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Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

**Re: PCAOB Rulemaking Docket Matter No. 025  
Proposed Auditing Standard – Engagement Quality Review**

Deloitte & Touche LLP (“D&T”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its *Proposed Auditing Standard on Engagement Quality Review*, PCAOB Rulemaking Docket Matter No. 025 (Mar. 4, 2009).

If you have any questions or would like to discuss these issues further, please contact Jim Schnurr at 203-761-3539.

Very truly yours,

/s/ Deloitte & Touche LLP

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**TABLE OF CONTENTS**

	<u>Page</u>
I. INTRODUCTION .....	1
II. GENERAL COMMENTS .....	1
A. The EQR Standard Should Reflect The Important, But Limited, Purpose Of Concurring Review As A “Second Look” At The Engagement.....	1
B. The PCAOB Should Adopt An EQR Standard That Is Consistent With Prevailing International Standards.....	2
1. Converging Standards Should Improve The Performance Of EQRs.....	3
2. In The Process For Adopting Audit Standards, The PCAOB Should Look To International Standards. ....	3
III. CONCERNS WITH SPECIFIC PROVISIONS AND RESPONSES TO QUESTIONS IN THE RELEASE.....	4
A. The Proposed “Due Professional Care” Reference Is Not Appropriate. ....	4
1. The Inclusion Of A Legal Standard Is Inappropriate In An Audit Standard. ....	5
2. If “Due Professional Care” Is Nonetheless Included In The Final Standard, The “Knows, Or Should Know” Interpretation Should Be Explicitly Rejected. ....	5
3. If “Due Professional Care” Is Nonetheless Included In The Final Standard, The PCAOB Should Clarify That In This Context, “Due Professional Care” Is Not A Negligence Standard. ....	7
4. Paragraph 12 Should Be Aligned With The Stated Objective Of EQRs And International Standards.....	8
B. Portions Of The Revised Proposal Could Be Read To Expand EQR Beyond Its Intended Scope. ....	9
1. The Standard Should Use Clear Language Consistent with EQR’s Function .....	10
2. Paragraph 9 Requires Clarification Concerning The Scope Of Review. ....	10
3. Paragraph 10 Requires Clarification Concerning The Scope Of EQR Procedures To Be Performed.....	11

**TABLE OF CONTENTS**  
**(continued)**

	<u>Page</u>
4. The Revised Proposal Appropriately Specifies A Separate EQR Process For Reviews Of Interim Financial Information But Some Of The Requirements Need Modification.....	13
C. The Extensive EQR Documentation Requirements Are A Significant Change In Practice And Will Be A Time Consuming And Costly Process Without Commensurate Benefits.....	15
D. The Proposed Competence Requirements Of The EQR Reviewer Require Clarification. ....	17
E. Providing An Objective In The Revised Proposal Is A Positive Change, But The Objective Needs Further Clarification. ....	19
F. The Proposed Effective Date Is Unrealistic And Should Be Modified. ....	20
IV. CONCLUSION.....	20
APPENDIX.....	A1

## I. INTRODUCTION

Deloitte & Touche LLP (“D&T”) appreciates the opportunity to provide comments on the PCAOB’s proposed standard on engagement quality review (“EQR”) (*Proposed Auditing Standard on Engagement Quality Review*, PCAOB Rulemaking Docket Matter No. 025 (Mar. 4, 2009) (the “Revised Proposal”). We applaud the PCAOB’s decision to re-propose the EQR standard and invite additional public comments, given both the importance of the standard itself and the extensive scope of comments on and numerous changes made to the original proposed standard (*Proposed Auditing Standard on Engagement Quality Review*, PCAOB Rulemaking Docket Matter No. 025 (Feb. 26, 2008) (the “Original Proposal”). We believe allowing for a second round of public comments enhances the transparency of the Board’s standard setting process and promotes the development of high quality standards.

As explained in our comments on the Original Proposal, D&T strongly supports the function of EQR and is committed to an effective EQR process that promotes audit quality. D&T supports several key improvements made in the Revised Proposal, including the adoption of an objective for the overarching framework of EQR, and the addition of a separate EQR process for reviews of interim financial information. We appreciate the consideration that was given to our previously submitted comments, as several of the changes that were adopted provide additional clarity and will help facilitate proper implementation of the EQR standard when finalized.

As explained below, we have several significant concerns with the Revised Proposal that we believe must be addressed to help provide for an effective and appropriate EQR standard. D&T’s comments on the Revised Proposal reflect the judgment and experience of numerous partners within D&T, including a significant number of partners who currently perform EQRs.

We first provide general comments on the Revised Proposal, and then provide responses to specific questions contained in the Release. In so doing, we suggest alternatives that we believe should be effective in promoting audit quality through EQR, while avoiding costly and unwieldy implementation problems. These suggested changes are described below and are also set forth in a copy of the Revised Proposal marked to show proposed changes in blackline, attached as an Appendix.

## II. GENERAL COMMENTS

### A. **The EQR Standard Should Reflect The Important, But Limited, Purpose Of Concurring Review As A “Second Look” At The Engagement.**

In the context of conducting an audit (or interim review), we recognize that concurring review plays an important role. Its purpose, as noted in the Release to the Original Proposal at page 2, is to provide an “objective ‘second look’ at the engagement.” In addition to the EQR, it is important to bear in mind that there are multiple layers of review that are performed by the audit engagement team and multiple layers of quality controls within the firm. The EQR is a supplemental layer of quality control, but it is not intended to duplicate other reviews performed by members of the engagement team or replace other controls embedded within the audit

process. Accordingly, the “second look” is limited by design: “a concurring reviewer is not expected to do the audit all over again.”<sup>1</sup>

We support the adoption of an EQR standard that aligns with the intended role of EQR as a second-look review, and is not duplicative of other elements of the audit process or the quality control systems of the firm. To this end, we believe the final standard should encourage the exercise of professional judgment by EQR reviewers in conducting reviews. Such a principles-based approach would result in higher quality audits because EQR reviewers – who are highly skilled and knowledgeable individuals – could approach the review based on the facts and circumstances presented by each engagement, and could use their seasoned judgment in determining which areas of the engagement require more attention. In contrast to this principles-based approach, establishing overly prescriptive procedures and requirements for EQRs would likely lead to a “check-the-box” approach that places undue emphasis on performing and documenting procedures in order to demonstrate compliance with the EQR standard. Although the checklist approach may facilitate after-the-fact review, it would not serve the goal of audit quality.

EQRs are particularly ill-suited for this type of mechanical exercise because these reviews inherently involve a significant degree of professional judgment. EQR reviewers provide a high-level review of the engagement team’s work, which cannot be readily encapsulated through a formulaic review process. EQR reviewers must be afforded the discretion to navigate through the overall engagement and select which areas of the engagement team’s work would most likely benefit from additional scrutiny. The EQR is not intended to replicate the work of the engagement team; rather, it is intended to provide a second review that allows the EQR reviewer to understand and concur with the overall conclusion of the audit based on the significant judgments made and related significant conclusions reached by the engagement team.

It is with this framework in mind that we make many of the specific comments below. Many of these suggestions relate directly to the intended focus of the EQR as a second-look review, and the need to adopt a principles-based approach that allows for the appropriate use of professional judgment by the EQR reviewer in conducting the review.

**B. The PCAOB Should Adopt An EQR Standard That Is Consistent With Prevailing International Standards.**

There are significant advantages that may be realized with increased convergence of global standards. The Board’s Strategic Plan states its intention to benefit from the work of other standard setters and professional bodies and to leverage best practices and other auditing enhancements made by the International Audit and Assurance Standards Board (“IAASB”) and

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<sup>1</sup> *Potts v. SEC*, 151 F.3d 810, 813 (8th Cir. 1998).

the Auditing Standards Board (“ASB”).<sup>2</sup> We appreciate the steps that have been taken toward convergence in the Revised Proposal.

