
STANDING ADVISORY GROUP MEETING

PANEL DISCUSSION – ENGAGEMENT QUALITY REVIEWS IN SMALLER REGISTERED FIRMS

OCTOBER 5-6, 2005

Section 103 of the Sarbanes-Oxley Act of 2002 requires the PCAOB to include in its auditing standards requirements that each registered public accounting firm provide a concurring or second partner review and approval of audit reports on the financial statements of issuers, and concurring approval of the issuance of such reports. At the time the PCAOB was established, members of the SEC Practice Section of the AICPA (“SECPS”) had a longstanding requirement to obtain a concurring partner review of audit reports on the financial statements of those companies that the SECPS described as SEC registrants. As part of its interim standards, the PCAOB adopted the SECPS concurring partner review requirement for registered firms that were members of the SECPS. (The interim requirement is reprinted in Appendix A.) The requirement specifies that the concurring partner review serves as an objective review of significant auditing, accounting, and financial reporting matters^{1/} that come to the attention of the concurring partner reviewer (hereinafter called “engagement quality reviews,” because that term is more descriptive of the objectives of such reviews). Engagement quality reviews are critically important to ensure the quality of audits and to enhance investor confidence in audited financial information.

^{1/} For purposes of the concurring partner review, “significant auditing, accounting, and financial reporting matters” refers to matters involving a significant risk of material misstatement of financial statements, including a material disclosure deficiency in the footnotes to the financial statements.

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

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The Standing Advisory Group (“SAG”) discussed engagement quality reviews at its June 2004 meeting. A briefing paper describing the issues discussed at that meeting is included in the materials prepared for that meeting and is available on the PCAOB Web site (www.pcaob.org/Standards/Standing_Advisory_Group/index.aspx). The SAG’s October 2005 meeting presents an opportunity to discuss additional issues regarding engagement quality reviews, including specifically how small registered public accounting firms can provide for or otherwise obtain cost-effective engagement quality reviews. In order to benefit from the experience of small firms that have included engagement quality reviews in their audit practices in the past under the SECPS’s requirements, the October 2005 SAG meeting will include an interactive discussion with a panel of auditors from small firms.

Discussion Topics –

The panel members will address:

- Processes the panelists have used to select appropriate engagement quality reviewers, and the role of the lead engagement partner in those processes.
- How the panelists’ firms have ensured that engagement quality reviewers have the appropriate levels of both competence and objectivity to perform the review, both in circumstances in which reviewers are employed by the panelists’ firms and in circumstances in which the panelists’ firms arrange for auditors at other firms to serve as reviewers.
- How differences of opinion between engagement quality reviewers and lead engagement partners are resolved.
- Challenges in implementing engagement quality reviews in small audit firms.

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The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

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APPENDIX A

PCAOB Interim Requirement (from the SEC Practice Section Requirement)

.39 APPENDIX E - Concurring Partner Review Requirement (Revised with an Effective Date of March 31, 2002)

Statement on Auditing Standards No. 25, *The Relationship of Generally Accepted Auditing Standards to Quality Control Standards*, and Statement on Quality Control Standards No. 2 (SQCS No. 2), *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, require the firm to maintain a system of quality control to provide reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality. Engagement performance policies and procedures required by paragraph .18 of SQCS No. 2^{1/} encompass all phases of a firm's policies and procedures for the design and execution of the engagement, which include the concurring partner review for SEC engagements. Accordingly, the concurring partner review is an integral part of the firm's system of quality control and serves as an objective review of significant auditing, accounting, and financial reporting matters^{2/} that come to the attention of the concurring partner reviewer and the resolution of such matters prior to the issuance of the firm's audit report with respect to financial statements of SEC engagements (see Appendix D, SECPS §1000.38). On the basis of that review, the concurring partner reviewer should conclude that no matters that have

^{1/} The Auditing Standards Board has issued a revision to SQCS No. 2, through adoption of SQCS No. 4, to specify "Where applicable, these policies and procedures should also address the AICPA's SEC Practice Section's concurring partner review requirement for SEC engagements."

^{2/} For purposes of the concurring partner review, "significant auditing, accounting, and financial reporting matters" refers to matters involving a significant risk of material misstatement of financial statements, including a material disclosure deficiency in the footnotes to the financial statements.

