



April 20, 2009

Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006-2803

Audit - Tax - Advisory

Grant Thornton LLP  
175 W Jackson Boulevard, 20th Floor  
Chicago, IL 60604-2687

T 312.856.0200  
F 312.565.4719

[www.GrantThornton.com](http://www.GrantThornton.com)

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

Dear Board Members and Staff:

We appreciate the opportunity to comment on the proposed auditing standard, *Engagement Quality Review*. We support the Public Company Accounting Oversight Board's ("Board" or "PCAOB") mission to develop auditing standards that promote audit quality, and we believe that a robust and effective engagement quality review enhances audit quality. In our opinion, an objective engagement quality review that focuses on a review of significant matters, including significant judgments made and conclusions reached by the engagement team, will accomplish that purpose.

We understand that the PCAOB received many comment letters on the first proposed Engagement Quality Review standards. We observe that many of those comments have informed the re-proposed standard, and we appreciate the PCAOB's careful and thoughtful consideration of those comments. Although we have some additional thoughts for your consideration, we believe that the re-proposed standard improves on the first proposal in advancing the quality of audits, increasing confidence in the capital markets, and setting appropriate expectations as to what an engagement quality review is or is not.

We would like to take the opportunity to offer to work with the PCAOB in the future, not only during the formal consultation phase of a project, but throughout the project. We recognize that high-quality standards that are in the public interest are also in the long-run interest of the profession, but standards that set unrealistic expectations are not in anybody's interest. Input from the firms would result in high-quality standards, and enable the PCAOB to expedite its standards setting activities, which we believe would be in the best interests of the PCAOB, the firms and most importantly, the public.

#### **Objective of the engagement**

We strongly support the inclusion of the objective in the proposed standard. We believe that the objective will enable the engagement quality reviewer to know when he or she has fulfilled

the objective of the standard. The objective will also help define who would be qualified to perform an engagement quality review in that the person qualified to perform the review would need to have the skills to meet the objective. The objective also will clarify expectations of third parties, for example, financial statement users and regulators, with respect to what an engagement quality review is and is not.

We suggest the following edits to the objective in paragraph 2, and similar edits to paragraph 9, to clarify that (1) the engagement quality reviewer meets the objective based on the results of the procedures required by the standard, and (2) the conclusions that should be the focus of the engagement quality review are those that result from the significant judgments.

The objective of the engagement quality reviewer is to perform an evaluation, based on the results of the procedures required by this standard, of the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report, if a report is to be issued, in order to determine whether to provide concurring approval of issuance.

#### The engagement quality review process

We believe that the current proposal much better describes the engagement quality review process than did the first proposal by:

- adopting a “negative assurance” standard as opposed to a “positive assurance” standard;
- relying on the concepts of due professional care, rather than imposing a “knows or should know” standard; and
- acknowledging that the engagement quality reviewer performs the engagement quality review through discussions with the engagement team and the review of documentation.

We believe that an engagement quality reviewer who performs the review in accordance with this proposed standard, using appropriate professional judgment, and due professional care as described in the Board’s Interim Standards in AU 230, *Due Professional Care in the Performance of Work*, would have an adequate basis to determine if he or she could provide concurring approval of issuance. This new construction helps prevent the unintended consequence of engagement quality reviewers spending inordinate amounts of time searching for, and coming to a positive conclusion about what they “should know.” At the same time, the requirement to perform the engagement with due professional care does not allow the engagement quality reviewer to turn a blind eye to conditions that should prohibit him or her from providing concurring approval of issuance.

We agree with the formulation of the requirement in paragraph 12 of the proposed standard; however, we believe the Board has introduced an inappropriate inconsistency as well as confusion in the release by stating 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.” We do not, in fact, believe this is a true statement. We also believe the courts have held these to be two

different standards. We do not think it appropriate for the Board to set a requirement in the standard, and then make a statement in the release that the words really mean something other than what they say. If the Board chooses not to change the release then it has, apparently, retained the “knows or should know” requirement. This, in turn, likely will lead engagement quality reviewers to obtain a level of knowledge comparable to that of engagement partners in order to avoid potential consequences of the inspection process.