The Revised Proposal, however, in some areas uses terminology and imposes requirements that are not contained in – and are seemingly inconsistent with – the international standards. This is not to say that convergence should be pursued indiscriminately. We recognize – and agree – that the EQR standard must reflect unique aspects of the regulatory and legal regime present in the United States that may require variance from international standards. For example, we explain below that wholesale adoption of international standards in Paragraph 10(c) is not appropriate, because independence requirements are significantly more intricate in the context of the regulatory environment that exists in the United States. Therefore, the PCAOB should be mindful of these important considerations when incorporating aspects of international standards. Where there is room to achieve convergence without encroaching upon such important policy concerns, however, we encourage the PCAOB to do so in adopting the final standard.

### **1. Converging Standards Should Improve The Performance Of EQRs.**

Building upon well-understood international standards for EQR, while departing where appropriate, will improve the quality of EQRs. Convergence also would facilitate the performance of quality EQRs because having a common framework of standards promotes a better understanding among auditors of the required procedures. Many firms develop their audit methodologies based on the ISAs, and for that reason are already quite familiar with the provisions therein. Ensuring that PCAOB requirements concerning EQRs are clear and consistent with the existing ISA standards will improve the overall understanding of what is expected for EQRs performed for public companies listed in the United States. Moreover, making sure that any PCAOB-specific requirements are obvious will make it easier for other countries (and the IAASB) to consider adding the same requirements.

### **2. In The Process For Adopting Audit Standards, The PCAOB Should Look To International Standards.**

In this comment letter we have focused on providing specific comments related to the Revised Proposal. We also would like to reiterate, however, some of the broader points about setting audit standards that we made in our letter dated February 18, 2009 in response to the PCAOB’s request for comments on the *Proposed Auditing Standards Related to the Auditor’s Assessment of and Response to Risk and Conforming Amendments to PCAOB Standards*, PCAOB Rulemaking Docket Matter No. 026 (Oct. 21, 2008) (“Proposed Risk Assessment Standard”).

In order to benefit from existing standards and avoid unnecessary differences with them, the PCAOB should establish a standard-setting process whereby it uses the language in the ISAs

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<sup>2</sup> PCAOB Strategic Plan 2008-2013, at 10 (Mar. 31, 2008).

(which are developed with PCAOB input) as the starting point (i.e., the “base”), and then expressly modifies this language as the PCAOB determines necessary for audits of SEC issuers. Using the ISAs as a base will help avoid unintentional changes in practice, make the intentional changes obvious to all interested parties, and make comparability between the standards more apparent – all of which will help auditors in applying the standards.

This approach would be beneficial because it is unclear in several instances whether the Revised Proposal presents a requirement that the PCAOB intends to be different from the ISAs, or that it intends to have the same meaning. This concern is particularly acute when the Revised Proposal seems to be referring to or explaining the same process or concept as the ISAs, but uses different terminology to do so. Specific examples are addressed below in analyzing EQR procedures required under Paragraphs 9, 10, and 15. Using terminology that is different from the ISAs adds significantly to the complexity of the EQR standard, challenging auditors to interpret what exactly is required and how it may differ from procedures performed when applying the ISAs. These differences could adversely affect audit quality and efficiency.

With regard to the Revised Proposal, we believe that much-needed clarity and guidance would be provided to the audit profession if the final standard included a comparison of its provisions to the current interim EQR standard and to the ISA. The PCAOB is certainly familiar with the utility of this approach as the recently Proposed Risk Assessment Standard included a general comparison with international standards. We believe this approach enhanced the public’s understanding of the Proposed Risk Assessment Standard, and believe that similar benefits would be realized by including such comparisons when the final EQR standard is adopted.

In addition, we recommend that the PCAOB issue separate standards pertaining to quality control policies and procedures rather than embody such requirements in audit standards. As noted below in the discussion of Paragraph 4, there are instances in this Revised Proposal where the proposed standard appears to intertwine the substance of the EQR standard with quality control policies and procedures designed to achieve compliance with the standard. The international standards, as well as the PCAOB interim standards, have separate standards for each. This structure provides greater clarity, and should be considered by the PCAOB, with respect to the current standard-setting effort.

### **III. CONCERNS WITH SPECIFIC PROVISIONS AND RESPONSES TO QUESTIONS IN THE RELEASE**

In this section, we provide comments on specific paragraphs of the Revised Proposal, as well as responses to several of the specific issues on which the PCAOB has sought comments. Our comments are presented in the order of relative significance, beginning with our more significant concerns.

#### **A. The Proposed “Due Professional Care” Reference Is Not Appropriate.**

***Question No. 10. Is the standard for the engagement quality reviewer’s concurring approval of issuance appropriately described in the repropoed standard?***

Although revised from the Original Proposal, the standard set forth in Paragraph 12 (as well as in Paragraph 17, in relation to interim reviews) still presents significant concerns.

The Original Proposal would have required the EQR reviewer to make a concurring approval based on what he or she “knows, or should know.” In our comment letter on the Original Proposal, we objected to this standard and explained its illogic and unfairness. Paragraph 12 of the Revised Proposal has removed the “knows, or should know” standard and instead provides that an EQR 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 deficiency.”

Removing the inappropriate and unworkable “knows, or should know” formulation from the text of Paragraph 12 is a positive step. Unfortunately, any improvements from removing the “should know” formulation are substantially offset by the statement in the Release at page 24 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’s formulation in the Board’s original proposal.” Further, we believe that inclusion of the legal standard of “due professional care” in the EQR standard itself presents concerns, separate and apart from the Release’s interpretation that it equates to a “should know” requirement.

**1. The Inclusion Of A Legal Standard Is Inappropriate In An Audit Standard.**

As an initial matter, the PCAOB should not include the concept of “due professional care” in this standard. Legal standards are not appropriate for explicit inclusion in audit standards; yet this is precisely what is done in Paragraphs 12 and 17.

As noted in the Release at page 23, AU sec. 230 imposes a general duty upon auditors to perform audit work with “due professional care.” The PCAOB thus acknowledges that auditors are currently subject to a due professional care requirement, and, therefore, inclusion of this legal standard in the final EQR standard is unnecessary. Other audit standards do not contain an explicit requirement of “due professional care.” It would be problematic to single out the EQR process, generally, and the issuance of a concurring approval, specifically, as being subject to a standard of due professional care – suggesting, perhaps, that the EQR standard is somehow different in this regard from other audit standards; or that the absence of an explicit invocation of due professional care in other standards must be given meaning. On this ground alone, the “due professional care” reference should not be included in the final standard.

**2. If “Due Professional Care” Is Nonetheless Included In The Final Standard, The “Knows, Or Should Know” Interpretation Should Be Explicitly Rejected.**

The interpretation of due professional care on page 24 of the Release as “essentially the same requirement” as the “knows, or should know” formulation from the Original Proposal creates additional concerns. As we discussed in our comment letter on the Original Proposal, the “should know” standard is illogical – and thus unworkable – in this context because a reviewer cannot reasonably be expected to provide a concurring approval based on what he or she “should know,” as opposed to what the reviewer actually knows. Adoption of this standard would have

created an undue incentive to perform additional procedures due to concerns of second-guessing by others about information that the EQR reviewer should have known. Such protective procedures would add disproportionately to the time and effort involved with the EQR and ultimately to audit costs. For example, the reviewer may believe it is necessary to perform a detailed review of all of the audit working papers to meet the “should know” standard. This would appear to be illogical and inconsistent with the objective of a review that is focused on the significant judgments made and the related significant conclusions reached by the engagement team.

Moreover, what the EQR reviewer “should know” could well be construed to impose a threshold that is unrealistic, and even higher than the general interpretation of due professional care, as it is well recognized that “even an audit conducted in strict accordance with professional standards countenances some degree of calibration for tolerable error which, on occasion, may result in a failure to detect a material omission or misstatement.”<sup>3</sup> The “should know” standard could be interpreted as requiring the EQR reviewer to be familiar with every conceivable aspect of an audit, going far beyond an appropriate use of professional judgment (and due professional care) in conducting a second-look review.

