

May 12, 2008

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

RE: PCAOB Rulemaking Docket No. 025, *Proposed Auditing Standard – Engagement Quality Review and Conforming Amendment to the Interim Quality Control Standards*

Dear Sir:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board's (PCAOB or the "Board") proposed auditing standard, *Engagement Quality Review* (the "standard" or "proposed standard") and conforming amendment to the interim quality control standards.

We strongly support auditing standards that promote audit quality and believe that a robust and effective engagement quality review that focuses on the significant judgments made and conclusions reached by the engagement team furthers that purpose. We support the Board's efforts to adopt an effective engagement quality review standard and acknowledge the Board's consideration of international auditing standards in developing the proposed standard. However, we believe that the proposed standard goes well beyond international auditing standards as promulgated by the International Auditing and Assurance Standards Board,¹ as well as the Board's current interim standard.² We believe that the Board's engagement quality review standard should be aligned with the international auditing standards. We are concerned that the additional effort and resulting cost will not have a commensurate benefit to audit quality.

We are also concerned about the absence of a clearly articulated objective for the review and significant aspects of the standard that, in our view, establish new and unwarranted standards of performance for engagement quality reviewers. In many respects, the proposed standard, in both substance and tone, seems designed to impose legal standards

¹ Proposed Redrafted ISA 220, *Quality Control for an Audit of Financial Statements* (ISA 220), and Proposed Redrafted ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* were proposed in July 2007 and are scheduled to be considered for adoption by the International Auditing and Assurance Standards Board in September 2008.

² SECPS Requirements of Membership, Section 1000.08(f), *Concurring Partner Review of the Audit Report and the Financial Statements of Commission Registrants*.

of conduct on the engagement quality reviewer, as opposed to establishing standards to guide the engagement quality reviewer in performing an independent and objective review of the engagement team's audit work. As discussed in more detail below, we believe that the focus of the proposed standard will have significant unintended consequences.

We believe that our concerns should be addressed by more closely aligning the new standard with international standards, which we believe would create an appropriately focused and effective review standard. Moreover, this would also be consistent with the growing demand for convergence of worldwide accounting and auditing standards, and the broad-based recognition of the benefits of developing a single set of standards for worldwide use.

Objective of the Engagement Quality Review

We believe that the engagement quality review standard should set forth a clear objective for the review, which would appropriately focus the standard on audit quality. We believe that the following objective articulates the purpose of the standard:

The objective of the engagement quality review is to provide for an independent, objective review of significant auditing, accounting, and financial reporting matters, including significant judgments made and conclusions reached, that results in a conclusion about whether the engagement quality reviewer concurs with the issuance of an engagement report.

In our view, this language makes it clear that the standard requires a "review" of key matters. The standard should not aim to create an additional level of independent substantive auditing procedures or require the engagement quality reviewer to engage in substantive oversight of the audit engagement team, substantively evaluate the performance of the engagement team, or determine compliance with the audit documentation requirements. The level of effort associated with performing such an independent *evaluation* would significantly exceed that required in an independent *review* of significant judgments made and conclusions reached, and yet the incremental benefit from an independent evaluation would be marginal.

This proposed objective recognizes that the responsibilities of the engagement quality reviewer differ from those of the engagement partner. The engagement partner has overall and ultimate responsibility for the engagement and the engagement report. The engagement quality review is an element of quality control. As such, the reviewer is in a position to provide an objective review of significant auditing, accounting, and financial reporting matters, including significant judgments made and conclusions reached by the engagement team. But the engagement quality reviewer is not, and could not be as a practical matter, responsible for the audit. Unlike the engagement team, the engagement quality reviewer's access to client records is generally limited to the audit documentation and discussions with the engagement team; he or she generally has limited interaction with client personnel. These limitations preclude the reviewer from independently forming the

necessary judgments and conclusions that would be required for an independent evaluation of certain aspects of the engagement team's work.

The proposed objective is also consistent with the requirements of international auditing standards and would reduce divergence from such standards.

