

Mr. J. Gordon Seymour  
Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

14 April 2009

## **Proposed Auditing Standard - Engagement Quality Review; PCAOB Rulemaking Docket Matter No. 025**

Dear Mr. Seymour:

We are pleased to comment on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Proposed Auditing Standard - Engagement Quality Review ("the Proposed Standard").

We support the Board's efforts to adopt a comprehensive standard consistent with Section 103 (a) (2) (A) (ii) of the Sarbanes-Oxley Act, which requires that the Board adopt a standard that registered public accounting firms "provide a concurring or second partner review and approval of [each] audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board)."

We believe that an engagement quality review that focuses on significant judgments made and related conclusions reached by the engagement team is effective in promoting audit quality. We also are of the view that engagement quality reviews are but one element of an overall system of quality control and proposed changes to the Board's interim standards should be considered in the context of a firm's system of quality control taken as a whole.

We commend the Board for the modifications and clarifications made to the Proposed Standard. We believe that the Proposed Standard more appropriately defines the requirements of the engagement quality review and adequately addresses many of the comments made by us and others on the original proposal. However, we believe that additional modifications would provide further clarity regarding the documentation of an engagement quality review, the concurring approval of issuance, the required competence of the engagement quality reviewer and the effective date of the final standard. Our comments about these and other matters are provided below.

### ***Paragraph 19 - Documentation of an Engagement Quality Review***

Paragraph 19(c) requires that documentation of the engagement quality review include sufficient documentation of the significant discussions held by the engagement quality reviewer and others who assisted the reviewer, including the date of each discussion, the specific matters discussed, the

substance of the discussion, and the participants. We believe the requirement is unnecessary and unduly burdensome, and we recommend it be deleted.

PCAOB Auditing Standard No. 3, *Audit Documentation*, states that “audit documentation...provides the reviewer with written documentation of the evidence supporting the auditor’s significant conclusions.” Separate documentation of significant discussions involving the engagement quality reviewer throughout the course of the audit and related interim reviews will duplicate other documentation already required to be included in the audit workpapers that provide evidence supporting significant audit conclusions. Additionally, significant discussions held by the engagement quality reviewer throughout the course of the audit and interim reviews may reflect fact patterns or matters that are no longer relevant to the engagement team’s conclusions and therefore would no longer be relevant audit documentation. We also believe it is unreasonable to expect the engagement quality reviewer to know, at the time of the discussions, whether such discussions will in fact be significant and therefore whether documentation of such discussions will be necessary to demonstrate compliance with the Proposed Standard. Some auditors may therefore determine that it would be necessary to document each discussion, which would be overly burdensome and costly and could possibly inhibit discussions or collaboration with the engagement quality reviewer. We do not believe this was the Board’s intent.

The Board indicates on page 24 of its Release accompanying the Proposed Standard (“Release”) that it has observed deficiencies in the documentation of concurring partner reviews based on information and findings from inspection teams, enforcement cases and academic research that may have contributed to the failure to properly address the concurring partner’s findings. It is our experience that matters considered and resolved through discussions with the engagement quality reviewer that are determined to be important accounting and auditing matters are documented in the engagement completion document. The documentation of such matters and their resolution would therefore be subject to review by the engagement quality reviewer as required by paragraph 10(i) of the Proposed Standard. We believe these procedures combined with the requirement of paragraph 19(b) to identify the documents reviewed by the engagement quality reviewer will result in sufficient documentation of the significant matters that the engagement quality reviewer focused on when performing the engagement quality review and enable the Board’s inspectors to evaluate whether the engagement quality review was appropriately performed.

#### ***Paragraphs 12 and 17 - Concurring Approval of Issuance***

The Proposed Standard indicates that the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due professional care the review required by the standard, he or she is not aware of a significant engagement deficiency. We commend the Board for requiring that the engagement quality review be conducted with due professional care, which we believe is preferable to the “knows or should know” standard provided in the original proposal. We believe these revisions convey appropriate standards of performance and care that are consistent with the objectives and requirements of the Proposed Standard. We agree with the Board’s observation that due professional care is a concept familiar to auditors and consistent with other auditing standards.

However, we respectfully disagree with the Board's statement on page 24 of the Release that the requirement to exercise due professional care imposes on a reviewer essentially the same requirement as the condition stated in the Board's original proposal (i.e., "knows or should know"). We continue to believe the condition "knows or should know" would be interpreted as imposing significant additional obligations on the engagement quality reviewer and therefore would elicit a level of effort that is not consistent with the objectives and requirements of the Proposed Standard. We recommend removing such language from the release that accompanies the final Engagement Quality Review standard.

#### ***Paragraph 5 - Qualifications of an Engagement Quality Reviewer-Competence***

We recommend that, when describing the competencies that the engagement quality reviewer must possess, the Board refer to those competencies required to serve as the engagement quality reviewer, rather than to the competencies required to serve as the engagement partner. This description would be consistent with International Standards on Quality Control (ISQC) 1 (R), paragraph 39. We are concerned that the Proposed Standard could be interpreted as requiring the engagement quality reviewer to possess all of the same competencies as the engagement partner. We believe the engagement quality reviewer can possess sufficient competence to perform the engagement quality review without possessing all of the same competencies of the engagement partner.

What constitutes sufficient and appropriate technical expertise, experience and authority depends on the circumstances of the engagement and the personnel assigned to the engagement. Therefore, many judgments are made when making assignments of the engagement quality reviewer and firms need a certain level of flexibility when making these decisions. Defining the competencies from the engagement quality reviewer perspective and removing the language of "the same type of engagement" from the Proposed Standard will broaden the criteria for assigning the engagement quality reviewer, while still providing the necessary framework for determining that an appropriate individual is selected.

