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April 20, 2009

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Request for Public Comment: *Proposed Auditing Standard – Engagement Quality Review, PCAOB Rulemaking Docket Matter No. 025*

Dear Office of the Secretary:

The Center for Audit Quality (CAQ or the Center) is a public policy organization that seeks to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for reform that are rooted in the profession's core values of integrity, objectivity, honesty, and trust. We also seek to improve the reliability of public company audits and to enhance their relevance for investors in this time of increasing globalization and financial complexity. Any U.S. accounting firm registered with the Public Company Accounting Oversight Board (PCAOB or the Board) may join the CAQ. The CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA) and has approximately 750 U.S. public company audit firms as members, representing tens of thousands of professionals dedicated to audit quality.

We welcome the opportunity to share our views¹ on the PCAOB's Proposed Auditing Standard – *Engagement Quality Review (EQR)* (the revised proposal).

We strongly support auditing standards that promote audit quality and believe that a robust and effective engagement quality review that focuses on significant judgments made and the related conclusions reached by the engagement team furthers that purpose. We commend the PCAOB for considering feedback from constituents on its original proposal and for exposing a revised proposal. We believe that compared to the original proposal, the revised proposal more appropriately defines the requirements of the EQR. However, we believe that additional modifications should be made to the revised proposal in order to, improve its quality, lead to its effective and efficient implementation, and enhance its application in practice.

We have organized our observations and concerns about the revised proposal around the following topics:

- Applicability of the Standard
- Overall Objective
- Qualifications of Engagement Quality Reviewer
- Engagement Quality Review Process for an Audit
- Due Professional Care
- Documentation of an Engagement Quality Review
- Effective Date
- Other Comments
 - Review of Interim Financial Information
 - Relationship of Firm Quality Control

Applicability of the Standard

We support the applicability of the revised proposal, which is limited to audits and reviews of interim financial information and which excludes other engagements such as those performed under the attestation standards. The revised applicability avoids the potential confusion of having requirements related to attestation engagements residing in the auditing standards.

Additionally, we believe the Board's inclusion, in paragraph 15, of those requirements that apply specifically to reviews of interim financial information is very helpful.

¹ This letter represents the views of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member.

Overall Objective

We believe that the stated objective for an engagement quality review will guide reviewers in satisfying themselves that, in doing their work, they understood and accomplished the requirements of the standard. Furthermore, by putting the review in the proper perspective, the Board improves the likelihood that third parties -- including other regulators and the public -- will have a consistent understanding of the intent of the standard. Finally, we believe that having an objective is beneficial to providing the appropriate framework for the standard-setting process itself, including laying the groundwork for convergence with the International Standards on Auditing (ISAs), which we support as a long-term goal of the PCAOB.

While we strongly support the inclusion of an objective, we note that the requirement is to perform an evaluation of the “significant judgments made by the engagement team and the conclusions reached.” We suggest a clarification to the objective by stating that the review relates to the “significant judgments made by the engagement team, and the **related** conclusions reached.” We believe that this minor change will make clear that the conclusions that should be the focus of the EQR are those that result from the significant judgments.

Qualifications of Engagement Quality Reviewer

Competence

We agree with the Board that the engagement quality reviewer competency requirement should be “principles-based” and that a general competence standard setting a minimum requirement for the engagement quality reviewer is appropriate.² However, we do not believe the language in paragraph 5 of the revised proposal achieves the Board’s intent to establish a “principles-based” requirement. As written, we are concerned that paragraph 5 may have the unintended consequence of prohibiting qualified persons from performing EQRs and may cause resource constraints, particularly for smaller audit firms.

Specifically, paragraph 5 does not make it clear that the reviewer’s competence is not required to match that of the engagement partner, and the paragraph may not provide sufficient flexibility in assigning an appropriate engagement quality reviewer. Instead language such as “required to serve,” and the reference to “the person who has overall responsibility for the same type of engagement,” will cause inevitable comparisons of the attributes of the engagement quality reviewer to those of the actual engagement partner. We do not believe such comparisons are necessary in assessing the competence of the engagement quality reviewer or that such a comparison is the intention of the Board.³ In

² See Release at page 11.

