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PROPOSED AUDITING STANDARD –  
ENGAGEMENT QUALITY REVIEW

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) PCAOB Release No. 2009-001  
) March 4, 2009  
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) PCAOB Rulemaking  
) Docket Matter No. 025  
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Summary: The Public Company Accounting Oversight Board (the "Board" or "PCAOB") is reproposing an auditing standard, *Engagement Quality Review*, that would be applicable to all registered firms and would supersede the Board's interim concurring partner review requirement.

Public

Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board's Web site at [www.pcaobus.org](http://www.pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 025 in the subject or reference line and should be received by the Board no later than 5:00 PM (EST) on April 20, 2009.

Board

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### I. Introduction

Engagement quality review ("EQR") is an opportunity for the auditor to discover any significant engagement deficiencies before issuing its opinion. In an EQR, a qualified reviewer takes a fresh, objective look at the engagement, and, based on that review, evaluates whether it is appropriate for the firm to issue its report. A well-performed EQR can be an effective safeguard against erroneous or insufficiently supported audit opinions, and, accordingly, can contribute to audit quality and reduce the need for restatements.

In the 1970s, the audit profession began requiring EQR – known as "concurring partner review" – for some, but not all, engagements. The standard adopted by the profession applied to members of the Securities and Exchange Commission Practice Section ("SECPS") of the American Institute of Certified Public Accountants ("AICPA"), who were generally U.S.-based auditors of Securities and Exchange Commission ("SEC") registrants.

In 2002, Congress enacted the Sarbanes-Oxley Act (the "Act"), which created the Public Company Accounting Oversight Board ("the PCAOB" or "Board") and put in place a comprehensive, independent regulatory scheme for auditors of public companies. The Act directs the Board, among other things, to set standards for public company audits, including a requirement for each registered public accounting firm to "provide a concurring or second partner review and approval of [each] audit report (and other related information), and concurring approval in its issuance, by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board)."<sup>1/</sup>

Soon after its creation, the Board adopted as its interim standards certain existing standards adopted and used by the auditing profession.<sup>2/</sup> One such standard was the profession's concurring partner review requirement, which the Board continued to apply, on a transitional basis, to registered firms that were members of the SECPS.<sup>3/</sup>

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<sup>1/</sup> Section 103(a)(2)(A)(ii) of the Act.

<sup>2/</sup> PCAOB Release No. 2003-006, Establishment of Interim Professional Auditing Standards (April 18, 2003).

<sup>3/</sup> See PCAOB Rule 3400T(b).

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According to this interim standard, "the concurring partner review . . . serves as an objective review of significant auditing, accounting, and financial reporting matters that come to the attention of the concurring partner reviewer and the resolution of such matters prior to the issuance of the firm's audit report with respect to financial statements of SEC engagements."<sup>4/</sup> Registered firms that were not members of the SECPS – generally non-U.S. firms and some smaller firms – are not subject to this interim requirement.

On February 26, 2008, the Board proposed to replace the interim requirement with a new auditing standard, *Engagement Quality Review*.<sup>5/</sup> The Board proposed this standard after considering feedback from its Standing Advisory Group ("SAG") as well as information from its inspection and enforcement programs. Some SAG members suggested that the interim requirement does not provide for a sufficiently thorough review to provide investors with assurance on the quality of engagements.<sup>6/</sup> 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."<sup>7/</sup>

Accordingly, the Board's proposal was intended to enhance the quality of the EQR process by strengthening the requirements in the standard. The Board believed that a more meaningful review would increase the likelihood that a registered firm would catch significant engagement deficiencies before issuing its audit report. 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

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<sup>4/</sup> SECPS Requirements of Membership Sections 1000.08(f); 1000.39, Appendix E.

<sup>5/</sup> PCAOB Release No. 2008-002, Proposed Auditing Standard – Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Control Standards (February 26, 2008).

<sup>6/</sup> The SAG discussed engagement quality review at its June 22, 2004 and October 5, 2005 meetings. Webcasts of those meetings are available on the Board's website at [www.pcaobus.org/News and Events/Webcasts Archive](http://www.pcaobus.org/News_and_Events/Webcasts_Archive).

<sup>7/</sup> See SECPS Requirements of Membership Sections 1000.08(f); 1000.39, Appendix E.

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engagement partner. The Board's proposal therefore attempted to describe a review process that would effectively target areas of greatest risk while avoiding duplication of the engagement team's efforts.

The Board received 38 comment letters on its proposal.<sup>8/</sup> A number of commenters commended the Board for proposing an auditing standard related to EQR, and noted that a well-performed engagement quality review is, in the words of one such commenter, a "pillar" of audit quality. Many commenters, however, were critical of key provisions of the proposal, including provisions describing the scope of the required review and the requirements for concurring in the issuance of the report.

The Board considered these comments and has made significant changes to the standard in response. 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. The Board also still believes that the new requirements should apply equally to – and be suitable for – all registered firms, rather than only a subset of them. For these reasons, the Board has determined that the interim requirement should be replaced. Because the Board has made extensive changes to the proposed standard, it is seeking comment on a revised standard.

## **II. Overview of the New Proposal**

Like the original proposal, the standard that the Board is proposing is intended to strengthen the existing requirements for an EQR and lead to a more meaningful EQR process. Also like the original proposal, it would supersede the Board's interim concurring partner review requirement and apply equally to all registered firms. The significant refinements reflected in the new proposal result from a constructive public comment process and are intended to better tailor the standard to its purposes. As described in more detail below, the changes reflected in the new proposal are generally related to:

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<sup>8/</sup> Comments on the proposal are available on the Board's website at [www.pcaobus.org/Rules/Docket\\_025](http://www.pcaobus.org/Rules/Docket_025).

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- *Applicability.* The new proposal would require an EQR for audits and reviews of interim financial information ("interim reviews"), but not for other engagements performed according to the standards of the PCAOB.
- *Objective.* The new proposal includes an explicit objective.
- *Reviewer qualifications.* Among other things, the Board refined the requirements in response to comments suggesting that only partners would have sufficient authority to conduct the review.
- *Scope.* Among other things, the Board revised the description of the procedures that would be required in an EQR, and, in recognition of the differences between an audit and an interim review, included separate requirements for reviewing those different types of engagements.
- *Concurring approval of issuance.* The Board revised the proposed provision on concurring approval by replacing the "knows, or should know based upon the requirements of this standard" formulation with a formulation grounded in the auditor's duty to exercise due professional care.
- *Documentation.* The Board clarified the scope of the documentation requirements.