Requirements of the Engagement Quality Review

We believe that the following provisions of the proposed standard should be revised, as they depart significantly from the Board's interim standard and the international standards:

- Procedures that require the engagement quality reviewer to make "evaluations" or "determinations" that, without clarification, may be interpreted to require a level of effort that is similar to that required of the engagement team in performing the work itself and require more than a review of the engagement team's judgments and conclusions (paragraphs 7 and 8);
- The requirement that the engagement quality reviewer identify areas of "higher risk," regardless of materiality, for which the engagement team may have failed to obtain sufficient competent evidence or reached an inappropriate conclusion, rather than identifying risks of material misstatement of the financial statements or material weakness in internal control over financial reporting that may not have been identified by the engagement team (paragraph 9);
- The requirement that the engagement quality reviewer independently evaluate the adequacy of audit documentation, particularly its compliance with Auditing Standard No. 3, *Audit Documentation* (AS 3) (paragraph 10); and
- A new standard of performance for the engagement quality reviewer's work and a conclusion that departs from the negative assurance in the interim standard. The proposed standard would require the reviewer to affirmatively conclude that there is nothing the reviewer "knows or should know" that would preclude concurrence with the engagement team's issuance of the report (paragraph 12).

As discussed below, these provisions, as proposed, could impose substantial new burdens on the engagement quality reviewer without a commensurate benefit to audit quality.

The proposed standard seems to redirect the focus of the engagement quality reviewer away from the work of the engagement team to the work of the reviewer. That is, by creating new standards of performance for the reviewer and a "knows or should know" level of assurance, the provisions of the proposed standard become too focused on the adequacy of the engagement quality review itself, rather than on a proper assessment of the quality of the work performed by the engagement team. For example, instead of considering the judgments made by the engagement team, the reviewer would be required to perform sufficient work to have a basis for separately forming his or her own independent determinations (e.g., whether appropriate matters have been communicated to

the audit committee, whether there are areas that create a "higher risk" of non-compliance, and whether the engagement team complied with documentation standards, etc.).

By mandating that these separate determinations and judgments be made by the reviewer, the focus of the proposed standard becomes the reviewer's own basis for his or her determinations, rather than the reviewer's consideration of the judgments and conclusions reached by the engagement team. The judgments the reviewer makes will likely be seen as supplanting, rather than enhancing or confirming, those of the engagement team. We believe a focus on the reviewer's consideration of the judgments and conclusions reached by the engagement team provides for a more effective and efficient engagement quality review.

We believe that investors, issuers, and auditors should continue to expect engagement partners to make reasonable judgments. Engagement quality reviews contribute to audit quality and, along with the other quality control processes, combine to provide reasonable assurance about the effectiveness of the firm's system of quality control, as required. However, we see neither a purpose nor a benefit in redirecting the focus of the engagement quality review or in the additional costs that will undoubtedly be incurred to address the additional requirements.

The following sections explain in greater detail our concerns with particular provisions of the standard and set forth our recommended changes to the Board's proposal.

Scope of Review Procedures

Paragraphs 7 and 8 prescribe general standards and specific procedures for conducting the engagement quality review. While we generally agree with the nature of these procedures, we are recommending changes to paragraphs 7 and 8 (as set forth in Appendix B to this letter) to clarify which procedures will satisfy the reviewer's responsibility and to avoid any suggestion that the reviewer is required -- or indeed able -- to duplicate the work of the engagement team or make independent judgments about matters that are the responsibility of the engagement team.

These recommended changes provide a more appropriate scope of procedures to be performed by the reviewer. Specifically, these changes would clarify the expected level of work and avoid a fundamental change in the nature of the review function, which could otherwise compromise the important principles of objectivity underlying the standard. The standard should result in an engagement quality review that reinforces, not diffuses, the accountability of the engagement partner.

Engagement Quality Reviewer Risk Assessment

Paragraph 9 of the proposed standard requires the reviewer to identify areas within the engagement that pose a "higher risk" that the engagement team failed to obtain sufficient competent evidence or reached an inappropriate conclusion, rather than a requirement to identify areas that pose a "higher risk" of material misstatement of the financial statements.

Under the proposed standard, for the areas that pose such a "higher risk," the engagement quality reviewer would be required to evaluate whether the engagement team performed procedures that were responsive to those risks, whether the judgments made by the engagement team were reasonable in the circumstances, and whether the results of the procedures support the engagement team's overall conclusion.

