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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 025
Proposed Auditing Standard, *Engagement Quality Review*

Dear Mr. Secretary:

KPMG appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) Release No. 2009-001 (the Release), which includes the Proposed Auditing Standard, *Engagement Quality Review* (the Proposed Standard), and we commend the Board for seeking further comment on the proposal.

We agree with the Board that a well-performed engagement quality review is an important element of audit quality. The Board explains in the Release that an engagement quality review standard should focus on the need to perform a robust review, must require a review that serves in a meaningful way to identify significant engagement deficiencies in time to correct them, and should provide a safeguard against erroneous or insufficiently supported opinions.¹ We believe the Proposed Standard's requirements are generally consistent with these objectives. We also believe a final standard substantively consistent with the Proposed Standard will promote improvements in audit quality without requiring a re-audit.²

While we support a rigorous engagement quality review standard, we recommend that the Board clarify certain of the engagement quality review requirements to ensure that the implementation

¹Release page 3, "The Board generally agreed that new requirements are necessary to focus reviewers on the need to perform a robust review rather than on whether particular matters had come 'to [their] attention'. Release page 4, "At the same time, the Board continues to believe that in order to improve audit quality, the standard must require an EQR that serves as a meaningful way to identify significant engagement deficiencies in time to correct them." Release page 15, "On the other hand, too narrow a scope could result in reviews that do not provide a safeguard against erroneous or insufficiently supported audit opinions."

² Release page 15 states that "At the same time, the Board recognized 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."



April 20, 2009
Office of the Secretary
Page 2

of the final standard is effective and consistent with the Board's intent. We believe that the Proposed Standard contains requirements that are unnecessary for the reviewer to achieve the engagement quality review objective in the Proposed Standard and may not be cost-effective.³ We recommend that the Board revise or eliminate these requirements. We also believe that the effective date of the final standard should reflect the time necessary to train firm engagement quality reviewers and engagement team members on the standard's requirements and to modify audit methodologies and work papers in a manner that promotes effective implementation. Specifics on these recommendations are provided in the remainder of this letter.

Clarify the Requirements of the Engagement Quality Review Process

We support the Proposed Standard's presentation of separate engagement quality review process requirements for audit and review engagements. This approach enables the Board to supplement the broadly articulated requirements, such as those in the objective (paragraph 2) and the general descriptions of the engagement quality review process (paragraphs 9 and 14), with the detailed requirements necessary for consistent and effective implementation. We also support the Proposed Standard's statement that the reviewer performs the engagement quality review procedures through discussions with the engagement team and review of engagement documentation (paragraphs 9 and 14). We believe that these statements help clarify that the engagement quality review process does not require the reviewer to reperform the work performed by the engagement team or to seek out evidence beyond that which is gathered by the engagement team. However, the Board's intent with respect to both the objective and the specific requirements of the engagement quality review process for audit and review engagements should be clarified.

As drafted, the structure of the Proposed Standard implies that the objective and the related definition of significant engagement deficiency should inform the reviewer's judgments about the nature and extent of procedures necessary to comply with the engagement quality review process requirements for audit and review engagements. In this regard, even though the Proposed Standard only requires an evaluation of the engagement team's "significant judgments," it is unclear whether a significant judgment is any engagement team judgment that, if the reviewer disagrees, could lead to a significant engagement deficiency. As "significant engagement deficiency" is defined in the Proposed Standard, any engagement team judgment poses the risk of a significant engagement deficiency if it involves matters that are pervasive to the conduct of the engagement or impact the nature, timing or extent of procedures performed for significant accounts or disclosures (or components thereof that could be material to the entity's financial reporting). We recommend that the Board clarify how the Proposed Standard's objective, including the related definition of significant engagement deficiency, should impact the judgments a reviewer makes in determining the nature and extent of procedures necessary to

³ Paragraph 2 of the Proposed Standard states 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, if a report is to be issued, in order to determine whether to provide concurring approval of issuance."



identify and evaluate significant judgments (paragraphs 9 and 14) by performing the engagement quality review process requirements described in paragraphs 10 and 15.

In addition, we observed that the Proposed Standard continues to use “identify,” “evaluate” and “determine” to describe a reviewer’s responsibilities. These words connote that a reviewer makes his or her judgments with a higher degree of certainty than does the use of “review.” And while “identify,” “evaluate” and “determine” are also used to describe requirements in other standards of the Board (e.g., AS No. 5), those standards are complied with in the context of obtaining reasonable assurance about the reporting objective. In light of this difference, we believe the Board should clarify how it intends a reviewer’s judgments about the nature and scope of the procedures necessary to comply with the Proposed Standard’s “identify,” “evaluate” and “determine” requirements to be different from the judgments he or she would make in the role of an engagement partner to comply with similarly worded requirements in other standards of the Board. An engagement quality review process that requires the reviewer to comply with the requirements in the same manner as if he or she were serving as the engagement partner, rather than the engagement quality review partner, appears inconsistent with the statements in the Release which explain that the Board recognizes that the role of a reviewer differs significantly from that of an engagement partner.⁴

The following sections elaborate on these overall comments and highlight specific matters where we believe further clarification of the engagement quality review process is necessary.