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come to his or her attention would cause the concurring partner reviewer to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects, or that the firm's audit was not performed in accordance with generally accepted auditing standards.

A member firm's system of quality control should include policies and procedures covering (a) the qualifications of concurring partner reviewers, (b) the nature, extent, and timing of the concurring partner review, (c) the documentation required to evidence compliance with the firm's policies and procedures with respect to the concurring partner review requirement, and (d) quarterly reviews.

As a minimum, the firm's policies and procedures should be responsive to the following:

- a. **Qualifications.** The concurring partner reviewer should have sufficient technical expertise and experience to achieve the purpose described above. The determination of what constitutes sufficient technical expertise and experience requires consideration and is tailored to the circumstances of the engagement, including the personnel assigned to the engagement. An effective concurring partner review contemplates knowledge of relevant specialized industry practices. It also contemplates that the concurring partner reviewer possesses knowledge of SEC rules and regulations in areas where such rules and regulations are pertinent. There are various ways to obtain such knowledge in addition to personal audit experience, such as attendance at relevant training courses and through self-study. The concurring partner reviewer should seek assistance from other individuals to supplement this knowledge when necessary in the circumstances.

The tone set at the top of the firm should encourage and support the performance of objective concurring partner reviews. In this regard, firm policy should state that the concurring partner reviewer is expected to carry out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the concurring partner reviewer.

Further, the concurring partner reviewer should not assume any of the responsibilities of the audit partner-in-charge of the engagement or have responsibility for the audit of any significant subsidiaries, divisions, benefit plans,

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or affiliated or related entities.^{3/} In addition, a prior audit engagement partner should not serve as the concurring partner reviewer for at least two annual audits following his or her last year as the audit engagement partner.^{4/} A member firm that is not subject to the SECPS membership requirement regarding rotation of an audit engagement partner of an SEC engagement after seven consecutive years is exempt from the preceding requirement.^{5/}

- b. **Nature, Extent, and Timing.** The concurring partner reviewer's responsibility is to perform an objective review of significant auditing, accounting, and financial reporting matters and to conclude, based on all the relevant facts and circumstances of which the concurring partner reviewer has knowledge, that no matters that 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.

The concurring partner reviewer's responsibility is not the equivalent of the audit engagement partner's responsibilities. Without first-hand knowledge of the client's business environment, the benefit of discussions with management and

^{3/} It is not unusual for clients to be aware of the existence of a concurring partner reviewer. A client may contact the concurring partner reviewer with respect to matters requiring immediate attention when the audit engagement partner is not available because of illness, extended travel or other reasons. When a concurring partner reviewer is thus required to deal with an accounting, auditing or financial reporting matter, he or she should advise the audit engagement partner of the facts and circumstances so that the audit engagement partner can review the matter and take full responsibility for its resolution.

^{4/} The SECPS Peer Review Committee may authorize alternative procedures when this requirement imposes an undue hardship on the firm. See SECPS §2000.147, Appendix F, of the SECPS Reference Manual for submitting requests for a waiver of this requirement to the SECPS Peer Review Committee.

^{5/} See SECPS §1000. 08(e)(1), "Requirements of Members," of the SECPS Reference Manual.

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other client personnel, the opportunity to review client documents or controls, or the ability to observe the client's actions or attitudes, a concurring partner reviewer generally is not in a position to make the informed judgments on significant issues expected of an audit engagement partner. However, the concurring partner reviewer is expected to objectively perform the procedures specified below and reach conclusions based on all relevant facts and circumstances of which he or she has knowledge.

The concurring partner reviewer's responsibility is fulfilled by performing the following procedures:

- Discussing significant accounting, auditing and financial reporting matters with the audit engagement partner;
- Discussing the audit engagement team's identification and audit of high-risk transactions and account balances;
- Reviewing documentation of the resolution of significant accounting, auditing and financial reporting matters, including documentation of consultation with firm personnel or resources external to the firm's organization (such as standard-setters, regulators, other accounting firms, the AICPA, and state societies)^{6/};
- Reviewing a summary of unadjusted audit differences;
- Reading the financial statements and auditors' report; and
- Confirming with the audit engagement partner that there are no significant unresolved matters.