The Board requests comment on the new proposal, including, in particular, the provisions that have been revised and responses to the specific questions below.

### **A. Applicability of the EQR Requirement**

The Board's original proposal required an EQR for all engagements performed in accordance with the standards of the PCAOB. The proposed standard reflected the Board's belief that investors and other users of financial information expect that any engagement performed according to the Board's standards should be subject to an objective review by a qualified person outside of the engagement team. The release accompanying the original proposal explained that such engagements include integrated audits, audits of financials statements only, interim reviews, and other audit and attestation engagements.

A significant number of commenters expressed views on the applicability of the proposed standard to different types of engagements. None of the commenters

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objected to making the EQR mandatory for audit engagements, and the overwhelming majority of the commenters did not object to including interim reviews in the scope of the standard if the Board more clearly defined the requirements of an EQR for an interim review. While many of the commenters did not object to making an EQR mandatory for other engagements, some asked the Board to reconsider the practicality of having one standard for different types of engagements. As described below, after considering these comments, the Board is proposing to require an EQR for audits<sup>9/</sup> and interim reviews – with separate requirements for each.

### Applicability to Interim Reviews

Commenters noted that interim reviews are more limited in scope and have a different objective than audits. Therefore, they suggested, only a subset of the requirements set forth in the original proposal should be required for an EQR of an interim review. Commenters also recommended that the Board modify the requirements for providing concurring approval of issuance in an EQR of an interim review.<sup>10/</sup> These commenters suggested that it would be inappropriate to require the reviewer to provide a higher level of assurance than what they termed the "negative assurance" required of the engagement team in an interim review.<sup>11/</sup> According to commenters, if a higher level

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<sup>9/</sup> Section 103 of the Act directs the Board to include in its standards a requirement for an EQR of each audit report and concurring approval of issuance.

<sup>10/</sup> Concurring approval of issuance is discussed below.

<sup>11/</sup> An interim review does not provide the auditor with a basis to issue an opinion on the financial statements. Rather, as provided by Paragraph .07 of AU section ("sec.") 722, *Interim Financial Information*:

[t]he objective of a review of interim financial information . . . is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles. The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with generally accepted auditing standards . . . . Likewise, the auditor's responsibility as it relates to management's quarterly certifications on internal control over financial reporting is different from the auditor's responsibility as it relates to management's annual assessment of internal control over financial reporting. The auditor should perform limited procedures quarterly to provide a basis for determining whether he or she has

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of assurance were required in order to provide concurring approval of issuance, the reviewer would not be able to comply with the standard unless he or she performed procedures that were more extensive in scope than those required of the engagement team. For example, commenters suggested that the reviewer would not be able to determine the sufficiency of the evidence obtained because in an interim review the auditor is not required to corroborate management's responses with other evidence.<sup>12/</sup>

The Board agrees with commenters who suggested that the EQR requirements for audits and interim reviews should be customized to reflect the differences in scope between these engagements. Accordingly, the new proposed standard includes specific requirements for audits and interim reviews in two separate sections, each of which describes review procedures and criteria for providing concurring approval of issuance. These provisions are discussed in more detail below, and should better align the EQR with the engagement under review.

### Applicability to Other Engagements Performed According to PCAOB Standards

Some commenters suggested that the requirements of the original proposal were so specifically tailored to financial statement and integrated audits that it would be difficult to apply certain requirements to other types of engagements. For instance, some commenters questioned whether the requirement to obtain an understanding of significant financial reporting issues and risks would apply to a review of the assessment of compliance with servicing criteria under the SEC's Regulation AB. In the commenters' view, a requirement to apply an auditing standard to an engagement performed under attestation standards would result in confusion and inconsistent practice.

After considering these comments, the Board agrees that other engagements performed according to PCAOB standards are sufficiently different from audits and interim reviews, and that any EQR requirements related to such other engagements should be considered separately. Accordingly, the standard the Board is proposing would require an EQR only for audits and interim reviews. The two primary types of

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become aware of any material modifications that, in the auditor's judgment, should be made to the disclosures about changes in internal control over financial reporting in order for the certifications to be accurate and to comply with the requirements of Section 302 of the Act.

<sup>12/</sup> See AU sec. 722.07

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engagements excluded from the scope of the new proposal are engagements performed pursuant to Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist* and engagements required by the SEC's Regulation AB.<sup>13/</sup>

### Question:

1. Should the standard require an EQR for other kinds of engagements performed according to PCAOB standards? If so, what types of engagements should be included and what should an EQR of such engagements entail?

## **B. Objective of the Standard**

In the release that accompanied the original proposal, the Board solicited comment on whether the standard should state an overall objective and, if so, what that objective should be. Most commenters expressed the view that the standard should contain a stated objective, and some commenters suggested an objective for the standard. Only three commenters believed that the standard did not need an overall objective.

The Board believes that a well-articulated objective can focus auditors on the purpose of a standard – the "big picture" – as they comply with the standard's more specific requirements and apply them to particular facts and circumstances. Applying a standard in light of its overall purpose should result in more effective and meaningful

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<sup>13/</sup> Under the SEC's Regulation AB and related rules (See Securities and Exchange Act Rule 13a-18, 17 C.F.R. § 240.13a-18; Item 1122 of Regulation AB, 17 C.F.R. § 229.1122), the annual report for a class of asset-backed securities must include from each party participating in the servicing function a report regarding its assessment of compliance with certain specified servicing criteria, and an attestation report by a registered public accounting firm on that assessment. The attestation report is to be prepared in accordance with standards for attestation engagements issued or adopted by the PCAOB.



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procedures and help auditors avoid a checklist approach. For these reasons, the Board included objectives in its recently proposed risk assessment standards.<sup>14/</sup>

Based on commenters' feedback, the Board included in the new proposal an objective that is consistent with the specific requirements for performing an EQR and the requirements related to concurring approval of issuance. It is phrased as an objective for the engagement quality reviewer rather than as an objective of the process (the EQR), to emphasize the responsibilities placed on a reviewer by this proposed standard.

### Questions:

2. Is the objective in the repropoed standard appropriately formulated? Does it articulate the purpose of an EQR?
3. Will this objective contribute to a more thoughtful and effective EQR?