We believe that it is important for the engagement quality reviewer to understand and review the significant risks of material misstatement to the financial statements and the risks of material weakness in internal control over financial reporting identified by the engagement team and the engagement team's response to such risks. However, we do not believe that requiring a separate assessment of the risk that the engagement team failed to obtain sufficient competent evidence or reached an inappropriate conclusion is practical or consistent with the objective of an engagement quality review for the following reasons:

- It is unclear how the engagement quality reviewer would make such a determination, particularly in hindsight. The standard does not articulate any procedures for making this determination, other than referring to the procedures in paragraphs 7 and 8 and "other relevant knowledge possessed by the engagement quality reviewer." In short, this concept of "higher risk," directed to the work of the engagement team rather than the financial statements or internal control over financial reporting, and without any reference to materiality, does not have any linkage to professional standards and we therefore do not believe it is subject to implementation in any reasonable or consistent manner.
- The Board's use of the term "higher risk" implies that there should always be some areas of higher risk, which presumably the reviewer must examine, even though there may be no audit areas that pose a sufficiently high risk to justify further consideration or action.
- The requirement seems to be more concerned with having the reviewer make his or her risk assessments separately from the engagement team, than with reviewing the engagement team's judgments for reasonableness. We question the focus of this requirement and the extent to which it will improve audit quality.
- We believe that paragraph 12, both as proposed and consistent with our recommended revision, contains provisions sufficient to prevent engagement quality reviewers from concurring with the issuance of the engagement report, if the reviewer believes that the engagement team failed to obtain sufficient competent evidence in accordance with PCAOB standards or reached an inappropriate conclusion about the subject matter of the engagement, based upon the engagement quality review procedures performed.

We recommend that the Board modify the proposed requirement in paragraph 9 to refocus it on whether certain important matters were identified during the engagement quality review that were not previously identified by the engagement team. These matters include

significant risks of material misstatement to the financial statements and significant difficult or contentious matters where consultation should be considered that were not identified by the engagement team. If such matters are determined to exist, the engagement quality reviewer should be required to communicate these matters to the engagement team and assess whether the engagement team responds appropriately. We believe that such a focus is much more likely to enhance audit quality.

As such, we recommend that paragraph 9 be replaced as follows:

9. Based on the procedures performed in accordance with paragraphs 7 and 8, and the engagement quality reviewer's knowledge, the engagement quality reviewer should assess whether any of the following matters were not previously identified by the engagement team:

- **significant risks of material misstatement to the financial statements,**
- **significant risks of material weakness in internal control over financial reporting, or**
- **significant difficult or contentious matters where consultation should be considered by the engagement team.**

If the engagement quality reviewer believes that there are such risks or matters, he or she should communicate that to the engagement team and then assess whether the engagement team has responded appropriately.

Review of Engagement Documentation

Paragraph 10 of the proposed standard requires the engagement quality reviewer to evaluate the engagement documentation. In particular, it requires the reviewer to evaluate whether the documentation "is appropriate in the circumstances and consistent" with AS 3.

Audit documentation is important and we support the Board's proposed requirement for an engagement quality reviewer to assess whether the engagement documentation supports the conclusions reached by the engagement team with respect to the matters reviewed by the engagement quality reviewer. However, as discussed below, we believe that the proposed standard, if not modified, would require a detailed, compliance-oriented review of documentation. We believe that the standard would impose substantial additional burdens on the engagement quality reviewer that would not enhance audit quality.

The requirements in paragraphs 9 and 10 of the proposed standard appear to duplicate certain other requirements of AS 3, and therefore, at a minimum, should be modified to avoid confusion. Paragraph 13 of AS 3 requires the engagement team to "identify all significant findings or issues in an engagement completion document." Paragraph 13 further states that "this document, along with any documents cross-referenced, should collectively be as specific as necessary in the circumstances for a reviewer to gain a thorough understanding of the significant findings or issues." In our view, the objective for the engagement quality review can be met by performing the procedures outlined in paragraphs 7 through 9 of the proposed standard, as amended by our proposed revisions,

which reflect existing requirements and include reading the engagement completion documentation.