An EQR reviewer confronted with the potentially unbounded scope of the “should know” formulation could reasonably construe the requirement as meaning that he or she must have the same – if not a greater – level of knowledge and understanding regarding the client and be in a comparable position as the engagement partner in order to draw the required conclusions. The burden it would impose on EQR reviewers could be prohibitive and inconsistent with the current understanding of the EQR as a “second look.”

Finally, equating due professional care to what the reviewer “should know” is incongruent with the last part of Paragraph 12, which specifies that after performing the EQR, the reviewer “is not aware of a significant engagement deficiency.” In that regard, Paragraph 12 specifies that the EQR reviewer provides the concurring approval based on what he or she is *actually* “aware of.” Yet, at the same time, by embracing an overly expansive interpretation of due professional care, the Release suggests that the EQR reviewer is also responsible for matters that he or she *should have known*. This plain conflict will undoubtedly cause significant confusion and uncertainty in implementation.<sup>4</sup>

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<sup>3</sup> *In re Ikon Office Solutions, Inc.*, 277 F.3d 658, 673 (3d Cir. 2002) (explaining that “audit requires only due professional care”).

<sup>4</sup> We note that the PCAOB has traveled down this path before in a separate rulemaking, *Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees*, PCAOB Rulemaking Docket Matter No. 017 (Jul. 26, 2005). The PCAOB considered a “should have known” standard with regard to the provision that an associated person of an audit firm not cause the firm to commit an ethical violation. As described on pages 9 through 14 of the Release to the final rule, however, the PCAOB ultimately decided against adopting the “should have known” formulation, stating, among other things, that it did not want to

[Footnote continued on next page]

**3. If “Due Professional Care” Is Nonetheless Included In The Final Standard, The PCAOB Should Clarify That In This Context, “Due Professional Care” Is Not A Negligence Standard.**

The proper meaning of “due professional care” can be a difficult legal question that the PCAOB may not wish to address or undertake to resolve in the context of establishing the new EQR standard. As set forth above, there are persuasive reasons for not including “due professional care” in the standard, independent of any dispute about legal interpretation of the phrase. But if the final standard does retain a reference to “due professional care,” the Board should clarify that in the context of EQR, this phrase is not intended to impose liability based on mere negligence.

The Release cites only one case on this issue, *Potts v. SEC*, 151 F.3d 810 (8th Cir. 1998). But *Potts* does not stand for the proposition that due professional care imposes a negligence standard. *Potts*, in fact, applied a *recklessness* standard, concluding that the concurring reviewer “had acted with reckless disregard of his duties as an independent auditor.”<sup>5</sup> The standard for recklessness, as applied to the concurring reviewer in *Potts*, was whether the reviewer’s conduct constituted an “egregious refusal to see the obvious, or to investigate the doubtful.”<sup>6</sup> Therefore, *Potts* did not equate due professional care owed by the concurring reviewer with negligence, as suggested by the Release. Rather, *Potts* simply held that concurring reviewers may be sanctioned for conducting reviews in a reckless manner.

Further, courts interpreting and applying a legal standard of due professional care recognize that audit professionals exercise professional judgment in discharging their duties and that the analysis is more nuanced than simply equating due professional care to negligence. The fact that one or more of the professional judgments made by an auditor in conducting a review may have been in error does not by itself render the audit work performed defective or breach the standard of due professional care. The court in *Mishkin v. Peat, Marwick, Mitchell & Co.*, 744 F. Supp. 531, 538 (S.D.N.Y. 1990), confirmed this view:

An auditor who undertakes to examine the books and audit the accounts of a client does not guarantee the correctness of the accounts. He does undertake to use skill and due professional care and to exercise good faith and to observe generally accepted auditing standards and professional guidelines, with the appropriate reasonable, honest judgment that a reasonably skillful and prudent auditor would use under the same or similar circumstances. He is not responsible

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sanction individuals “who act in an appropriate, reasonable manner that, in hindsight, turns out to have not been successful.” These same reasons caution restraint here as well.

<sup>5</sup> *Potts*, 151 F.3d at 812.

<sup>6</sup> *Id.* (citation omitted).

for mere error of judgment. Reasonable adherence to the standards is a matter calling for application of experience, skill and the exercise of independent judgment. The standards concern themselves not only with the auditor's professional qualities but also provide that judgment may be exercised by him in the performance of his examination and in his report. Deviation from standards does not perforce thereof spell negligence in an audit, nor are innocent blunders culpable fault.

This legal framework is not mentioned in the Release, which only adds to the uncertainty surrounding the purported meaning of “due professional care” in Paragraphs 12 and 17.

Moreover, there is an even more fundamental concern with the Revised Proposal's approach. The courts view due professional care in this context as characterizing the degree of departure from an underlying audit standard, not conduct that is prescribed by the standard itself. If required procedures for reaching an EQR conclusion are defined through the prism of due professional care, it is unclear how this affects the legal standard that the PCAOB will apply in assessing whether an auditor failed to comply with the audit requirements. Under the Sarbanes-Oxley Act of 2002, many of the sanctions that may be imposed against auditors for violating audit standards apply only to reckless conduct, or repeated instances of negligent conduct, in deviating from an applicable audit standard.<sup>7</sup> It would therefore be inconsistent with this statutory framework to impose indirectly a different liability standard – negligence, to the extent that the PCAOB interprets due professional care to be a negligence standard – through the EQR standard. This would be especially problematic because efforts could be made to invoke the different liability standard in private claims brought against auditors – this would conflict with Sarbanes-Oxley. Moreover, it would be a role ill-suited for the PCAOB to take upon itself to create standards of liability for private causes of action.

For all of the reasons noted above, we strongly urge that the PCAOB omit any reference to “due professional care” in the final standard. If for some reason, the reference is retained, the Board should explicitly disavow any intent to equate the legal standard with a “knows or should know” negligence standard in the EQR context.

#### **4. Paragraph 12 Should Be Aligned With The Stated Objective Of EQRs And International Standards.**

We suggest that the PCAOB adopt the following language, which retains the structure of Paragraph 12 from the Revised Proposal, but narrows the scope of the EQR reviewer's determination to the significant facts that have come to the reviewer's attention during the EQR:

In an audit, the engagement quality reviewer may not provide concurring approval of issuance if, after performing the review required by this standard, he or she is aware that (1) the engagement team failed to obtain sufficient appropriate

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<sup>7</sup> 15 U.S.C. § 7215(c)(5).

evidence in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, or (3) the engagement report is not appropriate in the circumstances.

This formulation is consistent with international standards, as well as current practices, that base the EQR reviewer's conclusion on what the reviewer actually knows based on the procedures performed.<sup>8</sup> Moreover, this recommended language – by removing the reference contained in the Note to Paragraph 12 to whether the firm is independent of its client – is more consistent with the stated objective of EQR, which Paragraph 2 describes as a review of the significant judgments and related significant conclusions reached by the engagement team. In addition, the EQR reviewer, in considering whether the engagement report is appropriate in the circumstances as required under Paragraph 12 above, will also take into consideration whether he or she is aware that the firm is not independent of its client.

**B. Portions Of The Revised Proposal Could Be Read To Expand EQR Beyond Its Intended Scope.**

***Question No. 7. Are the descriptions of the scope and extent of EQR procedures contained in the proposed standard appropriate? Will the performance of these procedures result in a high-quality EQR? If not, how should these procedures be revised?***

The scope and extent of the procedures contained in the Revised Proposal could result in substantial changes to the scope and manner in which concurring reviews are currently conducted. As an initial matter, use of the words “evaluate” and “determine” in the context of the EQR could be viewed to require the EQR reviewer, among other things, to undertake extensive procedures beyond those intended by the Board, particularly in light of the broadly described “reviewing documentation” requirement in Paragraph 9. Some aspects of the specified EQR procedures in Paragraphs 9 and 10 are inconsistent with the stated objective contained in Paragraph 2 – i.e., that an EQR should provide a review of the “significant judgments made by the engagement team” and the related significant “conclusions reached.” Further, some of the procedures for EQR related to interim reviews are inconsistent with the scope of the work performed in a review of interim financial information. These concerns can be readily addressed.