^{6/} Documentation to be reviewed should consist of summary memoranda and/or working paper summaries of the resolution of significant accounting, auditing, and financial reporting matters, and may include selected, more detailed working papers and other documentation. The review of the more detailed working papers and other documentation is a matter of professional judgment made by the concurring partner reviewer about the extent of information necessary to perform an objective review so that he or she has sufficient basis to conclude on the results of the review.

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These procedures provide the basis for the concurring partner reviewer to perform an objective review of accounting, auditing and financial reporting matters that were considered significant by the engagement team in conducting the audit. The concurring partner reviewer is not responsible for searching for additional matters to be considered by the engagement team. However, significant matters not previously identified by the engagement team that come to the concurring partner reviewer's attention should be referred to and resolved by the engagement team with the concurrence of the concurring partner reviewer.

In addition to performing the procedures described in the bullets above, the concurring partner reviewer's consideration and conclusions about whether significant matters were appropriately considered and resolved may require discussions with other firm personnel involved in any significant consultations. When discussion occurs with the concurring partner reviewer on an accounting, auditing or financial reporting matter during the engagement, the audit engagement partner ordinarily should develop an initial resolution to the matter before discussion with the concurring partner reviewer.^{7/}

The firm's guidelines for concurring partner review should take into account its policies and procedures for planning, supervising and reviewing engagements, and the extent to which those policies provide for the documentation of significant accounting, auditing, and financial reporting matters. The firm's guidelines also should identify the types of engagements for which a timely review should be made of the audit planning by the concurring partner reviewer so that any modifications can be implemented effectively during the performance of the audit. Firms should apply, as a minimum, this procedure to the firm's initial audit of a SEC engagement and other high-risk engagements as defined by the firm for this purpose. Such a definition might be influenced by the complexity of the entity, the engagement personnel's experience with the entity, and their knowledge of the entity's business. Factors to consider in this regard may include the entity's type of business; types of products and services; capital structure; related parties;

^{7/} Discussion with the concurring partner reviewer is most effective when the concurring partner reviewer is aware of and understands the issues at the time the issues are addressed by the audit engagement team rather than addressing the issues at the conclusion of the engagement.

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locations; production, distribution, and compensation methods; any material changes in the entity's business; and whether the entity has plans for a public offering. (See AICPA Professional Standards, Vol. 1, AU section 311, "Planning and Supervision" and AU section 312, "*Audit Risk and Materiality in Conducting an Audit*".)

If the concurring partner reviewer and the audit engagement partner of the engagement have conflicting views regarding important matters, the disagreement should be resolved in accordance with applicable firm policy.^{8/}

In all cases, the concurring partner review should be completed before the release of the audit report and before the re-issuance of the audit report where performance of subsequent events procedures^{9/} is required by professional standards.

- c. **Documentation.** The engagement files should contain evidence that the firm's policies and procedures with respect to the concurring partner review requirement were complied with before the issuance of the firm's audit report. Ordinarily, this would include documentation that the concurring partner reviewer has performed the procedures specified by the firm's policies and that no matters that have come to the attention of the concurring partner reviewer would cause him or her to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects or that the firm's audit was not performed in accordance with generally accepted auditing standards.
- d. **Quarterly Reviews.** Items (b) and (c) above relate to the concurring partner reviewer's involvement with an audit engagement. For a review conducted in accordance with SAS No. 71, "Interim Financial Information," on financial statements in an SEC client's quarterly Form 10-Q or 10-QSB filing, a member firm's policies and procedures should require discussion with the concurring partner reviewer, prior to the completion of the review, about any matters

^{8/} See Statement on Auditing Standards No. 22, "Planning and Supervision."

^{9/} In this instance, the concurring partner reviewer ordinarily would concern himself or herself with matters relating to the subsequent events procedures.

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identified in the review that involve a significant risk of material misstatement of the financial statements.^{10/} Any such involvement should be documented.

^{10/} For purposes of the concurring partner review, "significant risk of material misstatement of the financial statements" includes a material disclosure deficiency in the footnotes to the financial statements.