Accordingly, while we concur with the Board's proposal that the requirement to review engagement documentation be limited to documentation that was reviewed in connection with the procedures required to be performed in accordance with paragraphs 7 through 9 of the proposed standard, we believe that the requirement to review engagement documentation should be further revised as follows:

- Omit the requirement to evaluate whether the audit documentation is consistent with AS 3. We do not believe that this specific requirement is consistent with the overall objective of the engagement quality review, nor do we think it will meaningfully enhance audit quality. The engagement partner has primary responsibility for compliance with AS 3. It should not be the engagement quality reviewer's responsibility to duplicate the engagement partner's work.
- Clarify that the purpose of the review of engagement documentation is to assess whether the documentation selected for review supports the judgments made and conclusions reached by the engagement team. Our recommended change would eliminate any implication that paragraph 10 creates a more general requirement to assess detailed matters that may not be within the scope of procedures set forth in paragraphs 7 through 9.

Accordingly, we recommend that paragraph 10 of the proposed standard be replaced as follows:

10. Engagement Documentation. Based upon the procedures performed in accordance with paragraphs 7, 8, and 9, the reviewer should assess whether the engagement documentation reviewed during the course of the engagement quality review supports the significant conclusions reached by the engagement team.

Concurring Approval of Issuance

Paragraph 12 of the proposed standard states that the engagement quality reviewer cannot provide "concurring approval" of the issuance of an engagement report if he or she "knows or should know" that any of four enumerated conditions exist. We believe that the engagement quality reviewer's concurrence is an important contribution to audit quality. We agree with the four enumerated conditions, which, if present, would preclude the engagement quality reviewer from concurring with the issuance of the engagement report. We also support the requirement that the engagement quality reviewer consider the knowledge obtained in performing the review in accordance with the proposed standard.

Nonetheless, we are very concerned by the potential implications of the inclusion of a "knows or should know" standard in paragraph 12. Whether or not the Board intended this consequence, we believe that this term fundamentally changes the basis upon which the reviewer can concur in the issuance of the report. Under the current interim standard, the reviewer can concur as long as "no matters had come to his or her attention that would

cause the [reviewer] to believe" that the financial statements did not conform to GAAP in all material respects or that the audit was not performed in accordance with GAAS. That is, "negative assurance" is the current standard of performance.

The proposed standard, by contrast, requires the reviewer, like the engagement partner, to determine whether he or she has sufficient grounds to positively concur with the issuance of the report. It converts the engagement quality reviewer's conclusion to one that requires an affirmative finding or representation that, by definition, must be based on the performance of sufficient procedures to support the finding or representation.

Further, the phrase "knows or should know" imports a legal formulation into an auditing standard. We believe that inclusion of this phrase in auditing standards is neither necessary nor appropriate. Auditing standards and legal standards are different. Auditing standards are designed to guide auditors in carrying out their audit responsibilities and to provide sufficient clarity so that auditors can understand the requirements of the standards and others can evaluate their performance.³ Legal standards, on the other hand, are rules intended to assess the legal significance of behavior and are often applied after the fact. How they are applied may vary based on various factors, such as forum, parties, applicable law, etc.

Moreover, auditors are largely unfamiliar with this type of legal terminology in the context of auditing standards. Unlike the current interim standard which includes the auditing language described above (i.e., "negative assurance"), inclusion of the proposed language would likely lead to misunderstanding and inconsistent application of the standard.

"Knows or should know," moreover, is a simple *negligence* standard,⁴ which we do not think is appropriate. In another context, the Securities and Exchange Commission (SEC) expressly declined to impose a standard of "mere" or "simple" negligence as a basis for disciplinary action against accountants as a result of violations of professional standards. In adopting revised Rule 102(e) in 1998, the SEC specifically recognized that "creating an undue fear that an isolated error in judgment would result in a 102(e) proceeding could be counterproductive," and rejected a simple negligence standard.⁵ We believe that the

³ We note that the requirement to exercise due professional care applies to the planning and performance of all audits and the preparation of reports pursuant to PCAOB and other auditing standards.

⁴ It is worth noting that on its face, the "should know" formulation does not make sense in the context of the proposed auditing standard. The phrase implies that an engagement quality reviewer will be able to determine what he or she "should know" (but does not know) at the time of deciding whether or not to concur. This reinforces the concern that the standard will govern not just the conclusion the reviewer must make in order to concur, but also post hoc scrutiny of the reasonableness of the engagement quality reviewer's judgment based on what he or she should have known.

⁵ Release No. 33-7593, *Final Rule: Amendment to Rule 102(e) of the Commissions Rules of Practice* (Oct. 19, 1998). The SEC limited the scope of Rule 102(e) to instances of reckless or highly unreasonable behavior (rather than instances of merely negligent behavior) and to patterns of repeated behavior indicating a lack of competence to practice before the Commission.