## C. Qualifications of the Engagement Quality Reviewer

In order to be effective, an EQR must be performed by a qualified reviewer. The Board's original proposal described the required qualifications of a reviewer in terms of the reviewer's competence, independence, integrity, and objectivity. Specifically, the original proposal:

- Required the reviewer to possess the level of knowledge and competence related to accounting, auditing, and financial or other reporting required to serve as the person who has overall responsibility for the same type of engagement;<sup>15/</sup>
- Allowed the reviewer to be a partner or another individual in the firm, or an individual outside the firm;

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<sup>14/</sup> PCAOB Release No. 2008-006, Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Conforming Amendments to PCAOB Standards (October 21, 2008).

<sup>15/</sup> The release accompanying the original proposal noted 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 company.

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- Required the reviewer to be independent of the company, perform the review with integrity, and maintain objectivity with respect to the engagement and the engagement team.

The original proposal also required the reviewer to be associated with a registered public accounting firm.

The release accompanying the original proposal sought comment on these proposed requirements and explained, among other things, how a qualified person not already associated with a registered firm could become associated with the firm issuing the report by performing the EQR. The proposed qualification provisions of the standard generated significant comment, and the Board has considered those comments. Commenters generally did not object to the requirement that the person performing the EQR be an associated person of a registered public accounting firm, and, because of the importance of that provision to the Board's ability to administer the standard, that provision has not changed in the new proposal. As described below, however, the Board is proposing some refinements to other aspects of the standard's qualification provisions in response to comments.

### Competence

Many commenters agreed that the engagement quality reviewer should have a strong background in accounting, auditing and financial reporting. A number of commenters, however, believed that requiring the reviewer to have sufficient competence to serve as the engagement partner on the same type of engagement under review meant that the reviewer would have to be a "clone" of the engagement partner, which, they suggested, was not necessary for an effective EQR. Commenters were also concerned that this requirement placed too much emphasis on specialized industry expertise, which, they said, could limit unnecessarily the pool of suitable candidates and create resource constraints for firms.

At the same time, many commenters objected to the fact that the proposed standard did not expressly require the reviewer to be a partner. Others, however, believed that allowing someone other than a partner to perform the EQR would provide more flexibility to smaller and foreign firms. Commenters who suggested that the standard allow only partners to conduct the EQR were, for the most part, concerned that a non-partner would not have sufficient authority within the firm to provide an effective

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and objective review of the engagement partner's work.<sup>16/</sup> In response to these comments, the Board is proposing certain changes.

The principles-based requirement in the original proposal for the reviewer to possess the level of knowledge and competence required to serve as the engagement partner in the same kind of engagement was intended, among other things, to make clear that under ordinary circumstances a non-partner in an accounting firm would be unqualified to conduct the EQR. Indeed, one commenter noted that a non-partner would be unlikely to have the experience or judgment of an engagement partner. At the same time, under the existing interim requirement, a firm may seek a waiver to engage an academic or other experienced accountant to perform the EQR.<sup>17/</sup> Allowing a sufficiently qualified professor or other individual not employed by an accounting firm to perform the EQR should not negatively affect audit quality and may mitigate the compliance burden on sole practitioners and smaller firms. The Board intended the principles-based requirement to establish a sufficiently high standard for reviewer competence and authority, while providing sufficient flexibility for firms that wish to use reviewers who work outside a traditional partnership structure.

The Board continues to believe that this general competence standard is appropriate, and does not agree with commenters who suggested it requires the reviewer to possess skills identical to those of the engagement partner. The general competence provision merely sets a minimum requirement for those who would perform the EQR, but it does not require the reviewer's competence to match that of the engagement partner. In many cases, both individuals' competence will exceed the minimum level prescribed, but there is no requirement that they do so in tandem, or

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<sup>16/</sup> Some commenters also expressed concern that allowing someone who is not a "partner" to conduct the EQR would be inconsistent with the Act. The Board disagrees. Section 103(a)(2)(A)(ii) requires the Board to include in its auditing standards a requirement for "a concurring or second partner review and approval of such audit report (and other related information), and concurring approval in its issuance, *by a qualified person (as prescribed by the Board) associated with the public accounting firm, other than the person in charge of the audit, or by an independent reviewer (as prescribed by the Board).*" (Emphasis added). While that section describes the review as "a concurring or second partner review" – perhaps because those terms were already in use when the Act was enacted – it does not mandate that only "partners" conduct the review. To the contrary, the Board is specifically authorized to decide who is qualified to perform this review, so long as it is not the lead engagement partner.

<sup>17/</sup> See PCAOB Rule 3400T.

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even at all. Moreover, the Board continues to believe that if industry knowledge is necessary to conduct a particular audit, it is similarly necessary to effectively review that audit. For these reasons, the general competence requirement in the new proposal is substantially the same as was originally proposed.

Although the Board believes that application of this requirement would rarely, if ever, allow a manager or other non-partner in an accounting firm to perform the EQR, it is sensitive to the concerns commenters raised about authority. While what constitutes authority is not easily defined, the Board believes that concerns about authority will most often arise when the reviewer is employed by the same firm as the engagement partner. Accordingly, the new standard explicitly requires a reviewer who is employed by the firm issuing the report to be a partner (or a person in an equivalent position). The Board recognizes that all partners in a firm do not possess the same authority, regardless of how that term is defined, but does not believe that imposing a requirement based on perceptions of authority among and between partners would be sufficiently clear to be workable. The Board therefore has attempted to address the authority issue through the proposed requirement that an in-house reviewer be a partner (or person in an equivalent position).<sup>18/</sup>

Reviewers outside the firm would not be required to be partners because they may come from a variety of backgrounds. For example, they may be retired partners, professors of auditing, or other qualified accountants. In such circumstances, the Board believes that the general competence requirement – that the reviewer be qualified to serve as the engagement partner on the same type of engagement – should be sufficient to provide for an effective EQR.

### Independence, Integrity, and Objectivity

The Board is also proposing revisions to the original proposal's provisions on objectivity in response to comments.<sup>19/</sup> A number of commenters were concerned that

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<sup>18/</sup> A manager, for example, is not in a position equivalent to a partner.