We appreciate that paragraph 9 of the proposal states that the procedures described in paragraph 10 are to be performed by holding discussions with the engagement team and reviewing documentation. However, as worded, we do not believe that the requirements in 10(e) and 10(f) could be accomplished through discussions with the engagement team and reviewing documentation. These requirements to *determine* if appropriate matters have been communicated and to *determine* if appropriate consultations have taken place would require the engagement quality reviewer to identify matters that were *not* communicated or subject to consultation, but maybe should have been. To accomplish this requirement, the engagement quality reviewer would have to go beyond discussions with the engagement team and reviewing the documentation. There is no limit to how far the engagement quality reviewer would have to search for those items that had not been recognized by the engagement team as requiring communication or consultation. We suggest that the requirement be specifically limited to evaluating whether matters identified in the workpapers, or through discussions with the engagement team, have been communicated or were subject to appropriate consultation.

With respect to the evaluation of engagement documentation, we support the Board’s decisions to:

- Replace the phrase “documentation of the matters that were subject to the engagement quality review procedures” with “documentation that he or she reviewed when performing the procedures”;
- Require the reviewer to evaluate whether such documentation supports “conclusions reached by the engagement team with respect to the matters reviewed” but not also “the conclusions and representations in the engagement report”; and
- Remove the requirement for the reviewer to evaluate the documentation for consistency with AS No. 3.

#### Engagements for which an engagement quality review is required

We continue to support the PCAOB’s proposal to require that all registered public accounting firms – not just those that were members of the American Institute of Certified Public Accountant’s SEC Practice Section in April 2003 – be required to comply with the final standard. We believe that this certainly is in the public interest, and is consistent with the requirements of the Sarbanes-Oxley Act of 2002.

We agree with the Board’s decision to customize the engagement quality review requirements for audits and interim reviews to reflect the differences in scope between these engagements. We found the approach of specific requirements for audits and interim reviews in two separate

sections to be very helpful. We believe that this should better align the engagement quality review with the engagement under review, and clarify which requirements apply to which engagements.

We further support the Board's decision to limit the applicability of these requirements to engagement quality reviews of audits and interim reviews of financial statements. We believe this allows the Board to maintain the specificity in this proposed standard, and has the added benefit of keeping the auditing standards and the attestation standards clearly delineated. Should the Board believe engagement quality reviews are desirable for attestation engagements, those requirements should be provided for in the attestation standards rather than in the auditing standards.

We believe it is inappropriate for requirements of the firm to be included in the auditing standards, as is done in the note to paragraph 4. The policies and procedures set by the firm are out of the direct control of the engagement partner or the engagement quality reviewer. If, for example, the firm does not have the requisite policies and procedures in place, but the engagement quality reviewer otherwise performs the engagement quality review with competence, independence, integrity, and objectivity and in accordance with the standards of the PCAOB, then technically, the engagement still would not have been performed in accordance with the auditing standards.

As a result, we also would support updating the PCAOB's interim Quality Control standards, which establish standards regarding a firm's responsibilities for its system of quality control. Examples of requirements that would be appropriate to house in the Quality Control standards are:

- The requirement for the tone set at the top of the firm to encourage and support the performance of objective engagement quality reviews, which will be "lost" when this proposed standard supersedes SECPS Requirements of Membership §100.08(f); and
- The requirement for the firm's quality control policies and procedures to include provisions to provide the firm with reasonable assurance that the engagement quality reviewer has sufficient competence, independence, integrity, and objectivity to perform the engagement quality review in accordance with the standards of the PCAOB, which is misplaced in a note to paragraph 4 of the proposed standard.

With respect to the note to paragraph 4, we suggest either deleting the note, or referring to the requirement in the Board's interim quality control standards.

We believe that housing the firm's requirements in the Quality Control standards, and the auditor's requirements in the auditing standards and the attestation standards, as appropriate, lends clarity to the requirements, and in particular, who is responsible for compliance with the requirements, in the respective standards.

### Qualifications of the engagement quality reviewer

We continue to support the provision that an engagement quality reviewer should be an associated person of a registered public accounting firm, and that he or she should have competence, independence, integrity and objectivity.

#### Objectivity

We agree with the proposal to allow an engagement quality reviewer to be a partner (or equivalent) of the firm, or an individual outside the firm. Although this might appear to reduce flexibility in smaller registered firms, we agree that, under ordinary circumstances, a non-partner in an accounting firm would not be qualified to conduct the engagement quality review, as measured against the requirements of this standard. Furthermore, we are sympathetic to the concerns that some commentators expressed regarding the authority that a non-partner in the firm would have in conducting an objective review of the engagement partner's work.

We believe that the Board has found a sensible solution by requiring in-house engagement quality reviewers to be partners (or equivalents), while allowing engagement quality reviewers from outside the firm to come from a variety of backgrounds. This solution mitigates the concerns regarding the authority of in-house engagement quality reviewers. At the same time, it does not inappropriately limit the available qualified resources from outside the firm.