³ See Release at page 11.

our experience, it is not always essential for the engagement quality reviewer to have had experience with other companies in the respective industry. Many judgments are made in the assignment of an engagement quality reviewer, including but not limited to, consideration of the qualifications, experience, and knowledge of both the engagement partner and the potential engagement quality reviewer. We also do not believe the Board intended to preclude such judgments in assigning engagement quality reviewers; however, this is not clear in paragraph 5 of the revised proposal.

In addition, as indicated in the note to paragraph 6, the reviewer may use assistants in performing the EQR. Therefore, we believe that the standard should make clear that the competence requirements contemplate the combined skills of the engagement quality reviewer and any assistants.

In order to provide appropriate flexibility in assigning qualified engagement quality reviewers and to make the standard consistent with the Board's stated intentions to provide a principles-based standard setting a minimum requirement, we suggest paragraph 5 be revised as follows:

The engagement quality reviewer must possess, or obtain through utilizing assistants, the level of knowledge and competence related to accounting, auditing, and financial reporting required to perform the role. ~~serve as the person who has overall responsibility for the same type of engagement.~~ The appropriate level of knowledge and competence depends on the circumstances of the engagement including the size and complexity of the engagement.

To make it clear that the PCAOB is setting a "minimum requirement for those who would perform the EQR" and not requiring the engagement quality reviewer to "possess skills identical to those of the engagement partner,"⁴ we recommend changing the paragraph to refer to competencies required to fulfill the role of the engagement quality reviewer rather than the role of the engagement partner. This change is consistent with International Standards on Quality Control (ISQC) 1 (R) paragraph 39. Further, adding the second sentence makes it clear that the assignment of an appropriate engagement quality reviewer involves making judgments based on the facts and circumstances of the engagement, and is consistent with footnote 18 of the Board's initial proposal and ISQC 1(R) paragraph A47. These changes would provide audit firms with sufficient discretion to appropriately identify a qualified engagement quality reviewer.

Objectivity

We support the changes made to the standard to clarify the requirement for the engagement quality reviewer to remain objective. Specifically, we believe that the removal of the note to paragraph 6 of the Board's original proposal (now paragraph 7 of the revised proposal) eliminates the perception that the standard would limit consultation

⁴ See Release at page 11.

between the engagement team and the engagement quality reviewer. We believe that consultation is an important element of audit quality, and that these changes encourage appropriate consultation without compromising the objectivity of the engagement quality reviewer.

Additionally, we agree with the Board's intention stated in its Release that partners with leadership responsibilities in a firm, region, service, or industry practice should not be precluded from acting as an engagement quality reviewer, however, this intention is not made clear in the language in paragraph 7 of the revised proposal.⁵ While we believe that the changes in paragraph 7 appropriately define "objectivity" in terms of the engagement, and not in terms of the engagement team, we remain concerned that the language does not clearly express the intention of the Board. We recommend adding a footnote to paragraph 7 to articulate the view in the Board's Release, such as "Partners with leadership responsibilities are not precluded from acting as an engagement quality reviewer based upon those responsibilities."

Engagement Quality Review Process for an Audit

Paragraphs 9 and 10 prescribe general and specific requirements for conducting the EQR of an audit. We generally agree with the types of procedures to be performed. However, we recommend certain changes in the text of paragraphs 9 and 10 to reflect the intentions of the Board as set out in the Release and the objective of the standard.

We acknowledge and agree with changes in the revised proposal intended to clarify the extent of documentation that the engagement quality reviewer should review. However, we do not believe the language in paragraph 9 is sufficiently clear to communicate that engagement quality reviewers are able to complete the review by reviewing selected documentation. We note that Paragraph 11 refers to "engagement documentation ...reviewed when performing the procedures required by paragraph 10." However, this same clarification is not articulated in paragraph 9. Accordingly, based on these concerns and others articulated in this letter, we recommend that paragraph 9 be modified as follows:

In an audit engagement, the engagement quality reviewer should evaluate the significant judgments made by the engagement team and the **related** conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report. To identify and evaluate the significant judgments and **related** conclusions, the engagement quality reviewer should perform the procedures described in paragraph 10 by holding discussions with the person with overall responsibility for the engagement, by holding discussions with other members of the engagement team as necessary, and by reviewing **selected** documentation **as considered necessary by the engagement quality reviewer.**

⁵ See Release at page 14.

