12 sufficiently vague that they felt that they didn't  
13 have a strong enough legal basis to bring that action.

14           But I would give you kind of a concrete  
15 example. Let's assume I'm the second partner on an  
16 engagement, and in the work papers, inventory  
17 obsolescence is an issue. And so, I look at the  
18 documentation, and the documentation is a client  
19 schedule of a high and low estimate of the  
20 obsolescence reserve that is X'd through with no  
21 explanation, substituted with another client schedule  
22 with a high and low estimate, which are much lower  
23 numbers than on the first schedule.

1           And the number that's picked and that ends  
2 up in the 10-K is the low number, which is the same  
3 number that was in the 10-K in the previous year,  
4 where inventory had increased by a factor of 3 or 4 or  
5 5 and with indication that inventory was not turning  
6 over at all.

7           To me, that would indicate that if I'm the  
8 second partner and the audit procedures that had been  
9 done were minimal, at least in terms of documentation  
10 of those audit procedures, to me, that would indicate  
11 that I know or, if I didn't know, I should have known  
12 that I probably don't have sufficient appropriate  
13 audit evidence as it relates to the inventory  
14 obsolescence reserve because if I had used due care or  
15 professional skepticism, I would be troubled by that.

16           So maybe there's a legal issue that the  
17 people in the firms can explain to me. But short of  
18 that, it seems to me that the PCAOB's language here is  
19 completely appropriate.

20           GREG SCATES: Thank you, Joe.

21           Doug Anderson?

22           DOUGLAS ANDERSON: To go back to the other  
23 topic on documentation, I tend to agree with Jim that



1 I see 19(c) as unnecessary. If you've got the  
2 paragraph 16 and you've got the recurring partner  
3 completing 19(a), (b), and (d), I don't know what  
4 19(c) adds.

5 GREG SCATES: Jeff Mahoney?

6 JEFF MAHONEY: Thank you.

7 I'm certainly not supportive on unwieldy,  
8 unnecessary documentation, but you said to me a few  
9 minutes earlier that your inspection results revealed  
10 a lack of documentation so that you're unable to  
11 determine what the reviewer actually did. So I would  
12 err on the side of having more documentation, not  
13 less.

14 GREG SCATES: Thank you, Jeff.

15 Hal Schroeder?

16 HAROLD SCHROEDER: I would agree and take  
17 the opposite side of Doug. It's been a few years  
18 since I've done an audit, but when we had a concurring  
19 partner involved, we always -- the audit team would  
20 write up that discussion and what the conclusions  
21 were. So all the independent partner or engagement  
22 reviewer, whatever we're calling it today, would come  
23 in and sign off on that memo.

1           So it would be not a tremendous burden, but  
2           it went a long way in documenting what was actually  
3           done on the consultations, and that would include  
4           national office, which we haven't really touched on  
5           here. I guess that's other people that you consult  
6           with.

7           But I would strongly encourage you to leave  
8           (c) in there. I think it's highly appropriate.

9           GREG SCATES: Okay. Thank you, Hal.

10          Larry Salva?

11          LAWRENCE SALVA: I agree that something  
12          should be included in the standard about documentation  
13          of the areas reviewed by the engagement quality  
14          reviewer, but I think 19(c) is too prescriptive.  
15          Especially in large and complex and multinational  
16          engagements, et cetera, to say that the date of each  
17          discussion, the substance of the discussion, et  
18          cetera, et cetera, would become way too burdensome on  
19          the process and I believe would add a lot of time  
20          without significantly enhancing quality.

21          But I can appreciate that something should  
22          be written similar to like what Hal just suggested. A  
23          memo or something that indicates the areas that were

1 reviewed would be appropriate. But to be this  
2 detailed, I think, is overly prescriptive.

3 GREG SCATES: Randy Fletchall?

4 RANDY FLETCHALL: I just want to respond to  
5 Joe Carcello's observation, and I am smart enough to  
6 realize with Professor Cox and a bunch of other  
7 attorneys in the room, I'm not going to try to  
8 articulate a difference between "known and should have  
9 known" and "due professional care."