We support changes made to the standard to clarify the requirement for the engagement quality reviewer to remain objective. Specifically, we believe:

- the changes in paragraph 6 appropriately define “objectivity” in terms of the engagement, and not in terms of the engagement team;
- the removal of the note to paragraph 6 (now paragraph 7) eliminates the perception that the standard would limit consultation between the engagement team and the engagement quality reviewer. We believe that consultation is an important element of audit quality, and that these changes encourage appropriate consultation without compromising the objectivity of the engagement quality reviewer; and
- the language added to paragraph 7(c) clarifies that the engagement quality reviewer may not supervise the engagement team with respect to the engagement under review, but may otherwise be partners with leadership and supervisory responsibilities in the firm.

Further, we agree that it would be more difficult for an engagement partner, who has had overall responsibility for the audit for a year or more, to perform the review with the level of objectivity of someone who is new to the engagement. Accordingly, we support the new requirement that 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.

#### Competence

With respect to the description of what constitutes a competent engagement quality reviewer, the language on page 12 of the release, and removal of the “oil and gas” example in the original

proposal, which implied that the engagement quality reviewer had to have experience sufficient to serve as the engagement partner for the audit of a company in the industry, go a long way toward clarifying that the engagement quality reviewer need not be a “clone” of the engagement partner. Nevertheless, we believe further clarification is needed. There may be substantial overlap between the skills required of the engagement partner and the skills required of the engagement quality reviewer, but it is not the exact same skill set that is required by both.

Paragraph 5 of the proposal indicates that the engagement quality reviewer must possess the competence to serve as the engagement partner for the same type of engagement. We believe it is more important that the engagement quality reviewer possess the competence to serve as the engagement quality reviewer. We would propose the following statement regarding the competence of the engagement quality reviewer:

**Competence** The engagement quality reviewer must possess the level of technical knowledge and competence relating to accounting, auditing, and financial reporting required to [review] 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.

Note: The determination of what constitutes the appropriate level of technical knowledge and competence should be based on the circumstances of the engagement, including the size or complexity of the business<sup>1</sup>.

Note: Considerations in evaluating competence include, but are not limited to, technical expertise, experience, knowledge of SEC rules and regulations pertinent to the engagement, and industry knowledge.

#### Concurring approval of issuance

On page 16 of the release accompanying the first proposal, it is acknowledged that differences of opinion could occur between the engagement team and the engagement quality reviewer, and that, if those differences have not been satisfactorily resolved, the engagement quality reviewer must not provide concurring approval. We continue to believe that this resolution of differences is an important contributor to audit quality, but the concept is not addressed in the proposed standard itself. We suggest that the standard state that, if one of the four conditions in paragraph 12 exists, and those differences have not been satisfactorily resolved, the engagement quality reviewer must not provide concurring approval.

Although we believe that the resolution of difference of opinion between the engagement team and the engagement quality reviewer is an important contributor to audit quality, we do not believe that the fact that there have been such differences is an indicator of audit quality, or a lack thereof. The engagement quality review process is one of the internal processes by which the firm monitors the quality of its audits. Therefore, we would caution the board against

---

<sup>1</sup> This sentence is from the first proposal, footnote 18.



requiring the communication of any differences of opinion between the engagement team and the engagement quality reviewer to those outside the firm.

We believe that such a requirement would limit consultation between the engagement team and the engagement quality reviewer, which potentially would reduce audit quality. Furthermore, we do not believe that it would provide meaningful information to management or those charged with governance of the entity being audited. Finally, we believe that it may cause confusion among users, who may conclude that the entire firm is not behind the report. It may also incorrectly signal to users and the markets that auditing is an individual effort, rather than a multi-faceted collective enterprise involving many experts in many disciplines, with numerous institutional checks and controls.

#### Documentation of an engagement quality review

It is not clear to us if the discussions meant to be captured by the requirement in paragraph 19(c) are those among the members of the engagement quality review team, or those between the engagement quality review team and the engagement team. In either case, it seems like it would be an inordinate amount of documentation, especially since the specificity of the requirement to document “date of each discussion, the specific matters discussed, the substance of the discussion, and the participants,” goes beyond the requirements to document discussions in AS No. 3. Furthermore, since the significance of the discussion may not be clear when the discussion begins, we believe this requirement would result in the transcribing of many discussions that, at the end of the engagement, turn out not to be significant.