<sup>19/</sup> The new proposed standard, like the original proposal, requires the reviewer to perform the EQR with integrity and comply with all applicable independence requirements. Some commenters suggested that allowing a non-partner to serve as the reviewer would be inconsistent with SEC independence rules. Specifically, Rule 2-01(f)(7)(ii) of Regulation S-X defines "audit partner" to mean "a partner or persons in an equivalent position," and includes the "concurring or reviewing partner." The definition of "audit partner" is significant because "audit partners" (including "concurring partners")

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the original proposal could discourage communications between the reviewer and the engagement team, which, they said, would have a negative effect on audit quality.<sup>20/</sup> Commenters believed that allowing the engagement team to consult with the reviewer would not impair the reviewer's objectivity and stated that such consultations are an important element of audit quality.

The original proposal described how a reviewer can maintain the necessary objectivity to perform an EQR – specifically, by not making decisions on behalf of, assuming any responsibilities of, or supervising the engagement team. A note to the original proposal stated that the engagement team may consult with the reviewer but that the reviewer should not participate in such consultations in a manner that would compromise his or her objectivity. Commenters believed that the language about objectivity in the note discouraged consultations.

In response to commenters' concerns, the Board has not included the note in the new proposal. The new proposal – like the original proposal – does not prohibit the engagement team from consulting with the reviewer. The Board agrees that such consultations may contribute to audit quality. Accordingly, reviewers may participate in such consultations, provided they do so in a manner that complies with the objectivity

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are subject to certain independence requirements, such as mandatory partner rotation, 17 C.F.R. § 210.2-01(c)(6), and are members of the "audit engagement team," which is subject to other independence requirements. These definitions apply independence requirements to the person serving as the engagement quality reviewer, but they do not prohibit non-partners from performing that function. As described above, the Act gives the Board authority to determine who is qualified to perform the review. See *infra*, note 16. Moreover, under certain circumstances, a professor or other non-partner may perform the EQR even under the existing requirement. Accordingly, the Board will continue to consider anyone who performs the EQR to be an "audit partner" and a member of the "audit engagement team" for purposes of independence requirements.

<sup>20/</sup> In particular, commenters expressed concern about the requirement in paragraph 5 that the reviewer "must . . . maintain objectivity with respect to . . . the engagement team;" the statement in the Note to paragraph 5 that "[p]ersonnel assisting the engagement quality reviewer also must be independent . . . and maintain objectivity with respect to the engagement and the engagement team;" and the statement in the Note to paragraph 6 that the reviewer "should not participate [in consultations with the engagement team] in a manner that would compromise his or her objectivity with regard to the engagement."

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requirements in paragraph 7 of the new proposal, which, with one clarification described below, are the same as those originally proposed. Because these requirements sufficiently describe how the reviewer may maintain objectivity, the note that appeared in the original proposal is unnecessary.

Also in response to comments, the Board has clarified paragraph 5 of the original proposal along with the accompanying note. That paragraph required the reviewer (as well as any assistants to the reviewer), among other things, to "maintain objectivity with respect to the engagement and the engagement team," which some commenters believed discouraged the reviewer from communicating with the engagement team. That was not the Board's intent, and, in fact, the reviewer must communicate with the engagement team in order to satisfy the requirements of the standard – as originally proposed and as re-proposed.

In order to better reflect the intent of the paragraph, the new proposal replaces the words "maintain objectivity with respect to the engagement and the engagement team," with "maintain objectivity in performing the review." In addition, the Board has also replaced the statement in the note that the "reviewer may seek assistance from others to perform the engagement quality review" with a statement that the "reviewer may use assistants in performing the engagement quality review." Some commenters understood the note to refer to members of the engagement team, which was not the Board's intent. The change should clarify that the note refers to the reviewer's assistants, who must also perform the review with objectivity.

As noted above, the original proposal provided that in order to maintain objectivity, the reviewer should not, among other things, supervise the engagement team. Some commenters interpreted this restriction to preclude partners with leadership responsibilities in a firm, region, service, or industry practice from reviewing any engagement performed by their subordinates in the firm, which, they argued, could unnecessarily strain resources. This was not the Board's intention. Accordingly, the Board has clarified the proposed standard by adding the words "with respect to the engagement subject to the engagement quality review" to the end of the prohibition (in paragraph 7 of the new proposal) on "supervis[ing] the engagement team." With this change, the new proposal better reflects the Board's intent.

Finally, some commenters suggested that the Board prohibit the engagement partner from serving as the reviewer of the same client's engagement for at least two years following his or her last year as the engagement partner, if he or she served as the engagement partner for less than five years – the maximum term allowed under the

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SEC's independence rules.<sup>21/</sup> The Board agrees that the engagement partner should be prohibited from serving as the reviewer for at least two years following his or her last year as the audit engagement partner. As noted previously, in an EQR a reviewer is expected to take a fresh, objective look at the engagement. The Board believes that it would be harder 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, the new proposal contains the restriction suggested by the commenters.

### Questions:

4. Is it appropriate to explicitly require a reviewer from within the firm to be a partner or an individual in an equivalent position?
5. Should the standard allow qualified accountants who are not employed by an accounting firm to conduct the review?
6. Should the standard prohibit the engagement partner from serving as the reviewer for a period of time following his or her last year as the engagement partner? If so, is two years sufficient, or should it be extended?

## D. EQR Process

In describing the scope of the review required under the original proposal, the Board attempted to balance the need for a rigorous review with the need to avoid requiring unnecessary or duplicative procedures. A scope that is too broad risks turning the EQR into a second audit and could impose unnecessary costs without achieving the purpose of an objective second look at work that was already performed. 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.

Accordingly, the original proposal focused the EQR on those areas in the engagement that are likely to contain the greatest risk. It required an evaluation of the

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<sup>21/</sup> SEC independence rules do not prohibit the same person from serving as the engagement partner and engagement quality reviewer within one five-year term. See Rule 2-01(c)(6) of Regulation S-X, 17 C.F.R. § 210.2-01(c)(6). After serving a full five-year term, however, an engagement partner or engagement quality reviewer is subject to a five year "cooling off" period. Id.

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significant judgments made and conclusions reached by the engagement team, and specified certain procedures – some of which are similar to those described in the interim requirement and the standards of the International Auditing and Assurance Standards Board<sup>22/</sup> – that the reviewer should always perform. The original proposal then required the reviewer to perform additional procedures in the areas within the engagement that pose a higher risk that the engagement team failed to obtain sufficient competent evidence or to reach an appropriate conclusion.

A significant number of commenters believed that the scope of the required EQR was so broad that it could amount to a re-audit. Commenters also expressed concern about the breadth of the requirement in paragraph 9 of the original proposal to perform additional procedures in areas of higher risk, and of the documentation review requirement in paragraph 10. The Board has considered these comments and is proposing changes.