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<sup>8</sup> Redrafted Int'l Standard on Auditing 220, *Quality Control for an Audit of Financial Statements* (Int'l Auditing & Assurance Standards Bd. 2008) (“ISA 220 (R)”), par. 25; Redrafted Int'l Standard on Quality Control, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* (Int'l Auditing & Assurance Standards Bd. 2008) (“ISQC 1 (R)”), par. 42 (“The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions it reached were not appropriate.”).

## **1. The Standard Should Use Clear Language Consistent with EQR’s Function**

EQR is intended to be a second-look review of the engagement team’s work and not a re-audit, and the terminology used to describe the EQR process should be consistent with this concept throughout the final standard. In several instances, the Revised Proposal uses terms such as “evaluate”<sup>9</sup> and “determine”<sup>10</sup> when describing what is required of the EQR reviewer. It is not clear how “evaluate” is different from “determine” and what sort of procedures the EQR reviewer must perform to satisfy the requirements imposed by the use of either term. “Determine” can be defined as “[t]o decide or settle . . . authoritatively and conclusively,” and “evaluate” as “[t]o determine or fix the value of.”<sup>11</sup> These concepts are at odds with the intended function of EQR, because they suggest that the EQR reviewer should “decide authoritatively” matters related to the audit, rather than perform a more limited, second-look review of the engagement team’s significant judgments and related significant conclusions.

Given the more definitive inference these terms create, EQR reviewers may feel compelled to perform a broad array of unnecessary procedures in order to obtain more and more information to satisfy themselves that they have done enough to perform the proposed “evaluation” or make the proposed “determination.” As discussed further below, this concern is made more acute by the fact that Paragraph 9, in providing an overarching framework for the procedures to be performed under Paragraph 10, imposes an overly broad requirement of “reviewing documentation,” without providing any guidance concerning the extent of this review. As a result of the expansive manner in which these terms may be construed – especially in conjunction with one another – the time, effort, and resources spent on the EQR could be greatly increased, presumably beyond what the PCAOB intended when it stated in the Release at pages 3-4 that “an effective review need not – and should not – amount to a re-audit, and that the role of a reviewer differs significantly from that of an engagement partner.”

To clarify this issue, we identify specific recommendations below in context of the applicable paragraphs from the Revised Proposal.

## **2. Paragraph 9 Requires Clarification Concerning The Scope Of Review.**

Paragraph 9 provides that the EQR “should evaluate the significant judgments made by the engagement team and the conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report.” This language requires clarification to achieve its intended purpose, stated in the Release at page 17, “that the reviewer performs the EQR by reviewing the engagement team’s work, rather than by auditing the company himself or herself.” First, for the reasons discussed above, the word “review” should be used instead of

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<sup>9</sup> This term is used in Paragraphs 2, 9, 10, 11, 14, 15, and 16.

<sup>10</sup> This term is used in multiple instances in Paragraph 10.

<sup>11</sup> Webster’s II New College Dictionary 315, 395 (3d. ed. 2005).

“evaluate.” Second, the words “related significant” should be inserted before “conclusions reached” to link such conclusions to the “significant judgments.” This concern applies to Paragraph 2, as well, where the same language is used. Otherwise, Paragraphs 2 and 9 could be read to require the EQR to consider non-significant conclusions made by the engagement team, an anomalous result outside the intended scope of an EQR.

Third, as noted above, in considering the significant judgments and conclusions made by the engagement team, Paragraph 9 specifies that the EQR reviewer should perform the procedures described in Paragraph 10 by, among other things, “reviewing documentation.” This requirement is too open-ended and could be interpreted to require an extensive review of audit documentation. There is no guarantee that this language would not necessitate review of the entire complement of an audit’s underlying working papers – an undertaking that is contrary to basic precepts of concurring review and the Board’s stated intent.<sup>12</sup> The PCAOB should modify the final standard to make it clear that the EQR reviewer should exercise professional judgment in determining the scope of review of documentation. To accomplish this purpose, we recommend that the scope of the documentation requirement in Paragraph 9 be restated in the following manner: “reviewing selected documentation as considered appropriate by the engagement quality reviewer.” This would properly express the scope of document review for an EQR in a manner consistent with international standards.<sup>13</sup>

### **3. Paragraph 10 Requires Clarification Concerning The Scope Of EQR Procedures To Be Performed.**

Paragraph 10 of the Revised Proposal sets forth enumerated procedures that EQR reviewers are expected to perform as part of conducting the EQR. Many of these procedures, however, are vaguely described and are not appropriately linked to the stated objective of EQR. In the face of this uncertainty, EQR reviewers may feel compelled to perform a myriad of procedures that the standard could be interpreted to require, and thereby unnecessarily expend time, effort, and resources on an EQR that goes well beyond what the PCAOB may have intended. To avoid these concerns, we offer the following suggestions.

As an initial matter, and as discussed above, we have concerns regarding the use of the words “evaluate” and “determine” as used throughout Paragraph 10, and recommend substituting the language presented in the Appendix to address these concerns. Second, Paragraph 9 should establish the overarching standard of the EQR procedures to be performed; Paragraph 10 should

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<sup>12</sup> 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 the exchange, a PCAOB staff person stated that the engagement quality reviewer is expected to review “selected documentation.”

<sup>13</sup> ISA 220 (R), par. 20; ISQC 1 (R), par. 37 (specifying “[r]eview of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached”).

then specify specific procedures that the EQR reviewer, in exercising his or her professional judgment, may consider in conducting the review. This approach is consistent with international standards, whereby specific EQR procedures are phrased as guidance, and is also in accord with the notion of EQR as a “second-look” review of the engagement team’s work. To achieve this much-needed clarity concerning the scope of the EQR as well as the use of professional judgment by the EQR reviewer, we recommend rephrasing the beginning of Paragraph 10 in the following manner:

In reviewing the significant judgments and related significant conclusions referenced in Paragraph 9, the engagement quality reviewer, as he or she deems appropriate, may:

Turning to the specific procedures contemplated by Paragraph 10, we have some additional suggestions. First, the various procedures specified in paragraph 10 are not linked to the stated objective of EQR (including as restated in paragraph 9) that the review relate to the “significant judgments made by the engagement team and the [related significant] conclusions reached.” In conformity with the intended scope of the EQR, we believe that the subsections in Paragraph 10(a), (b), and (d) should be modified to make clear that these required procedures are intended to apply to the “significant judgments made by the engagement team and the related significant conclusions reached.” Otherwise, these provisions could be read to require EQR procedures well beyond the objective stated in Paragraphs 2 and 9. We also recommend that the language in Paragraph 10(a) concerning consideration of “risks identified in connection with the firm’s client acceptance and retention process” be deleted because it is already encompassed by the risk assessment language set forth in Paragraph 10(b). Having these duplicative provisions creates unneeded ambiguity about their intended scope.

Second, Paragraph 10(c) specifies that the EQR reviewer should “[r]eview the engagement team’s evaluation of the firm’s independence in relation to the engagement.” We recognize that international standards include a similar requirement under ISA 220 (R), par. 21; ISQC 1 (R), par. 38, but independence requirements in the United States’ regulatory environment are more intricate. Within this context, the engagement team performs certain procedures regarding independence matters (for instance with respect to monitoring the scope of services provided). However, many of the independence issues are monitored through the audit firm’s centralized independence compliance processes. Therefore, we recommend modifying Paragraph 10(c) to limit the scope of the EQR reviewer’s consideration of independence to written communications that the engagement team had with the client under PCAOB Rule 3526 and other relevant issues that come to the attention of the EQR reviewer in performing the procedures specified under Paragraph 10.

Third, under Paragraph 10(d), the EQR reviewer is to consider judgments about “the severity and disposition of identified control deficiencies.” However, there may be a large number of such deficiencies for any individual audit client, especially for large multinational companies. Therefore, the scope of review should be clarified under Paragraph 10(d) as pertaining to “significant deficiencies and material weaknesses” in controls. This suggested change would clarify that the EQR reviewer should focus on material issues related to internal control evaluations.