10 I think Jim Schnurr made a very valid point,  
11 that due professional care is already defined for all  
12 audit engagements for all roles and seems redundant.  
13 Having said that, Joe, we have no objection to  
14 performing the engagement quality review in accordance  
15 with due professional care. So if it needs to be in  
16 there to reinforce, no one is really fighting that.

17 What I think you're in objection to, and I  
18 think it was laid out fairly clearly in comment  
19 letters on the original exposure, was that "known or  
20 should have known" is a different standard and does  
21 have a legal connotation that we thought was not the  
22 right objective or the right standard. And so, to see  
23 the board to say, okay, we agree. We're going to

1 change it and go to due professional care, which is  
2 well understood, but in the release still say, but we  
3 really think it's the same thing -- it's that part of  
4 it, Joe, that we're saying we don't think it is the  
5 same thing.

6 And whether we have legal opinions on that  
7 in our comment letters, that's the only issue, I  
8 think, that's really on the table is we don't think  
9 it's the same thing. And I'm not going to be -- like  
10 I say, I'm too smart to take on exactly what those  
11 differences are. But that's all we're really talking  
12 about, not that we don't want to do the engagement  
13 quality review in accordance with due professional  
14 care.

15 GREG SCATES: Steve Rafferty?

16 STEVEN RAFFERTY: I'm going to switch back  
17 to this 19(c) issue and sort of pile on with the  
18 auditors here. I think this could be terribly  
19 cumbersome, and I suspect maybe this came from the  
20 issue that you couldn't tell where the concurring  
21 reviewers had been in the files. But I really believe  
22 19(b) probably accomplishes the objective in saying  
23 the documents reviewed by the engagement quality

1 reviewer. You have to identify where they've been in  
2 the file.

3 And I think requiring them to then document  
4 every discussion that they have on significant issues  
5 is going to be terribly cumbersome. A lot of those  
6 significant issues are going to be in the form of  
7 consultations that are documented in terms of what the  
8 issue is, what the applicable standards are, what the  
9 firm's evaluation of that is. And it's going to be  
10 signed off by that concurring reviewer. So it's going  
11 to be pretty obvious where they've been in the file  
12 and where they've spent their time.

13 To then take and write a second memo that  
14 says, "Oh, by the way, I did also discuss this with  
15 the engagement team," seems a little overboard to me.

16 GREG SCATES: Thank you, Steve.

17 Vin Colman?

18 VINCENT COLMAN: Perhaps two points. Just  
19 one final point in response to Joe's question by  
20 Randy. I think that Paul Beswick was kind of asking  
21 the question, is this a standard of performance or a  
22 standard of enforcement? And I think we're getting it  
23 confused, and I'd sure like to understand that because

1 I think that's where you just went, Joe. And I think  
2 we've got to -- if we're going to talk about it, I  
3 mean, candidly, that's kind of where you'd have to go,  
4 right?

5 Because we all know what due professional  
6 care is. We want to exhibit due professional care.  
7 So I think there is no debate around that. But when  
8 you start redefining what due professional care is, as  
9 Jim said, when there's a whole standard there, and  
10 then in a couple of words redefine it for enforcement  
11 reasons, I think it starts getting confused.

12 These are supposed to be standards of  
13 performance. Enforcement, let's decide how you handle  
14 that and handle that in a different manner, at least  
15 as it relates to how we would have people action a  
16 standard in our firm.

17 And then moving to 19(c), again just being  
18 somebody in the room who is a concurring partner on a  
19 very, very large organization, when it says including  
20 the date of each discussion, I would just ask that you  
21 think through these words. And if you've ever kind of  
22 tested it in a real-life engagement, I think that you  
23 would see the cost benefit would be incredibly

1 difficult if you really understand the number of  
2 interactions that go on during the course of a year if  
3 you're doing -- if you're satisfying all the other  
4 paragraphs of this standard.