### Specifically Required Procedures

The original proposal described certain required procedures designed to focus the reviewer on the areas of the engagement that generally pose the greatest audit risk. These procedures required the reviewer to obtain an understanding about the firm's recent experience with the client as well as the client itself and to evaluate, among other things, the engagement team's audit planning, judgments about materiality, and identification of risks. The original proposal also required the reviewer to read certain relevant documents, such as the engagement report and the financial statements, and determine whether appropriate communications and consultations had taken place.

Commenters' concern was focused, for the most part, on the requirements to "[o]btain 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," and "[o]btain an understanding of the company's business, significant activities during the current year, and significant financial reporting issues and risks."<sup>23/</sup> Some commenters suggested that these provisions would require the

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<sup>22/</sup> ISA 220 (Redrafted), Quality Control for an Audit of Financial Statements, and ISQC 1 (Redrafted), Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements, issued in December 2008.

<sup>23/</sup> Paragraphs 8.a and 8.b of the original proposal.



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reviewer to participate extensively in meetings with client management, make his or her own inquiries of client personnel, and perform other procedures that would duplicate work already performed by the engagement team. This was not the intent of the original proposal, and, to avoid confusion, the Board has made several changes that should clarify the scope of the requirements in the repropoed standard.

Like the original proposal, the new proposal requires the reviewer to evaluate the significant judgments made by the engagement team and the conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report and prescribes certain specific procedures. The new proposal makes clear (for both an EQR of an audit and an EQR of an interim review) that the reviewer should perform these procedures through discussions with the engagement team and the review of documents. This should clarify that the reviewer performs the EQR by reviewing the engagement team's work, rather than by auditing the company himself or herself.

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.

The Board has also revised the requirements in the original proposal to "[o]btain 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," and "[o]btain an understanding of the company's business, significant activities during the current year, and significant financial reporting issues and risks." In the new proposal, these requirements are elements of the requirement to evaluate engagement planning. In addition, they have been rephrased to direct the reviewer to evaluate the engagement team's consideration of these matters. These changes should clarify that the EQR is based on discussions with the engagement team and review of documents, rather than performance of procedures that should be performed by the engagement team.

As noted earlier in this release, the new proposal, in response to comments, describes specific requirements for an EQR of an interim review. These requirements are based on the proposed requirements for an EQR of an audit and are tailored to the different procedures performed in an interim review. Specifically, the evaluation of

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procedures performed by the engagement team, and information that the engagement quality reviewer is required to read has been modified to reflect the difference in scope between an audit and an interim review. For example, when performing an EQR of an interim review, the reviewer is not required to perform an evaluation of the engagement team's risk assessments and audit responses.

Additionally, when performing an EQR of an interim review – compared to an EQR of an audit – the reviewer is required, among other things, to –

- Read the "interim financial information for all periods presented and for the immediately preceding interim period," instead of the "financial statements;" and
- Read "management's disclosure for the period under review, if any, about changes in internal control over financial reporting," instead of "management's report on internal control."

### Additional Procedures

After performing the specifically required procedures, the reviewer was required under the original proposal to "assess whether there are areas within the engagement that pose a higher risk that the engagement team has failed to obtain sufficient competent evidence or reached an inappropriate conclusion." For any such areas, the reviewer was required to evaluate whether the engagement team performed procedures that were responsive to the assessed risks, the judgments made by the engagement team were reasonable in the circumstances, and the results of the procedures support the engagement team's conclusion.

Some commenters were concerned that this provision was vague and duplicative of other provisions of the original proposal. Other commenters believed that the proposed additional procedures did not take into account materiality, and that performance of these procedures could divert the reviewer's attention from important matters such as the significant risks of material misstatement or material weakness in internal control over financial reporting.

The Board has reconsidered this provision in light of comments and determined not to include it in the new proposal. While the Board does not agree that this provision would focus reviewers on immaterial matters, it does believe, upon reconsideration, that the specifically required procedures are sufficient to focus the reviewer on the areas of high risk. In an EQR of an audit, the reviewer is required to evaluate the engagement

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team's risk assessments and procedures performed in response to significant risks,<sup>24/</sup> including fraud risks. The new proposal highlights this requirement by stating it in a separate sub-paragraph. The reviewer is also required to review the engagement completion document and confirm with the engagement partner that there are no significant unresolved matters. A reviewer that performs the specifically required procedures in the new proposal with due professional care would necessarily focus his or her attention on the areas of greatest risk within the engagement.

### Documentation Review Requirements

Finally, the Board believes that a reviewer will acquire a great deal of the information necessary for an effective EQR through a review of the engagement team's documentation of its work. Accordingly, the original proposal required the reviewer to evaluate whether the documentation of the matters subject to the EQR supported the conclusions reached, indicated that the engagement team responded appropriately to matters that present a significant risk, and met the documentation requirements of PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3"). The requirement to review engagement documentation, under the original proposal, was intended to apply only to those areas that were subject to the EQR procedures. The scope of the documentation review requirement was, therefore, defined by the procedures required to be performed.

Some commenters believed that the documentation review requirements in paragraph 10 of the original proposal required a review of all or much of the engagement documentation. Some of these commenters believed that the phrase "matters that were subject to the engagement quality review" described all of the areas of an audit engagement because the entire engagement is subject to the EQR. Other commenters believed that the review of all or much of the engagement documentation would be necessary to determine whether the documentation supports "conclusions and representations in the engagement report." The commenters recommended that requirements to evaluate documentation be limited to the documentation that the

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<sup>24/</sup> The term "significant risk" is defined in the Board's recently proposed auditing standard on identifying and assessing risks of material misstatement to mean a "risk of material misstatement that is important enough to require special audit consideration." PCAOB Release No. 2008-006, Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Conforming Amendments to PCAOB Standards (October 21, 2008). The Board intends that definition to apply to the EQR standard as well.

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engagement quality reviewer has selected for review in connection with the procedures required by the standard.

Additionally, several commenters believed that the requirement to evaluate the documentation for consistency with AS No. 3 goes beyond what should be required of the reviewer. These commenters suggested that the engagement partner has primary responsibility for compliance with AS No. 3, and that requiring the engagement quality reviewer to re-perform this work would not meaningfully enhance audit quality.