"knows or should know" standard raises similar concerns about the consequences of an isolated error of judgment by the engagement quality reviewer.

We believe that the proposed formulation for concurring approval will have unintended consequences. Referring to what the reviewer "knows, or should know based upon the requirements of this standard" implies that the reviewer must perform sufficient procedures under the requirements of the standard to "know" that the four specified conditions do not exist. This would likely lead engagement quality reviewers to engage in substantial procedures to conclude that they do not know that any of the specified conditions are present. The phrase "should know" necessarily creates a potential for post hoc questioning of whether an engagement quality reviewer should have identified a condition that would have precluded him or her from concurring with the issuance of the engagement report.

Coupled with most auditors' lack of familiarity with the "knows or should know" standard, we believe that engagement quality reviewers will be overly focused on being second-guessed as to what they should have known if a problem with the audit were later identified. Therefore, reviewers are likely to spend substantially more time performing additional procedures at a higher cost.

Accordingly, we recommend that the Board adopt a standard that omits the "knows or should know" formulation. We recommend that paragraph 12 of the proposed standard be revised to either conform to the language used in ISA 220,⁶ or alternatively, as follows:

12. The engagement quality reviewer must not provide concurring approval of concur with the issuance of an engagement report if, based on he or she knows, or should know based upon the requirements of his or her review in accordance with this standard, the reviewer believes that (1) the engagement team failed to obtain sufficient competent 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, (3) the firm's report, if a report is to be issued, is not appropriate in the circumstances, or (4) the firm is not independent of its client.

We believe that the proposed language retains the essence of the standard – that the reviewer cannot concur if he or she believes, based on the review, that any of the four enumerated conditions are present. However, it eliminates the inappropriate "knows or should know" standard, while promoting behavior that enhances audit quality.

Documentation of Engagement Quality Review Procedures

We believe that documentation is an important component of audit quality and of demonstrating compliance with the Board's auditing standards. Paragraph 14 of the proposed standard sets forth the documentation requirements for the engagement quality review. We believe that some aspects of paragraph 14 could result in significant

⁶ Paragraph 22(c) of ISA 220 requires the reviewer to document that "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 they reached were not appropriate."

divergence in implementation and substantial incremental effort. Specifically, certain of the documentation requirements, including paragraphs 14(d) and (e), are unclear.

For example, paragraph 14(d) requires the documentation to reflect when the procedures were performed. However, many of the procedures performed by the engagement quality reviewer are continuous and performed throughout the course of the audit. Accordingly, we believe that it would be impractical to document when the procedures were performed. In our view, we believe that it is more important for the engagement quality reviewer to document the date of completion of the procedures and concurrence with issuance of the engagement report.

We also note that paragraph 14(e) requires the auditor to document the results of the review procedures performed. We are concerned that this requirement is too vague and provides no guidance as to whether the "results" to which it refers are the same or are different from the "result" (i.e., concurring approval of issuance) referred to in paragraph 12. Moreover, to the extent that this requirement is intended to go beyond the requirements of paragraph 12, inclusion of this subparagraph could result in (1) a substantial increase in effort as compared to current practice under the PCAOB's interim standard and international standards, and (2) the need for a significant increase in engagement quality reviewer resources. We believe that these incremental efforts will yield minimal benefits to audit quality.

We recommend that the Board amend the proposed documentation requirements so that they are consistent with ISA 220, which generally requires documentation of the following:

- The procedures required by the standard have been performed
- The engagement quality review has been completed before the date of the auditor's report
- The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments made and the conclusions reached were inappropriate.

Furthermore, we believe that the requirements of the standard, as amended, should supersede the documentation requirements of AS 3, as it relates to the engagement quality review (other than those provisions of AS 3 applicable to retention of and subsequent changes to audit documentation, as required by paragraph 15 of the proposed standard). In addition, the documentation requirements should provide flexibility in determining the method of documenting the results of the review, such as the use of review checklists or memoranda documenting the procedures performed.

Other Specific Provisions of the Proposal

In Appendix A to our letter, we have highlighted certain observations on several other provisions of the proposed standard that we believe merit further consideration by the Board.

