

May 12, 2008

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

Via email to comments@pcaobus.org

RE: PCAOB Rulemaking Docket Matter No. 025: Proposed Auditing Standard - Engagement Quality Review.

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the *PCAOB Rulemaking Docket Matter No. 025: Proposed Auditing Standard - Engagement Quality Review*. We very much appreciate the opportunity to provide input.

The views expressed in this letter and attachments are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member.

We hope that our attached comments and suggestions are helpful and will assist in finalizing the proposed guidance. If the Board has any questions about our input, please feel free to contact our committee chair for additional follow-up.

Respectfully submitted,

Auditing Standards Committee
Auditing Section - American Accounting Association

Committee Members:

Chair – Thomas M. Kozloski, Wilfrid Laurier University, tel: 519-884-0710 ext. 2679,
int: tkozloski@wlu.ca

Past Chair - Robert D. Allen, University of Utah
Vice Chair – Randal J. Elder, Syracuse University
Ed O'Donnell, University of Kansas
Robert J. Ramsay, University of Kentucky
Sandra Shelton, DePaul University
Jay Thibodeau, Bentley College

Auditing Standards Committee
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General Comments

The Committee commends the PCAOB (“the Board”) for proposing an audit standard relating to engagement quality review. We believe that in general the proposed standard sets the proper tone and maintains the proper balance as it strengthens the existing guidance in this area of practice. In the Committee’s opinion, this standard will assist practitioners in meeting the Board’s objective for guidance in this area: increasing the likelihood of identifying and correcting deficiencies in the planning, execution, and wrap-up of the audit engagement prior to the issuance of the auditor’s report. The Committee believes that, for most accounting firms, the proposed standard will assist practitioners in accomplishing this objective without the incurrence of excess or burdensome additional costs. In short, it is our opinion that the proposed standard will result in more effective audits.

The following section presents a number of specific comments or suggestions relating to the proposed standard, organized along the lines of the questions posed by the Board in the body of the guidance preceding the draft of the proposed standard.

Comments Addressing PCAOB-proposed Questions

1. The proposed standard does not explicitly state an overall objective of an engagement quality review. Should this standard state such an objective? If so, what should be the objective?

The Committee agrees with Board Member Charles Niemeier that the standard should state an objective. The Board has articulated an objective in the release (and related materials) regarding engagement quality review, without necessarily calling it such. Based on the guidance, it would seem that the objective of the proposed standard is (as stated above in “General Comments”): to increase the likelihood of identifying and correcting deficiencies in the planning, execution, and wrap-up of the audit engagement prior to the issuance of the audit report. Another way of presenting the objective, or an additional objective, framed in a less “negative” manner than focusing on the detection of deficiencies, might be: to ensure that the engagement complies with PCAOB standards and the audit firm’s own quality control standards. Even though these objectives are implied in the proposed standard, the Committee believes that explicitly presenting the objective(s) early in the standard will provide additional focus to the standard.

2. Should an engagement quality review be required for all engagements performed in accordance with the standards of the PCAOB? If not, when should an engagement quality review be required?

The Committee believes that engagement quality reviews should be performed for all engagements performed in accordance with the standards of the PCAOB. Specifically, we believe that applying the proposed standard to reviews of interim financial

Auditing Standards Committee
Auditing Section – American Accounting Association

information will result in more effective interim reviews, and therefore more effective audits. In support of this assertion, the Committee cites research that indicates that fraudulent financial reporting often begins in an interim period, with additional actions taken at year end (Beasley, et al., 1999).

3. Are the qualifications of the engagement quality reviewer appropriately described in the proposed standard? If not, how should they be revised?

The proposed standard provides flexibility as to who conducts the review, and sets an appropriate benchmark for the technical qualifications of the reviewer (i.e., the ability to function as an engagement partner on the audit of a similar entity). In the areas of independence and objectivity, however, it may be difficult for the engagement quality reviewer to challenge the decisions and actions of the engagement team if the reviewer does not have sufficient authority relative to the engagement partner. For instance, if the engagement partner of an audit is the partner-in-charge of a particular office of the firm, it may be advisable for the reviewer to come from another office of the firm. However, as noted in paragraph 3 of the proposed standard, specific guidance as to how a particular firm resolves these issues could be addressed in the firm's quality control standards.

4. Should the proposed standard allow the engagement team to consult with the engagement quality reviewer during the engagement? Would such a consultation impair objectivity?

This is a difficult and very critical issue. On the one hand, consultation provides for efficiency in the conduct of the audit. On the other hand, engagement quality reviewers may not be sufficiently objective to make final determinations or judgments that go against their earlier advice provided in the consultation.