#### ***Effective Date of the Standard***

We believe that the effective date of the final Engagement Quality Review standard should coincide with the beginning of the audit engagement period to allow for the requirements to be applied to interim reviews and audits in the same fiscal year. Linking the effective date to the beginning of the audit cycle will allow the engagement quality reviewer to comply with the requirements during audit planning activities and timely reviews of interim financial information. Accordingly, we recommend that the effective date of the final standard be for audits of fiscal years beginning on or after December 15, 2009 and for interim reviews within such fiscal years.

#### ***Other Aspects of the Proposed Standard***

##### Paragraph 2 - Objective

We commend the Board for including an objective of the engagement quality review in the Proposed Standard. The objective allows regulators, investors, audit committees and company management to

have a consistent understanding of the purpose of the engagement quality review. It allows auditors to apply professional judgment in determining the nature and extent of the review procedures to be performed to meet the requirements of the Proposed Standard. It also aids in differentiating the role and function of the engagement quality reviewer from that of the engagement partner and other members of the engagement team.

#### Paragraphs 3-8 - Qualifications of an Engagement Quality Reviewer

Paragraph 4 of the Proposed Standard states that an engagement quality reviewer must have competence, independence, integrity and objectivity. In order to clarify what is meant by this requirement, we believe the Proposed Standard should reference the PCAOB interim quality control standards that fully describe these requirements (QC sec. 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*).

We commend the Board for the revisions made to the Proposed Standard regarding the objectivity of the engagement quality reviewer. We believe that the revised requirements allow for ongoing consultations between the engagement team and the engagement quality reviewer, which we believe are critical to the audit process.

Also with respect to the objectivity of the engagement quality reviewer, we commend the Board for expanding the phrase "supervise the engagement team with respect to the engagement subject to the engagement quality review." However, we do not believe this is sufficiently clear to denote that partners in a leadership position in a firm, region, service line, or industry practice are permitted to perform engagement quality reviews. We recommend that the final standard more explicitly state the Board's intention to not prohibit such persons from performing engagement quality reviews if otherwise qualified.

#### Paragraph 10 - Engagement Quality Review for an Audit

Paragraphs 10(e) and 10(f) require the engagement quality reviewer to "determine if appropriate matters have been communicated, or identified for communication" and "determine if appropriate consultations have taken place on difficult or contentious matters." We believe these requirements could be interpreted to go beyond the other requirements of the Proposed Standard that are focused on the evaluation of the work performed by the engagement team. Therefore, we believe the procedures in paragraphs 10(e) and 10(f) of the Proposed Standard should be modified to indicate that the engagement quality reviewer should make an evaluation of the appropriateness of the matters described in paragraphs 10(e) and 10(f) based upon performing all of the other procedures set forth in paragraph 10.

We also suggest that the Board modify paragraphs 10(a), 10(b) and 10(d) to indicate that the engagement quality reviewer should "review" (rather than "evaluate") the applicable items to make clear that these procedures are intended to apply to significant judgments made by the engagement team. This change is consistent with the direction provided in paragraph 9 and will add appropriate clarity to the requirements.

Further, we believe paragraph 10(b) is not sufficiently clear to describe the extent of procedures required of the engagement quality reviewer with regard to risk assessments and audit responses. We believe a partner performing an engagement quality review could interpret the phrase, "evaluate the risk assessments and audit responses," to mean that he or she should review the audit responses for all areas of the audit. We believe such an interpretation would result in performing unnecessary procedures and also would appear to conflict with the phrase appearing later in paragraph 10(b) indicating the engagement quality reviewer should evaluate "the engagement procedures performed in response to significant risks." We also observe that paragraph 11(a) requires the engagement quality reviewer to evaluate whether the engagement documentation reviewed "indicates that the engagement team responded appropriately to significant risks." We recommend that the Board modify paragraph 10(b) to clarify that the engagement quality reviewer should evaluate the audit responses to significant risks.

#### Paragraphs 14-18 - Engagement Quality Review for a Review of Interim Financial Information

Paragraph 15(c) of the Proposed Standard indicates the engagement quality reviewer should read the related engagement report, if a report is to be filed with the SEC. We believe that the engagement quality reviewer should read the related engagement report, if a report is to be issued, regardless of whether the report is filed with the SEC.

Paragraph 17 of the Proposed Standard requires the engagement quality reviewer to provide concurring approval of issuance. However, as engagement reports are not issued in every review of interim financial information, the final standard should refer to the engagement quality reviewer's "concurring approval" rather than "concurring approval of issuance."

#### Relationship with Quality Control Standards

The note to paragraph 4 of the Proposed Standard indicates the firm's quality control policies and procedures should include provisions to provide the firm reasonable assurance that an engagement quality reviewer has sufficient competence, independence and integrity to perform the engagement quality review. While we agree with this statement, we do not believe that such a statement should be included in auditing standards, but instead should be included in quality control standards.

Having a system of internal quality control policies and procedures that, among other things, specify the criteria and procedures for the assignment of the firm's personnel to engagements is a firm requirement. Audit personnel, including the engagement quality reviewer, are required to follow auditing standards in the preparation and issuance of audit reports. We believe that delineating the audit firm's requirements in the quality control standards and the auditor's requirements in the auditing standards and the attestation standards, as appropriate, lends clarity to the requirements in the standards.

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We would be pleased to discuss our comments with members of the Public Company Accounting Oversight Board or its staff.

Sincerely,

*Ernst + Young LLP*