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## **STANDING ADVISORY GROUP MEETING**

### **PANEL DISCUSSION – ENGAGEMENT TEAM PERFORMANCE**

**JUNE 21, 2007**

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#### **Introduction**

At the June 2007 meeting of the Standing Advisory Group ("SAG"), a panel will discuss whether more direction should be included in the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") auditing and related professional practice standards about which members of the engagement team are responsible for performing the auditing procedures during an audit engagement. The panelists will provide brief remarks which will be followed by additional discussion with the SAG members.

The Board's interim auditing standards provide direction on how to conduct an audit and perform applicable auditing procedures. The standards, however, do not specifically provide direction as to which members of the engagement team have the responsibility to perform the auditing procedures. In general, the auditing standards provide high-level direction to the auditor with final responsibility for the audit (the "audit partner") for the planning and supervision of an audit engagement, and include a general discussion about technical training and proficiency of the independent auditor. The standards rely on the judgment of the audit partner to properly plan and supervise the audit engagement.

The Board's interim quality control standards require that an accounting firm establish policies and procedures that provide reasonable assurance that the work performed by the engagement team meets the applicable professional standards,

This paper was developed by the staff of the Office of the Chief Auditor to foster discussion among the members of the Standing Advisory Group. It is not a statement of the Board; nor does it necessarily reflect the views of the Board or staff.

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regulatory requirements, and the firm's standards of quality control. However, the interim quality control standards do not provide specific direction as to which members of the engagement team are responsible for performing the audit procedures.<sup>1/</sup> In contrast, the International Auditing and Assurance Standards Board's International Standard on Auditing 220 ("ISA 220"), *Quality Control for Audits of Historical Financial Information*, provides more detail about the audit partner's responsibilities as it relates to an audit engagement.

The panel discussion will focus on the audit partner's involvement in two aspects of the audit engagement – the planning and supervision of the audit engagement and the areas of the audit with higher risk or that involve complex issues and extensive use of professional judgment.

### Planning and Supervision

The Board's interim standards state that the work performed on an audit engagement "is to be adequately planned and assistants, if any, are to be properly supervised."<sup>2/</sup> The Board's interim auditing standards also state that "[a]uditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining."<sup>3/</sup>

An audit engagement team typically consists of individuals who possess different degrees of knowledge and audit experience. The Board's interim auditing standards classify auditors as either –

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<sup>1/</sup> Paragraph 17 of QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*. (References to quality control sections ("QC sec.") throughout this paper are to the Board's interim quality control standards, which are available on the PCAOB's Web site at [www.pcaobus.org](http://www.pcaobus.org).)

<sup>2/</sup> Paragraph .02 of AU sec. 150, *Generally Accepted Auditing Standards*. (References to AU sections ("AU sec.") throughout this paper are to the Board's interim auditing standards, which are available on the PCAOB's Web site at [www.pcaobus.org](http://www.pcaobus.org).)

<sup>3/</sup> Paragraph .06 of AU sec. 230, *Due Professional Care in the Performance of Work*.

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- The auditor with final responsibility for the audit (typically the audit partner), or
- An assistant (typically an engagement team member, defined as "firm personnel other than the auditor with final responsibility for the audit").<sup>4/</sup>

The Board's interim auditing standards indicate that the audit partner –

- "[I]s responsible for the assignment of tasks to, and supervision of assistants,"<sup>5/</sup>
- "[S]hould direct assistants to bring to his attention significant accounting and auditing questions raised during the audit so that he may assess their significance,"<sup>6/</sup> and
- "[M]ust exercise a seasoned judgment in the varying degrees of his supervision and review of the work done and judgment exercised by his subordinates....."<sup>7/</sup>

Additionally, the auditing standards state that the "extent of supervision appropriate in a given instance depends on many factors, including the complexity of the subject matter and the qualifications of persons performing the work."<sup>8/</sup>

In general, the interim auditing standards do not assign specific responsibilities to the audit partner for the planning and supervision of the audit. AU sec. 311, *Planning*

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<sup>4/</sup> Paragraph .02 of AU sec. 311, *Planning and Supervision*.

<sup>5/</sup> AU sec 230.06.

<sup>6/</sup> AU sec. 311.12.

<sup>7/</sup> Paragraph .03 of AU sec. 210, *Training and Proficiency of the Independent Auditor*.

<sup>8/</sup> AU sec. 311.11.

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*and Supervision*, specifically provides that the audit partner "may delegate portions of the planning and supervision of the audit to other firm personnel," without limiting the extent or portions of the audit planning and supervision that may be so delegated.<sup>9/</sup> Moreover, the portion of AU sec. 311 related to planning the audit engagement is directed to the auditor and does not assign the audit partner any specific procedures or responsibilities as part of planning the audit. With respect to supervision, although AU sec. 311 requires the work performed by each engagement team member to be reviewed to determine whether it was adequately performed and to evaluate whether the results are consistent with the conclusions to be presented in the auditor's report, the standard does not specify who is required to perform that review.<sup>10/</sup>

In contrast, ISA 220 describes the engagement partner's responsibilities in greater detail. Among other things, ISA 220 specifies the engagement partner's responsibilities for engagement team ethics and independence, the acceptance and continuation of audit client engagements, consultations, and engagement quality (*i.e.*, concurring partner) review. For example, as part of assigning an engagement team for the audit, ISA 220 provides that the engagement partner should be satisfied that the engagement team collectively has the appropriate capabilities, competence, and time to perform the audit engagement.<sup>11/</sup> With respect to supervision, ISA 220 details that the elements of supervision include –

- Tracking the progress of the audit engagement;
- Considering the capabilities and competence of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the audit engagement;

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<sup>9/</sup> AU sec. 311.02.