Finally, under Paragraph 10(f), the EQR reviewer is to “[d]etermine if appropriate consultations have taken place on difficult or contentious matters.” We reiterate our general concern with the use of the term “determine,” as explained above. In addition, we believe that the phrase “difficult or contentious” does not provide adequate specificity about which matters are covered. Accordingly, we recommend rephrasing Paragraph 10(f) in the following manner: “Consider whether appropriate consultations have taken place with respect to significant judgments, including conclusions and documentation of such consultations.” Defining the scope of 10(f) in terms of the “significant judgments” has a more objective meaning and should provide further clarity to the EQR reviewer about which matters to review. It also avoids analysis of “difficult/contentious” but trivial matters.<sup>14</sup>

**4. The Revised Proposal Appropriately Specifies A Separate EQR Process For Reviews Of Interim Financial Information But Some Of The Requirements Need Modification.**

***Question No. 8. Are the specifically required procedures appropriately tailored to reflect the difference in scope between an audit and an interim review?***

We agree with the approach in the Revised Proposal to differentiate between the EQR procedures to be performed for audits of annual financial statements and for reviews of interim financial information. However, we believe that several of the provisions contained in Paragraphs 14 through 17 are inconsistent with the scope of interim reviews. As discussed in PCAOB Interim Standard AU sec. 722.07, interim reviews consist principally of performing certain limited analytical procedures and making limited inquiries. Because several of the procedures set forth in the Revised Proposal are well beyond this limited scope, we offer the following suggestions for the final standard.

First, we reiterate the same concerns discussed above with regards to EQRs for audits that are also applicable to interim reviews, including the specification of EQR procedures that are broader in scope than the stated objective of EQR (Paragraph 15), the use of the words “evaluate” and “determine” (pervasive throughout the standard, including Paragraphs 14 and 15), the overly broad requirement of “reviewing documentation” (Paragraph 14), and the insertion of a due professional care requirement in the text of the EQR approval language (Paragraph 17).

In addition to these common issues, there are other concerns that are specific to the interim review provisions. Paragraph 15(a) instructs the EQR reviewer to “[e]valuate engagement planning” including “[t]he nature of identified risks of material misstatement due to fraud.” Paragraph 16(a) also specifies that the review of engagement documentation should “[i]ndicate[] that the engagement team responded appropriately to significant risks.” In connection with an interim review, the auditor takes risk into account, but does not engage in the

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<sup>14</sup> To the extent that the PCAOB does not adopt our suggested changes to paragraphs 9 and 10, we alternatively would recommend that these paragraphs conform with international standards specified in ISA 220 (R), par. 20, A28.

same type of risk assessment performed for an audit. Based on the language in Paragraphs 15(a) and 16(a), the Revised Proposal, however, would seem to require such risk assessments for interim reviews. We do not believe this is the intention of the Board, as this would significantly elevate the review that is currently performed and is inconsistent with PCAOB Interim Standard AU 722.07, 722.11, and 722.12. Accordingly, we recommend modifying the language in Paragraph 15(a) to align with AU sec. 722.11-13, and removing Paragraph 16(a) from the final standard.

In Paragraph 15(b), the Revised Proposal specifies that the EQR reviewer should perform the procedures described in Paragraph 10(c)-(f). We have previously noted why the scope of the second look at compliance with independence requirements needs to be modified for audits, and that concern applies to interim reviews as well. Paragraph 15(b) also would have the EQR reviewer, in connection with an interim review, evaluate judgments described under Paragraph 10(d)(2) for the “severity and disposition of identified control deficiencies.” However, such deficiencies are assessed by the engagement team under AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements*, as of the end of the fiscal year; therefore, it would be beyond the requirements of AS No. 5 for the EQR reviewer to engage in such a review in the context of an interim review. Accordingly, we recommend deleting Paragraph 10(d)(2) from the scope of the EQR of an interim review.

Turning to Paragraph 15(c), the Revised Proposal specifies that the EQR reviewer should “[r]ead the interim financial information for all periods presented and for the immediately preceding interim period.” This statement is confusing because it is not clear what one would review when performing the EQR for the first quarter (i.e., interim financial information for the fourth quarter is not reported in the same way interim financial information is reported for other quarters). Further, we note that the Revised Proposal does not contain a similar requirement to read prior financial statements in connection with the EQR of an audit. It would be anomalous to impose a more burdensome procedure on interim reviews. We therefore recommend removing the phrase “and for the immediately preceding interim period” from Paragraph 15(c) to avoid any ambiguity.

Paragraph 15(c) also specifies that the EQR reviewer should read the “related engagement report, if a report is to be filed with the SEC.” Although not all interim reports are filed with the SEC, we nevertheless believe this procedure should be performed regardless of whether a report is in fact filed, and accordingly we believe the standard should be strengthened in this manner.

We also have concerns about language describing the results of interim reviews, such as Paragraph 16(b) which specifies that the review of engagement documentation “[s]upports the conclusions reached by the engagement team with respect to the matters reviewed.” The use of the term “conclusions” is appropriate in connection with an audit, but is not well-suited to describe an interim review, as characterized under PCAOB Interim Standard AU sec. 722.07. The PCAOB should refrain from using this term in the final standard to avoid creating confusion regarding the scope of procedures performed in the context of interim reviews (and paragraphs

14 and 15 should be revised accordingly). Similarly, Paragraphs 17 and 18 specify that an EQR reviewer will provide a “concurring approval of issuance.” However, this term is misleading because reports are not required for interim reviews and are often not “issued.”<sup>15</sup> Therefore, we recommend substituting “concurring approval” in lieu of “concurring approval of issuance” to describe more accurately the EQR’s role with respect to an interim review.

Finally, we recommend that the paragraphs relating to the EQR for interim reviews be removed from this standard and instead incorporated into AU sec. 722, *Interim Financial Information*, as a conforming amendment. Placing these paragraphs in AU sec. 722 will make it clear that the scope of the procedures performed remain under the umbrella of the objective of a review of interim financial information (which is much different than the scope and objective of an audit).

**C. The Extensive EQR Documentation Requirements Are A Significant Change In Practice And Will Be A Time Consuming And Costly Process Without Commensurate Benefits.**

***Question No. 11. Are the documentation requirements in the repropoed standard appropriate? If not, how should they be changed?***

Paragraph 19 specifies that documentation of an EQR should be included in the engagement documentation and “should contain sufficient information to identify,” among other things, “(b) [t]he documents reviewed by the engagement quality reviewer and others who assisted the reviewer,” and “(c) [t]he 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.” Although we recognize the need to document audits appropriately, these provisions would significantly and unnecessarily increase the obligations of EQR reviewers by requiring an extensive compilation of audit documentation that is contrary to the basic precepts of EQR and could be duplicative of the documentation already developed and maintained by the engagement team.

With regard to Paragraph 19(b), we are concerned that requiring a detailed and itemized description of “documents reviewed” may lead to a scope of review inconsistent with the intended role of EQR – which is to perform a second-look review of the engagement team’s work. It may well be the case that based on professional judgment, an EQR reviewer concludes that the working papers that are appropriate for a second look are significantly less voluminous than what was reviewed by the engagement team. The EQR reviewer, however, may feel compelled to engage in an unnecessary review of additional documents in order to compile a more “complete” list for purposes of Paragraph 19(b) – efforts that do not add to audit quality. It also would be very burdensome for the EQR reviewer to make such an exhaustive list of the documents reviewed during the EQR process. In order to address these concerns, the PCAOB

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<sup>15</sup> This concern applies to Paragraphs 1 and 2 as well where the term “concurring approval of issuance” is used in apparent reference to both audits and interim reviews.

should modify the final standard to make it clear that the EQR reviewer should exercise professional judgment in determining which documents to identify as being “reviewed” in conjunction with documenting the EQR process. Moreover, the scope of this requirement should comport with the stated objective of EQR in Paragraph 2 to consider “significant judgments made by the engagement team and the [related significant] conclusions reached.” To accomplish this purpose, we recommend that Paragraph 19(b) be rephrased in the following manner:

As considered appropriate by the engagement quality reviewer, the documents relating to the significant judgments made by the engagement team and related significant conclusions reached that were reviewed by the engagement quality reviewer and others who assisted the reviewer,

In addition, we recommend modifying Paragraph 19(c). The scope of this requirement is impractical as an EQR reviewer engages in many discussions relating to an EQR, and the reviewer would be hard-pressed to document each and every discussion as it takes place. This could interfere with the effective conduct of the EQR itself. In addition to the burden, it also would in many respects be redundant of engagement documentation already in the audit file. PCAOB AS No. 3 already requires documentation of significant matters. Therefore, the documentation called for under Paragraph 19(c) may be largely duplicative of existing audit documentation on significant matters. To the extent that the overarching intent behind Paragraph 19 is to provide a record of the EQR process, we believe that a more appropriate way to accomplish this purpose is to require documentation under Paragraph 19(c) of “the procedures performed in accordance with this standard.” This would allow for adequate documentation of the procedures performed in connection with the EQR without requiring a detailed summary of each discussion that occurred along the way. This revised Paragraph 19(c), along with subsections (a), (b) as modified above, and (d) – coupled with existing audit documentation requirements – are more than sufficient to meet the stated goal conveyed in the Release at page 26: “to allow both the Board and the firm itself to understand how the review was conducted and how significant issues were resolved.”

We also have a concern with Paragraph 19(d), which requires identification of the date that concurring approval was issued “or, if no concurring approval of issuance was provided, the reasons for not providing the approval.” We are concerned that this provision could be read to require documentation related to EQRs in these situations, even when no audit report is issued. Providing extensive documentation related to an EQR in a situation where no audit report is issued does not appear to serve any purpose.<sup>16</sup> We therefore recommend revising Paragraph 19 accordingly to limit the scope of EQR documentation requirements under these circumstances.

In addition to the suggested changes described above, the PCAOB should provide further clarity, and lessen any undue burden from the audit documentation requirements, by specifying

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<sup>16</sup> For example, in instances where the audit is terminated before the EQR is completed, the EQR reviewer should not be expected to create additional documentation following the termination of the review.

in the final standard that “sufficient information to identify” under Paragraph 19 does not require an exhaustive list of documents reviewed and discussions (if Paragraph 19(c) is in fact included in some form in the final standard) with the engagement team, but rather may consist of a general overview of the EQR process that was performed. This approach is consistent with prevailing international standards under ISA 220 (R), par. 25; ISQC 1 (R), par. 42.

**D. The Proposed Competence Requirements Of The EQR Reviewer Require Clarification.**

We wholeheartedly agree that EQR reviewers should exhibit “competence,” as specified under Paragraph 4. We are concerned that the description of this requirement in the Revised Proposal could lead to confusion and difficulties in implementation. As set forth in Paragraph 5, the EQR reviewer “*must* possess the level of knowledge and competence related to accounting, auditing, and financial reporting *required to serve* as the person who has overall responsibility for the same type of engagement.” (emphasis added). This phrasing could be read to require the EQR reviewer to have the *same* level of competence (including technical expertise, experience with the client, and specialized knowledge) as the engagement partner. As described below, this is problematic, and there are several changes that should be incorporated into the final standard to alleviate these concerns.

First, the Note to Paragraph 4, which refers to the firm’s quality control policies and procedures governing competence, independence, integrity, and objectivity of the EQR reviewer, is the only place in the EQR standard where quality control policies and procedures of the firm are explicitly referenced. We reiterate our general view stated above that quality control policies and procedures should be issued in a separate quality control standard apart from this audit standard. Moreover, the singular reference contained in the Note to Paragraph 4 could be viewed to suggest that other EQR requirements need not be addressed in the audit firm’s quality control policies and procedures. We do not believe this is the intention of the PCAOB. The Note accordingly should be removed from the final standard to avoid this ambiguity.<sup>17</sup>

Second, the Release states at page 11 that the standard “does not require the reviewer’s competence to match that of the engagement partner.” Although we endorse this guidance, the actual text of Paragraph 5 could be read otherwise. Accordingly, we recommend that the quoted language from the Release be specifically incorporated into the text of Paragraph 5. We further

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<sup>17</sup> Apart from the specific concern about the Note to Paragraph 4, we have a broader structural concern with the use of Notes in the Revised Proposal. We recognize that Notes may be intended to provide clarity to the underlying standard. However, the use of Notes is confusing when it imposes additional requirements, such as when a standard includes unconditional or presumptively mandatory responsibilities within a Note, as is the case with the Note to Paragraph 6. Significant uncertainty also arises when a Note appears to be inconsistent with the related text in the standard. Notes should not be used in this manner to create additional, perhaps even conflicting, responsibilities separate and apart from the standard itself, and we recommend that the final standard eliminate the use of Notes.

recommend changing the phrase describing the EQR reviewer’s competence from required to “serve as the person who has overall responsibility for the same type of engagement” to “accomplish the objective of this standard.” This appropriately characterizes Paragraph 5 in terms of the competencies required to fulfill the role of the EQR reviewer rather than the role of the engagement partner.

Third, Paragraph 5 uses the word “must” in describing the same attributes of competence that Paragraph 4 concurrently requires of an EQR reviewer.<sup>18</sup> Paragraph 4 specifies the broad requisite qualifications of an EQR reviewer while Paragraph 5 provides guidance on how the overarching competence requirements are to be satisfied. The use of language creating unconditional responsibilities in Paragraph 5 could have the unintended consequence of unnecessarily limiting the availability of eligible and qualified EQR reviewers. The use in audit standards of terms identified in PCAOB Rule 3101 as unconditional responsibilities needs to be reconciled with a principles-based approach to setting standards, as contemplated by the Release at page 11, that facilitates the appropriate use of professional judgment by auditors in conducting reviews. We therefore recommend use of the term “should” in lieu of “must” in Paragraph 5 to avoid unnecessary constraints on assigning appropriate EQRs.

Coupled with the change from “must” to “should,” the final standard also should make clear that judgment should be applied in assigning an appropriate EQR reviewer, taking into account the characteristics of the engagement and an individual’s background and experience – and the experience and skill set of the assistants who will support the EQR reviewer in discharging his or her responsibilities. There may be times when an EQR reviewer without substantial knowledge of the industry may be better suited to conduct an EQR – for example, because he or she has particular expertise dealing with the accounting principles or risks of the engagement that are implicated by issues likely to arise in the audit. Footnote 18 from the Release accompanying the Original Proposal conveyed this approach, noting that competence should be assessed “based on the circumstances of the engagement, including the size or complexity of the business.” We recommend that the PCAOB incorporate this same language into the text of the competence standard. This would be consistent with international standards, which provide for more flexibility in selecting EQR reviewers.<sup>19</sup>

Adopting these suggested changes – which in some instances merely entails inserting language used in the Release into the standard – would help to ensure that audit firms have sufficient discretion to match the skills of an EQR reviewer with the characteristics and complexity of an audit. This flexibility will preserve a deeper pool of eligible EQR reviewers. This flexibility is especially important given the auditor independence requirements, including the required rotation of audit partners, which effectively limits the pool of available and

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<sup>18</sup> As defined in PCAOB Rule 3101, “must” places an “unconditional responsibility” on an auditor to perform the specified requirements.

<sup>19</sup> ISQC 1 (R), par. A42 (“What constitutes sufficient and appropriate technical expertise, experience and authority depends on the circumstances of the engagement.”).

appropriate concurring review partners. Also, restricting this group of reviewers may have a disproportionate effect on smaller audit firms that may lack the personnel and resources to meet overly rigid EQR reviewer competence requirements. Such a result is surely not intended by the PCAOB and should be rectified in the final standard.<sup>20</sup>

***Question No. 4. Is it appropriate to explicitly require a reviewer from within the firm to be a partner or an individual in an equivalent position?***

Paragraph 3 states that the EQR reviewer may be a partner or “another individual in an equivalent position,” but does not specify the meaning of this phrase. It is not clear whether this is intended for firms that do not have partners due to their legal structure, or whether it also applies to firms that have partners. If it is intended to apply to firms with partners, it is not clear who would be eligible to serve as an EQR reviewer. That is, it is not clear whether senior personnel in the firm who may otherwise possess the requisite competence, independence, integrity, and objectivity to serve as an EQR reviewer, but who are not partners, would be deemed to be an “individual in an equivalent position.” The final standard should provide further guidance on these issues.