Evaluations of Engagement Planning, Risk Assessments and Audit Responses in an Audit

The requirements in paragraphs 10(a) and 10(b) to *evaluate* engagement planning, risk assessments and audit responses likely will represent a significant increase in effort as compared to current concurring review practice. The breadth and depth of judgments made in an audit that constitute engagement planning, risk assessments and audit responses is significant. The Board’s recent proposals⁵ on the auditor’s assessment of and response to risk illustrate this point by explaining that engagement planning and risk assessment consist not only of matters pervasive to the conduct of the audit, but also the assessments of inherent, control, and detection risk made for individual assertions of significant accounts and disclosures and the corresponding judgments about what constitutes sufficient appropriate audit evidence and the nature, timing and extent of audit procedures necessary to obtain such evidence. Similarly, paragraph 10 of AS No. 5 explains that in an audit of internal control over financial reporting, “Risk assessment underlies

⁴ Release page 15 states that “At the same time, the Board recognized 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.”

⁵ See PCAOB Release No. 2008-006 dated October 21, 2008 relating to PCAOB Rulemaking Docket Matter No. 026.



April 20, 2009
Office of the Secretary
Page 4

the *entire* audit process described by this standard, including determination of significant accounts and disclosures and relevant assertions, the *selection of controls to test* and the *determination of the evidence necessary for a given control* (emphasis added).” Evaluations of the judgments of the engagement team related to engagement planning, risk assessments, and audit responses at the individual assertion level for significant accounts and disclosures would require a very detailed consideration of the engagement team’s work. For example, we observe that a requirement to evaluate control risk assessments in a financial statement audit or the judgments about which controls to test and the evidence necessary for a given control in an integrated audit would involve an evaluation of the detailed audit documentation supporting the team’s evaluation of the design and implementation of internal control.

We acknowledge the directive in paragraph 9 which explains that paragraphs 10(a) and 10(b) are performed to identify and evaluate “significant judgments,” however, we do not believe paragraph 9 effectively limits the nature and scope of procedures necessary to comply with paragraphs 10(a) and 10(b). As discussed above, what the Board intends to be considered a significant judgment is not sufficiently clear in the Proposed Standard. In addition, we believe the requirement for the reviewer to *identify* significant judgments is unclear. We believe the responsibility to identify (i.e., accumulate and present) significant judgments for the engagement quality review is that of the auditor with final responsibility for the engagement and not the engagement quality reviewer. This is particularly true when the judgments involve matters specific to relevant assertions of significant accounts or components thereof. As drafted, the Proposed Standard is not clear whether the Board intends the reviewer to review the engagement documentation supporting all engagement planning, risk assessments, and audit responses to identify those judgments that are, in the judgment of the engagement quality reviewer, “significant” and then evaluate whether the team’s conclusions for these judgments are reasonable or whether they may represent a deficiency that requires follow-up.⁶

As the preceding paragraphs illustrate, the requirements in paragraphs 9, 10(a) and 10(b) need further clarification. Depending on how the requirements in paragraphs 10(a) and 10(b) are interpreted, the effort required to implement and comply with the standard may vary significantly and, without further clarification, would not likely be implemented consistently. In addition, while the requirements in paragraphs 10(a) and 10(b) use “including” in a manner that highlights particular matters, it does not limit the scope of the evaluation to those matters listed. We recommend that the proposal be revised to clarify how the Board intends for paragraphs 9 and 10(a) and 10(b) to be implemented. In this regard, we recommend that the standard be revised to require that the engagement quality reviewer evaluate the significant judgments, as identified for the reviewer by the engagement team, that relate to engagement planning, risk assessments and

⁶ Release page 17 states “The specifically required procedures are intended to give the reviewer the necessary information to evaluate the engagement team’s significant judgments and conclusions, and like all audit procedures, they must be performed with due professional care and professional skepticism. Accordingly, when performance of the procedures suggests a deficiency or red flag that, if pursued, could preclude the reviewer from providing concurring approval of issuance, the reviewer must follow up and make sure the matter is resolved before providing concurring approval.”



April 20, 2009
Office of the Secretary
Page 5

audit responses, and any additional significant judgments of the engagement team that the reviewer identifies when performing the other procedures set forth in the standard.

Evaluations of Engagement Planning in a Review of Interim Financial Information

Paragraph 15(a) directs the engagement quality reviewer to evaluate the engagement planning of the interim review engagement. We note that SAS No. 100, *Interim Financial Information*, explains that procedures for conducting a review of interim financial information should be tailored to the engagement based on the accountant's knowledge of an entity's internal control. Engagement quality reviewers ordinarily would not have the necessary knowledge base about internal control to effectively "evaluate" the engagement planning. We recommend that the standard be revised to more clearly explain how the engagement quality reviewer would comply with this requirement. We also observe that the concerns we expressed in the *Evaluations of Engagement Planning, Risk Assessments, and Audit Responses in an Audit* section above relating to the lack of clarity in the requirement to identify significant judgments also apply to the requirements for engagement quality reviews of interim financial information.