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We support the Board's continuing efforts to promulgate standards that promote and improve audit quality. As noted above, we believe that engagement quality reviews generally further that purpose because they provide an independent, objective pre-issuance review of the significant audit judgments made and conclusions reached. Our comments in this letter have been directed to those provisions of the proposed standard that we believe go beyond international standards and may result in significant increased costs for procedures that will likely not provide a commensurate improvement in audit quality.

We appreciate the opportunity to provide our perspective to the Board. We would be pleased to discuss our comments and to answer any questions that the PCAOB staff or the Board may have. Please contact Vincent Colman (973-236-5390) or Jorge Milo (973-236-4300) regarding our submission.

Sincerely,

PriceWaterhouse Coopers LLP

Attachments

**Proposed Auditing Standard – Engagement Quality Review
Comments on Other Specific Provisions of the Proposal**

As indicated in our letter, this Appendix highlights observations on several other specific provisions of the proposed standard that we believe merit further consideration by the Board.

Effective Date

As proposed, the standard would be effective for reports issued on or after December 15, 2008. The proposed effective date would not permit sufficient time for registered public accounting firms to implement the new engagement quality review requirements. We also believe that the effective date should be linked to the beginning of an engagement period. By linking the effective date to the beginning of the engagement period rather than the report issuance date, the new requirements would (1) be known and anticipated as of the beginning of the engagement period, (2) allow the assigned engagement quality reviewer to comply with the requirements throughout engagement planning and execution, and (3) be in place for each quarterly review conducted under SAS No. 100, *Interim Financial Information*. In this manner, adoption of the new standard would be more effective and efficient.

The effective date should provide all registered public accounting firms with sufficient time to (1) adopt policies and procedures consistent with the new standard, (2) train their personnel in the requirements of the new standard, and (3) assign qualified engagement quality reviewers consistent with their system of quality control.

Engagements Subject to Engagement Quality Reviews

We support the Board's proposal that all registered public accounting firms – not just those that were members of the AICPA SEC Practice Section as of April 16, 2003 – be required to comply with the engagement quality review standard. We believe that requiring all firms to comply with the standard is consistent with the Board's directive under Section 103 of the Sarbanes-Oxley Act of 2002 and in the public interest.

As indicated in our letter, we believe that a standard on engagement quality review will enhance audit quality. However, while we acknowledge the Board's desire for the standard to apply to all engagements performed in accordance with the standards of the PCAOB, the requirements in the proposed standard appear to have been tailored to financial statement audits and integrated audits. Accordingly, it would be difficult to apply certain requirements to other types of engagements, such as attestations conducted in accordance with the Board's attestation standards, with appropriate consistency.

Furthermore, with respect to the evidence required to be assessed ("sufficient competent evidence") and the nature of the affirmative conclusion, the proposed standard appears to

place the engagement quality reviewer in a position of having to obtain as much or more evidence and, consequently, to provide a higher level of assurance, than even the engagement partner for certain engagements (e.g., a review of interim financial information or a comfort letter for underwriters). In addition, we believe that a requirement to apply an auditing standard to an engagement performed in accordance with attestation standards would result in confusion and inconsistent practice. We therefore believe that the standard cannot be practically applied to engagements other than financial statement audits and integrated audits. Accordingly, we believe that the standard should only apply to financial statement audits, integrated audits and, with improvement in clarity of how the standard should be implemented for reviews of interim financial information, to such interim reviews.

Qualifications of the Engagement Quality Reviewer

We agree with the Board that a competent and objective engagement quality reviewer is essential to an effective engagement quality review. Likewise, we agree that the determination of 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. However, we are concerned that the Board's use of an example from the oil and gas exploration industry in the release accompanying the proposed standard may, inappropriately, imply that an engagement quality reviewer should have a deeper level of industry expertise than necessary or required to function as an engagement quality reviewer, particularly in narrow or specialized industries.

In addition, we note that the proposed standard permits other individuals of the firm (i.e., non-partners) or individuals outside of the firm (subject to the competence, independence and other requirements of the proposed standard) to serve as engagement quality reviewers. Although we acknowledge that that this accommodation may facilitate implementation of the standard by smaller registered firms, we do not intend to change our existing practice of only having partners serving as engagement quality reviewers.

Communication between the Engagement Quality Reviewer and the Engagement Team

While we agree with the requirement of paragraph 5 of the proposed standard that the engagement quality reviewer must maintain objectivity, we also believe that communication and consultation with the engagement quality reviewer enhances audit quality.