**E. Providing An Objective In The Revised Proposal Is A Positive Change, But The Objective Needs Further Clarification.**

***Question No. 2. Is the objective in the reproposed standard appropriately formulated? Does it articulate the purpose of an EQR?***

***Question No. 3. Will this objective contribute to a more thoughtful and effective EQR?***

We appreciate the adoption of an objective in the Revised Proposal to further an understanding of the other provisions of the EQR standard, and offer the following suggestions to provide further clarity. Paragraph 2 specifies that the “objective of the engagement quality reviewer is to perform an evaluation of the significant judgments made by the engagement team and the conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report.” Consistent with the description in the Release, we recommend revising this formulation to make it clear that the overarching objective of the EQR reviewer is to “provide an objective second look at the engagement.” In addition, for the reasons explained above, we recommend that the word “reviewing” should be substituted for the phrase “perform an evaluation of,” and that the term “related significant” should be inserted before “conclusions reached” to link such conclusions to the “significant judgments.”

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<sup>20</sup> To the extent that the Board elects not to adopt our suggested changes described above, another way to lessen the potential burden is to specify that the EQR team collectively may possess the requisite competence, rather than only the designated EQR reviewer. Although this suggested change may present its own challenges, it would still be an improvement over the less flexible standard in Paragraph 5 of the Revised Proposal.

#### **F. The Proposed Effective Date Is Unrealistic And Should Be Modified.**

The PCAOB has proposed that the standard be effective for audits of fiscal years ending on or after December 15, 2009. For reviews of interim financial information, the standard would be effective for fiscal years beginning after December 15, 2009. The Release at pages 27-28 explained that the reason that “implementing the new standard on EQRs of interim reviews in 2009 may not be possible [is] because some of the interim reviews will be performed earlier in the year, and registered firms would not have sufficient time for implementation of the new requirements.”

We fully concur that it is important to provide adequate lead time to implement the new EQR standard, but do not believe that the proposed effective date for either audits or interim reviews provides this necessary transition period.

Firms will have to train their partners and professional employees, re-deploy resources, and create the tools necessary to assist in conducting EQRs compliant with the new requirements imposed by this standard. There would not be sufficient time to implement these steps with the proposed effective date for audits and interim reviews, particularly given the uncertain timeframe of when a standard will be approved as final by the SEC and the potential under the Revised Proposal to increase significantly the amount of work performed (including documentation requirements).

In addition, the proposed effective dates overlook the fact that audits are facilitated by procedures performed during the interim reviews. These interim reviews in many respects are important foundational blocks for the audits of the annual financial statements. Therefore, it would be confusing to require the EQR for an audit to be performed under the new EQR standard if concurring reviews for some of the interim reviews for that audit year were performed under the existing standard. It may lead to EQRs reperforming procedures performed for the interim periods, which would be very burdensome and inefficient.

For these reasons, the new EQR standard should apply to fiscal years beginning twelve months after the date the SEC approves the final standard. The EQR for the first quarter of such fiscal year would then be the first performed under the new EQR standard. During the transition period, the PCAOB could encourage early adoption by firms of concurring review procedures consistent with this standard, and set the expectation that auditors would incorporate features of the new EQR standard into their concurring reviews to help ensure their readiness for full implementation when the standard becomes effective. This would allow sufficient lead time for the firms to take necessary measures to comply with the requirements of the standard, would minimize the impact of the other implementation issues addressed herein, and result in an effective and efficient implementation process.

#### **IV. CONCLUSION**

D&T supports efforts to strengthen EQR. We appreciate the changes made in the Revised Proposal. However, we believe that further changes are needed concerning the proposed EQR standard.

We recognize that the issues presented herein are complex and may require further discussion to understand fully the implications of particular comments made by us and by other commenters. We encourage the PCAOB to engage in active and transparent dialogue with commenters as the proposed standard is further evaluated and changes are considered. Such a dialogue will facilitate a more complete understanding of the proposed standard and, we believe, will ultimately improve the final standard and the auditor's ability to implement it effectively and efficiently. We would welcome the opportunity to participate in any such process and to further discuss these matters with the Board and its staff.

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## Appendix

### Auditing Standard No. X

*Supersedes SECPS Requirements of Membership § 1000.08(f).*

#### *Engagement Quality Review*

#### **Applicability of Standard**

1. An engagement quality review and concurring approval of issuance are required for each audit engagement and for each engagement to review interim financial information conducted pursuant to the standards of the Public Company Accounting Oversight Board ("PCAOB").

#### **Objective**

2. The objective of the engagement quality reviewer is to ~~perform an evaluation of~~ provide an objective second look at the engagement by reviewing the significant judgments made by the engagement team and the related significant conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.<sup>1</sup>

#### **Qualifications of an Engagement Quality Reviewer**

3. An engagement quality reviewer may be a partner of the firm that issues the engagement report (or communicates an engagement conclusion, if no report is issued), another individual in an equivalent position in the firm, or an individual outside the firm. The reviewer may use assistants in performing the engagement quality review. The engagement quality reviewer and assistants must be ~~an~~ associated ~~person~~ persons of a registered public accounting firm.

4. As described below, an engagement quality reviewer must have competence, independence, integrity, and objectivity.

~~Note: The firm's quality control policies and procedures should include provisions to provide the firm with reasonable assurance that the engagement quality reviewer has sufficient competence, independence,~~

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<sup>1</sup> In the context of an audit, "engagement report" refers to the audit report (or reports if, in an integrated audit, the auditor issues separate reports on the financial statements and internal control over financial reporting). In the context of an engagement to review interim financial information, the term refers to the report on interim financial information. An engagement report might not be issued in connection with a review of interim financial information. See paragraph .03 of AU section ("sec.") 722, *Interim Financial Information*.

~~integrity, and objectivity to perform the engagement quality review in accordance with the standards of the PCAOB.~~

5. *Competence.* The engagement quality reviewer ~~must~~should possess the level of knowledge and competence related to accounting, auditing, and financial reporting that is required to serve as the person who has overall responsibility for the same type of engagement.<sup>2</sup>accomplish the objective of this standard. This does not require the reviewer's competence to match that of the engagement partner. The judgment as to what constitutes the appropriate level of knowledge and competence should be based on the circumstances of the engagement, including the size or complexity of the business.

6. *Independence, Integrity, and Objectivity.* The engagement quality reviewer must be independent of the company, perform the engagement quality review with integrity, and maintain objectivity in performing the review. Assistants also must be independent, perform the assigned procedures with integrity, and maintain objectivity in performing the review.

~~Note: The reviewer may use assistants in performing the engagement quality review. Personnel assisting the engagement quality reviewer also must be independent, perform the assigned procedures with integrity, and maintain objectivity in performing the review.~~

7. To maintain objectivity, the engagement quality reviewer should not: (a) make decisions on behalf of the engagement team; (b) assume any of the responsibilities of the engagement team; or (c) supervise the engagement team with respect to performance of the engagement subject to the engagement quality review. The person who has overall responsibility for the engagement remains responsible for the engagement and its performance, notwithstanding the involvement of the engagement quality reviewer.

8. The engagement quality reviewer may not be the person who had overall responsibility for either of the two audits preceding the audit subject to the engagement quality review.

### **Engagement Quality Review for an Audit**

9. *Engagement Quality Review Process.* In an audit engagement, the engagement quality reviewer should ~~evaluate~~review the significant judgments made by the engagement team and the related significant conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report. To identify and ~~evaluate~~review the significant judgments and related significant conclusions, the engagement quality reviewer

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<sup>2</sup> ~~PCAOB interim quality control standards describe the competencies required of a person who has the overall responsibility for an engagement (or any practitioner in charge of an attest engagement). See QC sec. 40, *The Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner in Charge of an Attest Engagement.*~~

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 appropriate by the engagement quality reviewer.