The above changes are consistent with: 1) the articulated intention of the revised proposal,⁶ 2) paragraph 11 of the revised proposal, and 3) ISQC 1 (R) paragraph 37.

Further, we believe that the procedures set forth in paragraphs 10.e. and 10.f., which require the 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” could be interpreted to go beyond the other requirements of the standard that are focused on the evaluation of the work performed by the engagement team. We believe that the procedures in paragraphs 10.e. and 10.f. of the revised proposal should be modified to indicate that the engagement quality reviewer should make an evaluation of the appropriateness of such matters based upon performing all of the other procedures set forth in this standard.

We suggest that these two paragraphs be modified as follows:

e. ~~Determine if~~ *Evaluate whether* appropriate matters *that are identified through the performance of the other engagement quality review procedures in this standard* have been communicated, or identified for communication to the audit committee, management, and other parties, such as regulatory bodies.

f. ~~Determine if~~ *Evaluate whether* appropriate consultations have taken place on difficult or contentious matters *that are identified through the performance of the other engagement quality review procedures in this standard*. Review the documentation, including conclusions, of such consultations.

Alternatively, the Board could include these two procedures in a new paragraph which would follow paragraph 10 and clarify that the evaluation should be made based upon the results of all other procedures performed in accordance with this standard.

Finally, we suggest that the Board modify paragraphs 10.a., 10.b. and 10.d. 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.

Due Professional Care

The revised proposal indicates that the engagement quality reviewer “may provide concurring approval of issuance only if, after performing with due professional care the review required by this standard, he or she is not aware of a significant engagement

⁶ During the Board’s open meeting on March 4, 2009 to discuss the revised proposal, Board Member Goelzer asked a question regarding documentation requirements and during that exchange PCAOB staff stated that the engagement quality reviewer is expected to review “selected documentation.”

deficiency.” We agree with and support the description of the basis of conclusions, which is consistent with the Board’s interim standard and the overall objective of an EQR. The revised proposal also requires that the EQR be conducted with due professional care, which we believe is preferable to the “knows or should know” standard of the original proposal.

However, we respectfully disagree with the Board’s suggestion in the Release that “the requirement to exercise due professional care imposes on a reviewer essentially the same requirement as the ‘knows, or should know based on the requirements of this standard’ formulation in the Board’s original proposal.”⁷ Additionally, as explained in our comment letter on the original proposal, we remain concerned that “know or should know” imposes additional responsibilities on a reviewing partner beyond those implied by a “due professional care standard.”

Potts v. SEC, 151 F.3d 810 (8th Cir. 1998), which the Board cites, discusses a standard that resembles the “due professional care” standard proposed by the Board (“Having taken on the concurring review task, Potts also shouldered the duty to perform that task professionally”⁸). However, nothing in that decision suggests that due professional care includes engaging in procedures to ensure that there is nothing the reviewing partner “should have known.” Indeed, the SEC’s and the appellate court’s decisions were based on findings that “[Potts] had acted with *reckless disregard* of his duties as an independent auditor.”⁹ (Emphasis added). His conduct amounted to “an egregious refusal to see the obvious, or to investigate the doubtful.”¹⁰ Because its holding was predicated on recklessness, the court had no occasion to consider whether a concurring partner could be liable where he or she “should have known” (but did not “recklessly disregard”) matters that would have caused him or her to withhold concurring approval.

In light of these considerations, we believe that it is inappropriate for the Board to read into the due professional care standard an element that is not established by precedent and would continue to raise concerns among engagement quality reviewers about the Board’s intent for their performance obligations.