Paragraph 5 of the proposed standard indicates that the engagement quality reviewer "must be independent of the company, perform the engagement quality review with integrity and maintain objectivity with respect to the engagement and the engagement team" (emphasis added). Paragraph 5 could be read to suggest that the PCAOB is changing the definition of the word "objectivity." Historically, objectivity has been defined with respect to the audit; that is, the engagement team and the engagement quality reviewer are required to perform their procedures with skepticism and objectivity. The requirement that the engagement

quality reviewer must maintain objectivity with respect to the engagement team could be misinterpreted to mean that the engagement quality reviewer is somehow limited in his or her ability to have discussions with the engagement team. We believe that such consultation is an important element of audit quality and that the standard should encourage consultation with the engagement quality reviewer.

To avoid the unintended consequence of limiting communications between the engagement team and the engagement quality reviewer, which we do not believe compromise objectivity, we recommend replacing the language in paragraph 5 with language similar to that of PCAOB interim standard, QC Section 20.09, so that it states the following: "Engagement quality reviewers must be independent of the company and perform all professional responsibilities with integrity, and maintain objectivity in discharging professional responsibilities."

Proposed Auditing Standard – Engagement Quality Review
Scope of Review Procedures

As indicated in our letter, we recommend that the Board revise the required procedures outlined in Paragraphs 7 and 8 of the proposed standard. We believe certain of the provisions in Paragraphs 8 could be clarified to provide more clarity about how to satisfy the presumptively mandatory requirements in each of these sections:

7. The engagement quality reviewer should evaluate ~~include an evaluation of the significant judgments made by the engagement team and the significant conclusions reached by the engagement team in forming the overall conclusion on in conducting~~ the engagement and in preparing the engagement report, if a report is to be issued. ~~To identify and evaluate the significant judgments and conclusions, The evaluation should be conducted by~~ the engagement quality reviewer ~~should include through~~ discussions with the person with overall responsibility for the engagement, discussions with other members of the engagement team as necessary ~~appropriate~~, and other procedures, as described in paragraphs 8 and 9.

8. As part of performing the engagement quality review, the engagement quality reviewer should:

- a. **~~Obtain an understanding of the firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process for the company.~~**
- b. **~~Obtain an understanding of the company's business, significant activities during the current year, and significant financial reporting issues and risks through discussions with the person with overall responsibility for the engagement, discussions with other members of the engagement team, as appropriate, and the performance of the procedures enumerated in the subparagraphs below.~~**
- c. **~~Review the engagement team's evaluation of the firm's independence in relation to the engagement (i.e., the communication with the audit committee required by Rule 3526, *Communication with Audit Committees Concerning Independence*, formerly Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*).~~**
- d. **~~Evaluate~~ Review engagement planning, including (1) the judgments made about materiality and the effect of those judgments on the engagement strategy and (2) the identification of significant risks, ~~including fraud risks of material misstatement to the financial statements and the risks of material weakness in internal control over financial reporting~~, and the plan for and performance of engagement procedures in response to those risks.**

- e. ~~Evaluate Review judgments made about (1) the materiality and disposition of corrected and uncorrected identified misstatements and (2) the severity and disposition of identified control deficiencies.~~
- f. ~~Determine if appropriate consultations have taken place on difficult or contentious matters. Review the documentation, including conclusions, of such consultations that have taken place on significant difficult or contentious matters.~~
- g. Read the financial statements, management's report on internal control over financial reporting, or other information that is the subject of the engagement and the engagement report (if an engagement report is to be issued) for the period covered by the engagement and for the prior comparative periods presented.
- h. Read other information in periodic filings and offering documents, as applicable, containing financial statements that are the subject of the engagement and are to be filed with the SEC and evaluate whether the engagement team has taken appropriate action with respect to material inconsistencies with the financial statements or material misstatements of fact of which the engagement quality reviewer is aware.
- i. ~~Determine if Review whether appropriate matters of which the engagement quality reviewer is aware have been communicated, or identified for communication to the audit committee, management, and other parties, such as regulatory bodies.~~
- j. Review the engagement completion document and confirm with the person with overall responsibility for the engagement that there are no significant unresolved matters.

Note: Matters of which the engagement reviewer is "aware" are those matters that have come to the attention of the reviewer during the course of performing the procedures required by this standard.