10. In an audit, reviewing the significant judgments and related significant conclusions referenced in paragraph 9, the engagement quality reviewer should, as he or she deems appropriate, may:

- a. EvaluateReview significant judgments made by the engagement team and the related significant conclusions reached pertaining to engagement planning, including –
  - The consideration of the firm's recent engagement experience with the company ~~and risks identified in connection with the firm's client acceptance and retention process,~~
  - The consideration of the company's business, recent significant activities, and related financial reporting issues and risks, and
  - The judgments made about materiality and the effect of those judgments on ~~the engagement strategy~~planning.
- b. Evaluate theReview significant judgments made by the engagement team and the related significant conclusions reached pertaining to risk assessments and audit responses, including the identification of significant risks, including risk of material fraud risks, and the engagement procedures performed in response to significant risks.
- c. Review the engagement team's evaluation of the firm's independence in relation to the engagement by considering written communications that the engagement team had with the client (in accordance with PCAOB Rule 3526) and other relevant issues that come to the attention of the engagement quality reviewer in performing the procedures specified under this paragraph.
- d. EvaluateConsider significant judgments made by the engagement team and the related significant conclusions reached about (1) the materiality and disposition of corrected and uncorrected identified misstatements and (2) the severity and disposition of identified ~~control~~ significant deficiencies and material weaknesses.
- e. Determine ifConsider whether appropriate matters have been communicated, or identified for communication to the audit committee, management, and other parties, such as regulatory bodies.
- f. Determine ifConsider whether appropriate consultations have taken place ~~on difficult or contentious matters.~~ Review the documentation with respect

to significant judgments, including conclusions, and documentation of such consultations.

- g. Read the financial statements, management's report on internal control, and the related engagement report.
- h. Read other information in documents containing the financial statements to be filed with the Securities and Exchange Commission ("SEC")<sup>32</sup> and ~~evaluate~~consider whether the engagement team has taken appropriate action with respect to any material inconsistencies with the financial statements or material misstatements of fact of which the engagement quality reviewer is aware.
- i. Review the engagement completion document<sup>43</sup> and confirm with the person who has overall responsibility for the engagement that there are no significant unresolved matters.

11. ~~*Evaluate*~~Consider *Engagement Documentation*. In an audit, the engagement quality reviewer should ~~evaluate~~consider whether the engagement documentation that he or she reviewed when performing the procedures ~~required by paragraph 10~~in accordance with this standard –

- a. Indicates that the engagement team responded appropriately to significant risks, and
- b. Supports the conclusions reached by the engagement team with respect to the matters reviewed.

~~12. *Concurring Approval of Issuance*. In an audit, the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due professional care<sup>5</sup> the review required by this standard, he or she is not aware of a significant engagement deficiency.~~

~~12. *Note: A significant engagement deficiency in an audit exists when*~~Concurring Approval of Issuance. In an audit, the engagement quality reviewer may not provide concurring approval of issuance if, after performing the review required by this standard, he or she is aware that (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall

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<sup>32</sup> See paragraphs .04-.06 of AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*; AU sec. 711, *Filings Under Federal Securities Statutes*.

<sup>43</sup> PCAOB Auditing Standard No. 3, *Audit Documentation*, requires the auditor to identify all significant findings or issues in an engagement completion document.

~~<sup>5</sup> See AU sec. 230, *Due Professional Care in the Performance of Work*.~~

conclusion on the subject matter of the engagement, or (3) the engagement report is not appropriate in the circumstances, ~~or~~ (4) ~~the firm is not independent of its client.~~

13. In an audit, the firm may grant permission to the client to use the engagement report only after the engagement quality reviewer provides concurring approval of issuance.<sup>64</sup>

### **Engagement Quality Review for a Review of Interim Financial Information**

14. *Engagement Quality Review Process.* In an engagement to review interim financial information, the engagement quality reviewer should ~~evaluate~~review the significant judgments made by the engagement team and ~~the~~any related significant conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued. To identify and ~~evaluate~~review the significant judgments and any related significant conclusions, the engagement quality reviewer should perform the procedures described in paragraph 15 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 appropriate by the engagement quality reviewer.

15. ~~In a review of interim financial information, reviewing the significant judgments and any related significant conclusions referenced in paragraph 14, the engagement quality reviewer should, as he or she deems appropriate, may:~~

- a. ~~Evaluate~~Review significant judgments made by the engagement team and any related significant conclusions reached pertaining to engagement planning, as performed in accordance with AU sec. 722.11-13, including the consideration of –
  - ~~The firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process,~~company's business and its internal control, and
  - ~~The company's business, recent significant activities, and related financial reporting issues and risks, and~~
  - ~~The nature of identified risks of material misstatement due to fraud.~~

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<sup>64</sup> Concurring approval of issuance by the engagement quality reviewer also is required when reissuance of an engagement report requires the auditor to update his or her procedures for subsequent events. In that case, the engagement quality reviewer should update the engagement quality review by addressing those matters related to the subsequent events procedures.

= The engagement team's identification of events, transactions, or assertions to which inquiries may be directed or analytical procedures applied.

- b. Perform the procedures described in paragraphs 10.c through 10.f., with the exception of 10.d.(2).
- c. Read the interim financial information for all periods presented ~~and for the immediately preceding interim period~~, management's disclosure for the period under review, if any, about changes in internal control over financial reporting, and the related engagement report, if a report is to be ~~filed with the SEC~~issued.
- d. Read other information in documents containing interim financial information to be filed with the SEC<sup>75</sup> and ~~evaluate~~consider whether the engagement team has taken appropriate action with respect to material inconsistencies with the interim financial information or material misstatements of fact of which the engagement quality reviewer is aware.
- e. Review the engagement completion document and confirm with the person who has overall responsibility for the engagement that there are no significant unresolved matters.

16. ~~*Evaluate*~~*Consider* *Engagement Documentation.* In a review of interim financial information, the engagement quality reviewer should ~~evaluate~~consider whether the engagement documentation that he or she reviewed when performing the procedures ~~required by paragraph 15~~in accordance with this standard supports the review performed by the engagement team.

- a. ~~Indicates that the engagement team responded appropriately to significant risks, and~~
- b. ~~Supports the conclusions reached by the engagement team with respect to the matters reviewed.~~

~~17. *Concurring Approval of Issuance.* In a review of interim financial information, 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 deficiency.~~

17. Note: A significant engagement deficiency in a review of interim financial information exists when*Concurring Approval.* In a review of interim financial information, the engagement quality reviewer may not provide concurring approval if, after performing the

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<sup>75</sup> See paragraph .18f of AU sec. 722, *Interim Financial Information*; AU sec. 711, *Filings Under Federal Securities Statutes*.

review required by this standard, he or she is aware that (1) the engagement team failed to perform interim review procedures necessary in the circumstances of the engagement, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, or (3) the engagement report, if a report is to be issued, is not appropriate in the circumstances, or (4) ~~the firm is not independent of its client.~~

18. In a review of interim financial information, the firm may grant permission to the client to use the engagement report (or communicate an engagement conclusion to its client, if no report is issued) only after the engagement quality reviewer provides concurring approval ~~of issuance.~~

### **Documentation of an Engagement Quality Review**

19. ~~Documentation of~~ if an engagement quality review approval under paragraph 12 or 17 is provided, documentation of the review should be included in the engagement documentation and should contain sufficient information to identify:

- a. The engagement quality reviewer and others who assisted the reviewer,
- b. ~~The documents~~ As considered appropriate by the engagement quality reviewer, the documents relating to the significant judgments made by the engagement team and related significant conclusions reached that were reviewed by the engagement quality reviewer and others who assisted the reviewer,
- c. ~~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, and~~ procedures performed in accordance with this standard, and
- d. The date the engagement quality reviewer provided concurring approval of issuance ~~or, if no concurring approval of issuance was provided, the reasons for not providing the approval.~~

20. The requirements related to retention of and subsequent changes to audit documentation in AS No. 3 apply with respect to the documentation of the engagement quality review.