Assuming that the discussions meant to be captured are those between the engagement quality reviewer and the engagement team, we believe that the essence of the discussions would have been required to have been documented by the engagement team in accordance with AS No. 3, making this requirement redundant. We recommend amending paragraph 19(c) to apply to significant discussions between the engagement quality reviewer and the engagement team that have not otherwise been documented by the engagement team. We further recommend that the language in footnote 36 of the Release, which explains what constitutes a “significant discussion,” be included in the final standard.

#### Effective date

As proposed, the standard would be effective for audits of fiscal years ending on or after December 15, 2009, and for interim reviews for fiscal years beginning after December 15, 2009. Because the SEC is unlikely to approve this standard before the end of the second quarter of 2009, this effective date would result in the engagements to perform interim reviews on the first two or three quarters of 2009 being reviewed under the extant standard, while the audit, and perhaps the third quarter interim review would be reviewed under this standard as finalized. Furthermore, we will have begun planning for some of our December 31, 2009 audits before this proposed standard is finalized. In this event, firms would be required to perform interim reviews and planning December 31, 2009 audits using their best guess as to the form of the final standard. We do not believe that introducing this uncertainty and potential variance in practice is desirable. We recommend that the PCAOB set the effective date for audits and interim reviews to annual periods beginning no earlier than twelve months after SEC approval.

### Content and structure of the standards

The Sarbanes-Oxley Act of 2002 requires the PCAOB to establish auditing, related attestation, and quality control standards. We believe that some thought should be put into the structure of the standards, and how they relate to each other, before the Board goes much further down one path or the other.

In the context of providing comments on the PCAOB's proposed standard, we supported the proposal to limit the application of this standard to audit engagements and engagements to review interim financial information. We did so because we believe that the requirements in the proposed standard are so specific to those engagements that it would be difficult to adapt them to other types of engagements. Furthermore, we believe that, because it is contained in the auditing standards, it should only apply to the engagements to which the auditing standards apply. The logical extension of this approach would be, if the Board believes engagement quality reviews are desirable for attestation engagements, those requirements should be established in an attestation standard rather than an auditing standard.

However, we believe the engagement quality review should be considered in the context of all the elements of quality control, for example, consultation, supervision, and training, and not as an independent issue. We believe it would be appropriate for the standards on those topics to be included together in the quality control standards. We believe that keeping this proposed standard in the auditing standard perpetuates the misperception that the engagement quality review compensates for lapses in other aspects of quality control.

### Convergence with international standards

We found the comparison to the International Standards on Auditing in the PCAOB's proposed *Auditing Standards Related to the Auditor's Assessment of and Response to Risk* to be very helpful; we missed a similar comparison in this proposed standard. We believe it would be good practice for the PCAOB to publish such comparisons in all of its proposals and final standards. To understand what the PCAOB considers (and does not consider) to be a significant difference helps clarify the meaning of the standard and the intent of the Board.

We would like to again express our recommendation that the Board consider the feasibility of adopting the ISAs as a base. In doing so, PCAOB standards can be focused on the incremental requirements that would be necessary for audits of issuers.

### Paragraph-level comments

The following offers specific paragraph-level comments for the Board's consideration.

Paragraph	Comment
7(b)	While we understand the clear need for independence of the engagement quality reviewer, words like "any" are absolute and must be used with caution given the potential for unintended consequences. Such is the case in paragraph 7(b). Given the very broad and diverse activities that the word "responsibilities" encompasses, indicating that the engagement quality reviewer should not "assume any of the responsibilities of the engagement team" could lead to potential violations of this requirement for insignificant or inconsequential matters or for matters where efficiencies could be gained.



Paragraph	Comment
9	This paragraph does not make clear the fact that the engagement quality reviewer is not required to review each and every piece of audit documentation, but rather the selected documentation that the engagement quality reviewer considers necessary to identify and evaluate the significant judgments and conclusions. We propose the following language: "...and by reviewing documentation <u>that the engagement quality reviewer considers necessary.</u> "
12	With respect to the note in this paragraph, we believe that the overall conclusion on the subject matter of the engagement is expressed in the engagement report. That is, if the overall conclusion was incorrect, the engagement report would be inappropriate. If we are correct in our understanding, we suggest that items (2) and (3) in the note to this paragraph be combined. If we are incorrect, we suggest that these items be clarified.
17	This paragraph provides guidance to the engagement quality reviewer as to when he or she may provide concurring approval of issuance in a review of interim financial information, However, often, in the case of a review of interim financial information, a report is not "issued."

We would be pleased to discuss this letter with you. If you have any questions, please contact Mr. John L. Archambault, National Managing Partner of Professional Standards, at (312) 602-8701.

Sincerely,