In response to the comments received, the Board has revised the documentation review requirements to clarify the extent of documentation that the engagement quality reviewer should review. In the new proposal, the Board replaced 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" required by paragraph 10, in an EQR of an audit, or 15, in an EQR of an interim review.<sup>25/</sup> In addition, the new proposal requires 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," as was required by the original proposal. Finally, the new proposal no longer requires the reviewer to evaluate the documentation for consistency with AS No. 3.

### Questions:

7. Are the descriptions of the scope and extent of EQR procedures contained in the repropoed standard appropriate? Will the performance of these procedures result in a high-quality EQR? If not, how should these procedures be revised?
8. Are the specifically required procedures appropriately tailored to reflect the difference in scope between an audit and an interim review?
9. Do the specifically required procedures sufficiently focus the reviewer on areas of highest risk? Are there other procedures that should be required?

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<sup>25/</sup> Also to improve clarity, the new proposal requires the reviewer to evaluate whether the documentation of the matters reviewed indicates that the engagement team responded appropriately to "significant risks," rather than to "matters that present a significant risk."

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### E. Concurring Approval of Issuance

The purpose of the required procedures in an EQR is to provide the reviewer with a sufficient basis to make a meaningful decision about whether to concur in the issuance of the audit report.<sup>26/</sup> That decision must be based upon knowledge about the engagement obtained through performance of the standard's requirements, but concurring approval of issuance is not a second opinion, and the reviewer does not need to perform a second audit in order to provide it. The original proposal attempted to articulate this distinction in the standard that must be met in order for the reviewer to provide concurring approval of issuance. Specifically, the original proposal provided that the reviewer must not provide concurring approval of issuance if he or she knows, or should know based upon the requirements of the standard, 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.<sup>27/</sup>

A substantial number of commenters objected to this proposed provision and were most concerned about the standard's use of the phrase "knows, or should know based upon the requirements of this standard." Some objected to the inclusion of what they called "legal language" in the Board's standard and claimed that the proposed provision would change the nature of the reviewer's conclusion from "negative assurance" to "positive assurance." Others were concerned that the provision would be unworkable because, as stated by one commenter, it is inherently impossible to make a self-assessment of what one "should have known." Similarly, some commenters believed that the proposed provision would, in effect, require the reviewer to serve as a second engagement partner. Finally, some commenters suggested that the "should know" part of the formulation would create a potential for *post hoc* questioning with the benefit of hindsight – or "second guessing" – about whether a reviewer should have identified a condition that would have precluded him or her from providing concurring approval of issuance.

Commenters who opposed the proposed provision generally did not object to the list of the conditions that would preclude the reviewer from providing concurring

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<sup>26/</sup> The Act requires the Board's standard to provide for concurring approval of issuance of each audit report. See Section 103(a)(2)(A)(ii) of the Act.

<sup>27/</sup> Paragraph 12 of the original proposal.

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approval of issuance. These commenters recommended requiring the reviewer's conclusion to be based on what he or she actually knows about the engagement, having performed the review in accordance with the provisions of the standard, rather than on what he or she should know. One such commenter recommended the Board rely on the concepts of due professional care, professional judgment, and lack of recklessness, which, the commenter said, are already included in the professional literature in describing the reviewer's responsibilities.

A small number of commenters approved of the original proposal's provision on concurring approval of issuance. One such commenter noted that it "requires the reviewer to make inquiries into the audit" and stated that "[t]his modest duty of inquiry is critical to making the engagement quality review something more than a 'hear no evil, speak no evil' exercise." Other supporters of the proposed provision suggested that it would further legitimize the EQR process.

The Board continues to believe that the existing standard's description of the requirements for providing concurring approval of issuance is inadequate and that a new provision is necessary. The Board also believes that a new EQR standard should explicitly include a standard of care, particularly in light of some of the comments it received on the original proposal. The Board recognizes that the original proposal suggested to some commenters that the Board would evaluate decisions to provide concurring approval of issuance with the benefit of hindsight. Moreover, the Board understands that such concerns may be particularly acute in the context of an EQR, which involves reviewing someone else's work and then concurring in the firm's opinion.

Accordingly, the Board has determined to revise the formulation of the standard for concurring approval in its repropoed standard. The revised provision would rely on the existing concept of due professional care, rather than the original proposal's "knows, or should know based upon the requirements of this standard" formulation. Specifically, for an EQR of an audit, the new proposal provides that the 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." A note to the same paragraph describes a "significant engagement deficiency" as any of the same four conditions included in the original proposal's provision on concurring approval of issuance.<sup>28/</sup> The new proposal's requirements for

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<sup>28/</sup> As included in the new proposal, these conditions are: (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB; (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement; (3) the engagement report is not appropriate in

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providing concurring approval of issuance in an EQR of an interim review are the same, except that the Board has modified the first of these four conditions in light of the differences between an interim review and an audit. Specifically, in an EQR of an interim review, the first condition is "the engagement team failed to perform interim review procedures necessary in the circumstances of the engagement" rather than "the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB."

Auditors have an existing duty to perform their work with "due professional care."<sup>29/</sup> The auditing standards describe "due professional care" as "reasonable care and diligence" and note that negligent performance of audit procedures violates the due professional care requirement.<sup>30/</sup> The SEC has recognized that, like all other audit procedures, the engagement quality review must be performed with "due professional care"<sup>31/</sup> – a position that has been upheld by a federal court of appeals.<sup>32/</sup>

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the circumstances; or (4) the firm is not independent of its client. In order to be consistent with the Board's proposed standards on risk assessment, the new proposal refers to "sufficient appropriate" rather than "sufficient competent" evidence.

<sup>29/</sup> AU sec. 230, *Due Professional Care in the Performance of Work*.

<sup>30/</sup> See AU sec. 230.05; AU sec. 230.03, quoting Cooley on Torts (4th ed. 1932) ("he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment").

<sup>31/</sup> See, e.g., In the Matter of Robert D. Potts, 53 SEC 187, 195-97 (September 24, 1997).

<sup>32/</sup> See Potts v. SEC, 151 F.3d 810, 813 (8<sup>th</sup> Cir. 1998), cert. denied, 526 U.S. 1097 (1999) ("Having taken on the concurring review task, Potts also shouldered the duty to perform that task professionally . . . . Accordingly, we reject the view put forward by the AICPA that a concurring partner is not an auditor and thus not subject to GAAS."). The AICPA SECPS revised its concurring partner review standard after the Potts case. The revisions did not alter the requirement to perform the review with due professional care.