Documentation of an Engagement Quality Review

Paragraph 19(c) requires that the engagement documentation include 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

⁷ See Release at Page 24.

⁸ See Potts v. SEC, 151 F.3d 810 (8th Cir. 1998) at 813.

⁹ See Id. at 812

¹⁰ See Id.

unnecessarily burdensome¹¹, which will result in additional costs that are not likely to provide a commensurate benefit to audit quality. As a result, we recommend it be deleted.

The engagement team's existing obligation to prepare documentation consistent with the objective and requirements of PCAOB Auditing Standard No. 3 *Audit Documentation*, when combined with the revised proposal's requirement to indicate which documents were reviewed by the engagement quality reviewer and his or her assistants, should provide adequate documentation of the basis for the engagement quality reviewer's compliance with the standard.

If the Board continues to believe that it is necessary to document discussions involving the engagement quality reviewer, we recommend that paragraph 19 be revised to include the explanation of what constitutes a "significant discussion" as described in footnote 36 of the Release.

Effective Date

As proposed, the standard would be effective for audits of fiscal years ending on or after December 15, 2009, and for interim reviews for fiscal years beginning after December 15, 2009.

As it relates to audits, we believe that the effective date should be linked to the beginning of an audit engagement period. By linking the effective date to the beginning, the new requirements would: (1) be known and anticipated as of the beginning of the audit engagement period by auditors, audit committees and companies, (2) allow the assigned engagement quality reviewer to comply with the requirements throughout audit engagement planning and execution, and (3) apply equally to each interim review during an audit period to which the revised proposal applies.

Due to the anticipated timing of final approval of the standard by the SEC, we are also concerned that the proposed effective dates would not permit sufficient time for registered public accounting firms to effectively and efficiently implement the new EQR requirements. As proposed, we believe implementation might require significant changes to a firm's quality control processes, particularly those firms that have not historically performed concurring reviews. The effective date should provide all registered public accounting firms with sufficient time to: (1) adopt policies and procedures consistent with the new standard, (2) train their personnel in the requirements of the new standard,

¹¹ For example, an engagement quality reviewer ordinarily has frequent dialog with the engagement team during the course of an engagement. At the time of each discussion, it is unreasonable to expect the engagement quality reviewer to know whether documentation of such discussions ultimately will be necessary to demonstrate compliance with the EQR standard as contemplated in footnote 36 of the Release.

and (3) assign or engage qualified engagement quality reviewers consistent with their system of quality control.

Accordingly, we believe the PCAOB should base the effective date on fiscal years beginning after December 15, 2009, if the SEC approves the final standard by September 2009, to provide adequate time for firms to prepare for adoption.

Other Comments

Review of Interim Financial Information

As proposed, in a review of interim financial information, the engagement quality reviewer must read the engagement report only if it is filed with the SEC. The final standard should require the engagement quality reviewer to read such a report if issued. Also, given that 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 to Firm Quality Control

The note to paragraph 4 in the revised proposal contains a presumptively mandatory requirement related to the firm's quality control policies and procedures which, in most cases, is likely to be beyond the control of the engagement quality reviewer or the engagement partner.

The International Auditing and Assurance Board (IAASB) structured its standards according to whom the requirements apply. The ISQCs prescribe requirements for the firm to establish policies and procedures that, among other things, include EQRs. The ISQCs also establish standards on the conduct of the engagement quality reviews, including many requirements similar to those in the revised proposal. The ISAs establish standards for the auditor in the conduct of the audit engagement. We believe that the discipline of keeping 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 appreciate the opportunity to comment on the revised proposal and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,

A handwritten signature in black ink that reads "Cynthia M. Fornelli". The signature is written in a cursive, flowing style.

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc: PCAOB

Mark W. Olson, Chairman
Daniel L. Goelzer, Member
Willis D. Gradison, Member
Steven B. Harris, Member
Charles D. Niemeier, Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

SEC

Chairman Mary L. Schapiro
Commissioner Luis A. Aguilar
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James L. Kroeker, Acting Chief Accountant
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