<sup>10/</sup> AU sec. 311.13.

<sup>11/</sup> ISA 220.19.

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- Addressing significant issues arising during the audit engagement, considering their significance and modifying the planned approach appropriately; and
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.<sup>12/</sup>

### **Discussion Topics –**

Presentations and discussion may address the following topics:

- The level of involvement the audit partner should have in the planning and supervision of the audit engagement.
- Whether the auditing standards should specify the audit partner's role in the planning of the audit, the staffing of the engagement team, determining the proper level of supervision of less experienced engagement team members, or other aspects of the planning and supervision of the audit engagement.

### **Performing the Audit**

In general, the Board's interim auditing standards do not specify which member of the engagement team should perform the auditing procedures related to the key risk areas of the audit, such as risk assessment, fraud risk analysis, and other aspects of the audit that involve analysis of complex issues or the extensive use of professional judgment. Rather, the auditing standards, in most instances, direct the auditor to perform the auditing procedures versus directing the audit partner or another member of the engagement team to perform them. The auditing procedures that the interim auditing standards explicitly direct the audit partner to perform are –

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<sup>12/</sup> ISA 220.24.

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- The *auditor with final responsibility for the audit* should participate in the brainstorming session during the planning of the audit.<sup>13/</sup>
- When evaluating the risks of material misstatement due to fraud at or near the completion of fieldwork the *auditor with final responsibility for the audit* "should ascertain that there has been appropriate communication with the other audit team members throughout the audit regarding information or conditions indicative of risks of material misstatement due to fraud."<sup>14/</sup>
- When the auditor has concluded that there is a significant risk of material misstatement of the financial statements, the auditor should consider this when determining the staff assignments and appropriate level of supervision because "ordinarily higher risk requires more experienced personnel or more extensive supervision by the auditor with final responsibility for the engagement during both the planning and the conduct of the engagement."<sup>15/</sup>

Apart from these instances, the auditing standards generally direct the auditor, who can be either the audit partner or another member of the engagement team, to perform a specific audit procedure. For example, as part of the overall auditor's response to the risk of material misstatement, AU 316.50 states when assigning personnel that "[t]he knowledge, skill, and ability of personnel assigned significant engagement responsibilities should be commensurate with the auditor's assessment of the risks of material misstatement due to fraud for the engagement.... In addition, the extent of supervision should reflect the risks of material misstatement due to fraud."

Similarly, the international standards on auditing do not provide specific direction as to which member of the engagement team should perform the auditing procedures

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<sup>13/</sup> Paragraph .14 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*.

<sup>14/</sup> AU sec. 316.74.

<sup>15/</sup> Paragraph .17 of AU sec. 312, *Audit Risk and Materiality in Conducting an Audit*.

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during the engagement. Any specific direction provided is comparable to the direction provided in the Board's interim auditing standards.

In contrast to the audit partner's responsibilities, the interim quality control standards provide specific direction to the concurring partner reviewer regarding his or her responsibilities on an audit engagement. Specifically, the Board's interim quality control standards state that "the concurring partner reviewer's responsibility is to perform an objective review of the significant auditing, accounting, and financial reporting matters and to conclude, based on all the relevant facts and circumstances of which the concurring partner review has knowledge, that no matters have come to his or her attention would cause the concurring partner reviewer to believe that the client's financial statements covered by the firm's audit report are not in conformity with generally accepted accounting principles in all material respects or that the audit was not performed in accordance with generally accepted auditing standards."<sup>16/</sup> The Board's interim quality control standards further state that the concurring partner reviewer fulfills his or her responsibility by among other things discussing significant accounting, auditing and financial reporting matters with the audit engagement partner and reviewing applicable documentation regarding the resolution of the matters; discussing the audit engagement team's identification and audit of high-risk transactions and account balances; reviewing a summary of unadjusted audit differences; and reading the financial statements and auditor's report.<sup>17/</sup> Although the interim quality control standards outline the minimum procedures the concurring partner reviewer is responsible for performing, the interim auditing standards do not have a similar list of the specific auditing procedures the audit partner is required to perform on an audit engagement.

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<sup>16/</sup> PCAOB, QC standards, SEC Practice Section Requirements of Membership, sec. 1000.08(f), *Concurring Partner Review of the Audit Report and the Financial Statements of Commission Registrants*, SECPS 1008.39, Appendix E, par. b.

<sup>17/</sup> Id.

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### **Discussion Topics –**

Presentations and discussion may address the following topics:

- Whether the auditing standards should direct the senior member or members of the engagement team to be directly involved in the highest risk areas of the audit, such as risk assessment, fraud risk analysis, and other aspects of the audit that involve analysis of complex issues or the extensive use of professional judgment.
- Whether the auditing standards should define or outline specific roles for the auditors at each level of the engagement team (audit partner, manager, staff).
- Whether special consideration should be given to audit engagements based on the size and complexity of the issuer being audited or the size of the accounting firm.

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