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While auditors should be more familiar with "due professional care" than the concurring approval standard in the original proposal, 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. To perform an EQR with due professional care, a reviewer must undertake the required procedures with "reasonable care and diligence."<sup>33/</sup> A reviewer therefore would be expected to know the things that a reasonably careful and diligent EQR would uncover. Accordingly, under the revised standard, like the one originally proposed, a reviewer cannot evade responsibility because, as a result of an inadequate review, he or she did not discover a problem that a reasonably careful and diligent review would have revealed. At the same time, eliminating the phrase "should know" from the repropoed standard should alleviate commenters' concerns that the Board would evaluate decisions to provide concurring approval of issuance with the benefit of hindsight.

### Question:

10. Is the standard for the engagement quality reviewer's concurring approval of issuance appropriately described in the repropoed standard? Is the first condition appropriately tailored to reflect the difference in scope between an audit and an interim review?

## **F. Documentation of the EQR**

In the release accompanying the original proposal, the Board noted that the information received from PCAOB inspection teams, findings from PCAOB enforcement cases, and recent academic research indicated deficiencies in the documentation of concurring partner reviews prepared in accordance with the Board's interim requirements. In some cases, these deficiencies prevented a determination by PCAOB inspectors as to whether the scope of the review was appropriate, and may have contributed to the firm's failure to properly address the concurring partner's findings. The academic research showed substantial variability and lack of detail in the documentation of concurring partner reviews.

In order to address these problems, the original proposal contained more specific requirements related to the documentation of the EQR than the Board's interim

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<sup>33/</sup> See AU sec. 230.05.



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standard.<sup>34/</sup> The original proposal provided that the engagement documentation should indicate: who performed the review; the areas of the engagement subject to the review; the procedures performed by the reviewer; when the review procedures were performed; the results of the review procedures; and whether the engagement quality reviewer provided concurring approval of issuance. Additionally, the requirements in AS No. 3 related to retention of and subsequent changes to audit documentation would also apply to the documentation of the EQR.<sup>35/</sup>

A number of commenters viewed the requirements of the original proposal as unnecessarily burdensome. Some of the commenters suggested that the original proposal would require the reviewer to document information concerning all areas of the engagement since all areas of the engagement could be subject to the EQR. Other commenters were concerned that detailed documentation of the EQR procedures and their results, which would be duplicative of the engagement team's efforts, would be required under the original proposal. Most commenters recommended that the Board clarify the proposed requirements in order to avoid excessive documentation related to the EQR.

After considering these comments, the Board continues to believe that the documentation requirements in the new standard should be more specific than those in the Board's interim standard. As discussed above, poor documentation has not only made it difficult for the Board's inspectors to evaluate whether an EQR was appropriately performed, it may have also contributed to the firm's failure to properly address the reviewer's findings. The Board has, however, attempted to clarify the proposed requirements to avoid duplication of effort. Specifically, in the new proposal the Board has replaced the broad requirements to document "the areas of the

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<sup>34/</sup> Under the interim standard, "[t]he engagement files should contain evidence that the firm's policies and procedures with respect to the concurring partner review requirement were complied with before the issuance of the firm's audit report. Ordinarily, this would include documentation that the concurring partner reviewer has performed the procedures specified by the firm's policies and that no matters that have come to the attention of the concurring partner reviewer would cause him or her to believe that the financial statements are not in conformity with generally accepted accounting principles in all material respects or that the firm's audit was not performed in accordance with generally accepted auditing standards."

<sup>35/</sup> Commenters did not object to applying these requirements of AS No. 3 to the documentation of the EQR.

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engagement subject to" the review, the procedures performed by the reviewer, and the results of those procedures with more narrowly tailored requirements, the scope of which should be clearer.

Under the new proposal, the documentation should "contain sufficient information to identify" who performed the review, the documents reviewed and significant discussions held during the review,<sup>36/</sup> and the date that the reviewer provided concurring approval of issuance. If the reviewer did not provide concurring approval of issuance, the new proposal would require documentation of the reviewer's reasons for not providing concurring approval of issuance. These requirements should not be unduly burdensome or distract the reviewer from his or her task to identify any significant engagement deficiencies so that they may be corrected. At the same time, they should be sufficient to allow both the Board and the firm itself to understand how the review was conducted and how significant issues were resolved.

### Question:

11. Are the documentation requirements in the repropoed standard appropriate? If not, how should they be changed?

## **G. Timing of the EQR**

The Board noted in the release accompanying the original proposal that the EQR could be more effective if performed shortly after the engagement team's resolution of significant issues. Accordingly, the original proposal required the reviewer to complete the EQR prior to providing concurring approval of issuance but stated, in a note, that the EQR procedures may be performed at various points throughout the engagement.<sup>37/</sup> Most of those who commented on this issue believed the description of the timing of the review in the original proposal was appropriate. In particular, several commenters were in favor of allowing the reviewer to perform the review at various points throughout the engagement.

The Board continues to believe that, as long as the review is completed before concurring approval of issuance is provided, the reviewer and the engagement team

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<sup>36/</sup> Significant discussions are those that the reviewer will rely upon to demonstrate compliance with the standard.

<sup>37/</sup> Paragraph 11 of the original proposal.

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should determine the appropriate timing for the review procedures. In the new proposal, the requirement to complete the review before providing concurring approval of issuance is explicitly included in the paragraphs on concurring approval, rather than in a separate provision on timing of the review.<sup>38/</sup> Accordingly, the new proposal does not include a statement explicitly allowing the reviewer to perform procedures at various points during the engagement. Such a statement is not necessary because the new proposal – like the original one – does not impose any requirements on when the review take place, other than that it be completed before the reviewer provides concurring approval of issuance.<sup>39/</sup>

### H. Effective Date

The Board originally proposed to make the standard effective, subject to approval by the SEC, for engagement reports issued (or the communication of an engagement conclusion, if no report is issued) on or after December 15, 2008. Commenters expressed concern that this effective date would not allow sufficient time for registered firms to implement the new requirements. Many commenters noted that an engagement quality reviewer is typically selected early in the engagement process so that he or she can review the engagement planning activities and interim reviews, and that audits of some issuers with fiscal years ending December 31, 2008 had already advanced beyond the planning stage. The EQRs on these engagements, the commenters suggested, are already being performed under the Board's interim standard. A number of commenters suggested that the effective date of the new standard be linked to the beginning of an engagement period, rather than to the report issuance date, so that firm personnel could familiarize themselves with the new requirements before beginning work on engagements subject to the new standard.