Evaluations of Engagement Documentation in a Review of Interim Financial Information

Paragraph 16(a) directs the engagement quality reviewer to evaluate whether the engagement documentation indicates the engagement team responded appropriately to *significant risks*. The concept of significant risks relates to audit engagements and is not discussed in SAS No. 100. It is unclear whether the Proposed Standard is intending for the significant risks identified in the most recent audit engagement to be considered in paragraph 16(a), or whether the Board intends for the engagement team to conclude on what represent significant risks each interim period. We recommend that the Board eliminate paragraph 16(a) from the final standard so that it does not create a performance requirement for engagement teams to identify significant risks in an SAS No. 100 interim review engagement in a standard whose objective is targeted at engagement quality reviews.

Determining the Appropriateness of Consultations that Have Taken Place and Matters Identified for Communication

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 Proposed 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 Proposed Standard should be modified to indicate that the engagement quality reviewer should make an evaluation of the appropriateness of such matters based upon performing the other procedures set forth in the standard.



April 20, 2009
Office of the Secretary
Page 6

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.

Concurring Approval in a 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."

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 that this requirement is unnecessary in light of the objective and requirements of AS No. 3. Furthermore, the engagement partner has ultimate responsibility for ensuring that engagement documentation supports the significant judgments made and related conclusions reached. As such, the effectiveness of AS No. 3 may be undermined by a requirement in the engagement quality review standard to document or otherwise supplement documentation of the engagement team's basis for significant judgments made and related conclusions reached. Moreover, maintaining responsibility for engagement documentation with the engagement team will ensure that it is prepared by those with the most knowledge and information and therefore promote audit effectiveness.

Additionally, we believe the requirement in paragraph 19(c) is unnecessarily burdensome, 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. For example, an engagement quality reviewer ordinarily has frequent dialog with the engagement team during the course of an engagement. At the time of a discussion, it is unreasonable to expect the engagement quality reviewer to know whether documentation of such discussions will ultimately be necessary to demonstrate compliance with the engagement quality review standard as contemplated in footnote 36 of the Release. As a result, the proposal will likely lead to effort spent transcribing discussions that, by the time concurring approval of issuance is provided, are appropriately reflected in the engagement documentation prepared by the engagement team in order to comply with AS No. 3. In other situations, summaries of these discussions may later be determined unnecessary to demonstrate compliance with the engagement quality review standard because of additional information or documentation that becomes available.

Based on the foregoing, we recommend the Board revise the engagement quality review documentation requirements to leverage the engagement documentation prepared by the engagement team in accordance with AS No. 3. In this regard, we note that paragraph 19(b) is drafted in a manner that appropriately focuses the documentation requirements on documentation prepared by the engagement team. If the Board believes that it is necessary for the final standard to contain guidance to ensure that documentation is prepared for information provided to the engagement quality reviewer through discussions, we recommend that paragraph 19 be revised. These revisions should include:

- eliminating paragraph 19(c) and revising paragraph 19(b) to clarify that the “documents reviewed” should include engagement documentation that is prepared based on significant discussions between the engagement quality reviewer and the engagement team.
- adding the explanation in footnote 36 of the Release of what constitutes a ‘significant discussion’ in the final standard, and
- clarifying that the discussions for which the work papers may need to be supplemented are those between the engagement quality reviewer, including any assistants, and the engagement team, and not discussions between the engagement quality reviewer and his or her assistants.

Due Professional Care

We note the Proposed Standard’s requirement 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 deficiency.” 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 Due professional care has established and accepted meaning and therefore we believe that it is inappropriate for the Board to read into the

⁷ See Release at Page 24.



April 20, 2009
Office of the Secretary
Page 8

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.

Effective Date of the Proposed Standard

As proposed, the final 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 continue to believe that the effective date should be linked to the beginning of an audit engagement period. By linking the effective date to the beginning rather than the end of an audit engagement period, the new requirements would (1) be known and anticipated as of the beginning of the audit engagement period, (2) allow the assigned engagement quality reviewer to comply with the requirements, such as the proposed documentation provisions, throughout audit engagement planning and execution, and (3) apply equally to each interim review during an audit period to which the proposed standard applies.

Due to the anticipated timing of approval, we are also concerned that the proposed effective date for audits would not permit sufficient time for registered public accounting firms to provide sufficient training and develop appropriate tools to ensure effective and efficient implementation of the new engagement quality review requirements. The effective date should provide sufficient time for registered public accounting firms to (1) adopt policies and procedures consistent with the new standard, (2) train their personnel in the requirements of the new standard, (3) modify audit methodologies and work papers and (4) assign or engage qualified engagement quality reviewers consistent with each respective firm's 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.

If you have any questions about our comments, please do not hesitate to contact Jon Fehleison, (212) 909-5491 (jongfehleison@kpmg.com) or Glen Davison, (212) 909-5839 (gdavison@kpmg.com).

Very truly yours,

KPMG LLP



April 20, 2009
Office of the Secretary
Page 9

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