5 GREG SCATES: Wayne Kolins?

6 WAYNE KOLINS: On that 19(c), it looks like  
7 it's almost combining a couple of things. I can see  
8 having that standard, and there is a standard in there  
9 already for consultations during an engagement, where  
10 you consult with somebody in the national accounting  
11 department or whatever it happens to be, and you have  
12 a significant issue that you consulted on, you  
13 document that. That's fine.

14 These kinds of discussions that happen on an  
15 engagement are at various levels, various gradations  
16 from a very insignificant issue to very significant  
17 issues, and the ultimate resolution of those  
18 discussions are, hopefully, embedded in the work  
19 papers. And the work papers should indicate whether  
20 the concurring reviewer, engagement quality reviewer  
21 reviewed those work papers.

22 So I think that that ultimate resolution was  
23 already in the other parts of 19, and you don't need

1 19(c) for that reason.

2 GREG SCATES: Thank you, Wayne.

3 Sharon Fierstein?

4 SHARON FIERSTEIN: Wayne, I actually have to  
5 disagree with you. I think that actually if you just  
6 look at 19(a), (b), and (d), it doesn't really get the  
7 whole flavor of what was done in that concurring  
8 review process.

9 And while I agree that 19(c) is certainly  
10 overly prescriptive and there really won't be enough  
11 of a cost benefit there, it's just the benefit will  
12 clearly not outweigh the cost of it. I think that  
13 there does need to be some type of summary describing  
14 what has gone on during that process because, frankly,  
15 telling me who did it and when they did it isn't  
16 really enough to tell me what was really happening in  
17 that process.

18 GREG SCATES: Gaylen Hansen? Hal Schroeder?  
19 Sorry.

20 HAROLD SCHROEDER: I do see a definite  
21 difference between (b) and (c). You can look at whole  
22 sections of an audit that have no major issues, but  
23 you still thought it appropriate as a concurring



1 partner to sign off on those documents or at least  
2 gain understanding.

3 And I've heard a couple of times, "Well,  
4 that would be two memos in the file on an issue," and  
5 I would think that there would only be the one, the  
6 one that the team wrote that talks about how the  
7 concurring partner was involved in that process.

8 And I'm still focusing on the word  
9 "significant." I would assume that and I've heard  
10 several people, "Well, they'd have to document every  
11 discussion." I think we're carrying it too far. It  
12 would be only those things that are significant.

13 The team would document, and then it would  
14 be the concurring partner's responsibility to go and  
15 sign off on those memos. Presumably, they'd be in  
16 some order for it to be not a very burdensome process.

17 So I see (b) and (c) as different things,  
18 and I think it's the only way to close the loop and  
19 finalize what actually happened on the engagement.

20 GREG SCATES: Jim Cox?

21 JAMES COX: Yes, I sort of feel the same  
22 way, Harold, that I think the point -- and it may not  
23 be well expressed in 19(c). But I think the point is

1 to communicate the level of intensity of the review  
2 that was carried out, the quality review. And that is  
3 best communicated, I think, by identifying the areas  
4 where there was some evidence of drilling down.

5 We could think about there's lots of other  
6 ways of handling it, but we all live by time logs,  
7 even academics, by the way. And so, we may want to  
8 keep track of that and know that you've allocated a  
9 significant amount of time to a particular engagement  
10 and a particular inquiry. But I think the key point  
11 here is "significant," and perhaps you'd like to flesh  
12 that out.

13 But I think what the real issue here is so  
14 that if a third party, such as the PCAOB, comes in and  
15 reviews the quality of the quality reviews, they have  
16 some evidence of the intensity of the review that  
17 occurred. And if you don't have that, then I don't  
18 think 19(a), (b), and (d) get you there.

19 GREG SCATES: Thank you, Jim.

20 Any other comments on documentation or any  
21 other part? Jamie Miller?

22 JAMIE MILLER: I just want to comment on  
23 this one as well. You know, I agree with the overall

1 objective of requiring documentation for the review  
2 and that covering both the significant matters  
3 discussed and the nature of the documents reviewed.  
4 But I have to say from a cost benefit perspective, I  
5 completely agree with the discussion we've had.