The Committee believes that consultation with the engagement quality reviewer may be particularly useful in planning (especially risk assessment, and the planned response to identified risks). As to unexpected and significant matters that arise during the conduct (testing phase) of the engagement, the proposed standard might include language that directs consultations regarding these matters first to other persons and resources in the accounting firm, and then to the engagement quality reviewer, as a last source of consultation.

If the Board decides that consultation with the engagement quality reviewer is appropriate, the Committee believes that the reviewer should not consult with the engagement team about an issue, whether it involves the planning, execution, or wrap-up of the audit, until the engagement team has first determined its own position on that issue. Numerous research studies in decision-making have found that decision-makers are susceptible to confirmation bias. Auditors in the setting of professional practice have been found to be likewise susceptible (Bamber, et al., 1997; Church, 1990). The implication of this research for engagement quality reviewers is that reviewers may not

Auditing Standards Committee
Auditing Section – American Accounting Association

be objective relating to the decisions and judgments in which they have formerly participated. Libby and Trotman (1993) note that “there are systematic offsetting differences in the manner in which initial decision makers and reviewers attend to information which ensure that evidence inconsistent with initial judgments is given adequate consideration. The review process can act as an effective control by increasing the chances that the implications of inconsistent evidence are considered.” Specifically, “initial decision makers’ judgments resulted in a tendency for their relative recall to be in the direction of information consistent with their judgments, while initial decision makers’ judgments resulted in the reviewers’ relative recall being in the direction of information inconsistent with that decision.”

Therefore, the concern is that engagement quality reviewers who are involved in decisions will tend to remember information consistent with the decision. However, if they act only as reviewers, and not decision makers, they will consider more information that is inconsistent with the decision, which may enhance the quality of the overall review.

5. Are the descriptions of the scope and extent of the engagement quality review procedures appropriate? If not, how should they be changed?

In general, the Committee considers the scope and extent of the engagement quality review procedures included in the proposed standard to be appropriate, but we offer the following suggestions.

The standard is silent on a process for the resolution of disagreements between engagement partner and reviewer. We believe that it may be useful to include language in the proposed standard that requires the firm to have such a process in place as part of the firm’s quality control standards.

Also, it may be useful to include language in the proposed standard that indicates that the procedures in para 7, 8 and 9 must be performed, but the auditor is not necessarily limited to those procedures. In addition, since the evaluation of the engagement documentation is one of the duties and responsibilities of the reviewer, it may be useful to incorporate the substance of para 10 into the list in para 8, with para 9 presenting the “wrap-up and evaluate” guidance as it does already.

6. Is the risk-based approach to the engagement quality review described by the proposed standard sufficient to identify significant engagement problems? If not, how should the proposed standard be changed?

The Committee believes that a risk-based approach is appropriate, but the risk-based approach is not well-described. Auditors’ standard methodology for evaluating risk is the risk-model, but it is not clear that is what is intended here. For example, auditors have been criticized for not gathering sufficient evidence on “high risk” engagements. How

Auditing Standards Committee
Auditing Section – American Accounting Association

should the engagement quality review differ on such engagements? Should the engagement quality reviewer evaluate procedures for all identified inherent risks, or all fraud risks, or all significant risks (a term used but not defined on p. 15, which could be defined as inherent and control risk combined)? Are there evidential risks that are separable from inherent and fraud risks?

For example, many frauds arise from revenue recognition issues such as channel stuffing and side agreements with customers. These are clearly inherent and/or fraud risks which influence the nature of the evidence gathered. We suggest that the term “significant risk” be defined in the standard and that the engagement quality reviewer be required to evaluate whether the evidential matter to be gathered and evaluated is sufficient and competent to address each significant risk.

10. Are the documentation requirements for an engagement quality review appropriate? If not, how should they be changed?

The Committee believes this is another critical and difficult issue. The release refers to academic research that indicates the reviews have mostly consisted of checklists. However, it is important to note that the reviewer reviews, rather than performs detailed, evidence gathering procedures, which is why the checklist may be used to guide and possibly document the work of the reviewer.

It seems based on the discussion in the release that the Board would like to provide guidance that would lead practitioners to move away from a checklist and sign-off approach, with little or no additional documentation behind the checklist or decision aid concerning the particulars of what the reviewer did in conducting the review. The Committee believes that the guidance provided in the proposed standard will likely accomplish this objective.

References

Bamber, E.M., R. Ramsay, and R. Tubbs. (1997). An examination of the descriptive validity of the belief-adjustment model and alternative attitudes to evidence in auditing. *Accounting, Organizations, and Society*. Oxford: Apr./May. Vol. 22, Iss. 3, 4; p. 249.

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