6 I think, as a practical matter, when you are  
7 dealing with very, very large engagements where the  
8 review can take hundreds, sometimes even thousands of  
9 hours, I think the level of -- the prescriptive words  
10 you have here may not be practicable.

11 And so, what I hear today is nobody is  
12 disagreeing with the intent of what's being written.  
13 It's the way it's written and the actual specific  
14 requirement that's articulated in (c). So maybe that  
15 could be shortened and moved to a more objectives-  
16 based language?

17 GREG SCATES: Jim Cox?

18 JAMES COX: Yes, I think that that -- maybe  
19 the wording suggestion is that you want to avoid sort  
20 of ironclad wording, but you'd like to communicate  
21 again what your objective is, and you'd like to have  
22 sufficient records or documentation so that should  
23 there ever be a third-party review, that one can make

1 a judgment or the records are adequate to feel  
2 comfortable with the level of intensity that was  
3 appropriate given the challenges of the review.

4 GREG SCATES: Any more comments on  
5 documentation or any other aspect of the engagement  
6 quality review that we've discussed today?

7 Gary?

8 GARY KABURECK: I have one on a subject we  
9 haven't discussed if you're moving to a general  
10 discussion.

11 And actually up on question one, where  
12 you're talking about types of engagements, you've got  
13 an audit. You've got the inner reviews. And as a  
14 general statement, I would agree those are the ones  
15 you need to do, and a lot of other agreed-upon  
16 procedures or long-form report for some due diligence,  
17 those aren't necessary.

18 But did you consider requiring an engagement  
19 quality review for SAS 70 reports? I'm thinking  
20 particularly SAS 70 Type II, thinking for our own SOX  
21 procedures. I mean there is a lot of stuff is  
22 outsourced to vendors and information providers and so  
23 on. And that's sort of where the world is going these

1 days, more and more outsourcing, more and more  
2 offshoring to specialists.

3 So I've found over the five years we've been  
4 doing the 404 work, we actually have more SAS 70  
5 reports now than we did in year one because just the  
6 normal evolution of business. The question is, should  
7 you require an engagement quality review for a SAS 70  
8 report that you're issuing? Did you consider it?

9 My instincts tell me it probably is a good  
10 thing. I don't know if it's a great thing, and I  
11 don't even know if I'd hold up finalizing this and  
12 deal with it separately. But was it considered and  
13 listen for reaction from anybody else.

14 GREG SCATES: We certainly would appreciate  
15 your comments, Gary, and any others of anything, any  
16 type of report that we should consider that should be  
17 subject to an engagement quality review, and we would  
18 like to have that in a comment letter.

19 And if there's anything else, Gary, or  
20 anyone else, any other item that we should consider  
21 including, please let us know. Let us know now or in  
22 a comment letter, let us know if there's anything else  
23 we should consider.

1                   Yes, Gaylen Hansen?

2                   GAYLEN HANSEN: I happen to agree that the  
3                   SAS 70, and you can't really rely on a Type I, but a  
4                   Type II. We're seeing more and more of those in  
5                   practice, and the reliance on those are significantly  
6                   increasing in quantity and volume. So reliance on  
7                   information service providers, I think, is going to be  
8                   part of where this profession is going, and I would  
9                   look forward rather than go through this standard and  
10                  leave it out. But maybe consider pulling that into  
11                  the standard.

12                  GREG SCATES: Thank you, Gaylen.

13                  Any other comments?

14                  [No Response.]

15                  GREG SCATES: Okay. Well, I thank you for  
16                  your input, and I want to remind you that the comment  
17                  period ends on April 20th. And we would -- I  
18                  encourage you to write comment letters, anything you  
19                  mentioned today or anything you want to comment on in  
20                  the release. I encourage you to get those letters  
21                  into us.

22                  As you can see from this reproposal the  
23                  impact that those comment letters had on the staff and

1 the board, and we certainly appreciate your input.

2 I now turn the meeting over to Jennifer

3 Rand.

4 JENNIFER RAND: Thanks, Greg. And thanks

5 again for your input in connection with that

6 discussion.