While the Board is sympathetic to concerns that implementing the new EQR requirements in the middle of an engagement could be disruptive, it also believes that it is important to strengthen the existing requirements as soon as practicable. The Board recognizes that implementing the new standard on EQRs of interim reviews in 2009 may not be possible because some of the interim reviews will be performed earlier in the year, and registered firms would not have sufficient time for implementation of the

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<sup>38/</sup> Paragraphs 12 and 17 of the new proposal.

<sup>39/</sup> Like the original proposal, the new proposal prohibits the firm from granting the client permission to use the engagement report (or communicating an engagement conclusion if no report is issued) until the reviewer provides concurring approval of issuance.

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new requirements. Therefore, for EQRs of interim reviews, the Board intends to make a final standard effective, subject to approval by the SEC, for fiscal years beginning after December 15, 2009. For EQRs of audits, however, the Board intends to make a final standard effective, subject to SEC approval, for audits of fiscal years ending on or after December 15, 2009.

**III. Opportunity for Public Comment**

The Board will seek comment for a 45-day period. Interested persons are encouraged to submit their views to the Board. Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board's Web site at [www.pcaobus.org](http://www.pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 025 in the subject or reference line and should be received by the Board no later than 5:00 PM (EST) on April 20, 2009.

The Board will consider all comments received. Following the close of the comment period, the Board will determine whether to adopt final rules, with or without amendments. Any final rules adopted will be submitted to the SEC for approval. Pursuant to Section 107 of the Act, proposed rules of the Board do not take effect unless approved by the Commission. Standards are rules of the Board under the Act.

On the 4th day of March, in the year 2009, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour  
Secretary

March 4, 2009

**RELEASE**

**Auditing Standard No. X**

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

***Engagement Quality Review***

**Applicability of Standard**

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

**Objective**

2. The objective of the engagement quality reviewer is to perform an evaluation of 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.<sup>1/</sup>

**Qualifications of an Engagement Quality Reviewer**

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

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

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

Note: The firm's quality control policies and procedures should include provisions to provide the firm with reasonable assurance that the engagement quality reviewer has sufficient competence, independence, integrity, and objectivity to perform the engagement quality review in accordance with the standards of the PCAOB.

5. *Competence.* The engagement quality reviewer must possess the level of knowledge and competence related to accounting, auditing, and financial reporting required to serve as the person who has overall responsibility for the same type of engagement.<sup>2/</sup>

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

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

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

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

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

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**Engagement Quality Review for an Audit**

9. *Engagement Quality Review Process.* In an audit engagement, the engagement quality reviewer should evaluate the significant judgments made by the engagement team and the conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report. To identify and evaluate the significant judgments and conclusions, the engagement quality reviewer should perform the procedures described in paragraph 10 by holding discussions with the person with overall responsibility for the engagement, by holding discussions with other members of the engagement team as necessary, and by reviewing documentation.

10. In an audit, the engagement quality reviewer should:

- a. Evaluate engagement planning, including –
  - The consideration of the firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process,
  - The consideration of the company's business, recent significant activities, and related financial reporting issues and risks, and
  - The judgments made about materiality and the effect of those judgments on the engagement strategy.
- b. Evaluate the risk assessments and audit responses, including the identification of significant risks, including fraud risks, and the engagement procedures performed in response to significant risks.
- c. Review the engagement team's evaluation of the firm's independence in relation to the engagement.
- d. Evaluate judgments made about (1) the materiality and disposition of corrected and uncorrected identified misstatements and (2) the severity and disposition of identified control deficiencies.
- e. Determine if appropriate matters have been communicated, or identified for communication to the audit committee, management, and other parties, such as regulatory bodies.

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- f. Determine if appropriate consultations have taken place on difficult or contentious matters. Review the documentation, including conclusions, of such consultations.
  - g. Read the financial statements, management's report on internal control, and the related engagement report.
  - h. Read other information in documents containing the financial statements to be filed with the Securities and Exchange Commission ("SEC")<sup>3/</sup> and evaluate whether the engagement team has taken appropriate action with respect to any material inconsistencies with the financial statements or material misstatements of fact of which the engagement quality reviewer is aware.
  - i. Review the engagement completion document<sup>4/</sup> and confirm with the person who has overall responsibility for the engagement that there are no significant unresolved matters.
11. *Evaluate Engagement Documentation.* In an audit, the engagement quality reviewer should evaluate whether the engagement documentation that he or she reviewed when performing the procedures required by paragraph 10 –
- a. Indicates that the engagement team responded appropriately to significant risks, and
  - b. Supports the conclusions reached by the engagement team with respect to the matters reviewed.
12. *Concurring Approval of Issuance.* In an audit, the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due

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<sup>3/</sup> See paragraphs .04-.06 of AU sec. 550, *Other Information in Documents Containing Audited Financial Statements*; AU sec. 711, *Filings Under Federal Securities Statutes*.

<sup>4/</sup> PCAOB Auditing Standard No. 3, *Audit Documentation*, requires the auditor to identify all significant findings or issues in an engagement completion document.



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professional care<sup>5/</sup> the review required by this standard, he or she is not aware of a significant engagement deficiency.

Note: A *significant engagement deficiency* in an audit exists when (1) the engagement team failed to obtain sufficient appropriate evidence in accordance with the standards of the PCAOB, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client.

13. In an audit, the firm may grant permission to the client to use the engagement report only after the engagement quality reviewer provides concurring approval of issuance.<sup>6/</sup>

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

14. *Engagement Quality Review Process.* In an engagement to review interim financial information, the engagement quality reviewer should evaluate 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. To identify and evaluate the significant judgments and conclusions, the engagement quality reviewer should perform the procedures described in paragraph 15 by holding discussions with the person with overall responsibility for the engagement, by holding discussions with other members of the engagement team as necessary, and by reviewing documentation.

15. In a review of interim financial information, the engagement quality reviewer should:

- a. Evaluate engagement planning, including the consideration of –

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

<sup>6/</sup> Concurring approval of issuance by the engagement quality reviewer also is required when reissuance of an engagement report requires the auditor to update his or her procedures for subsequent events. In that case, the engagement quality reviewer should update the engagement quality review by addressing those matters related to the subsequent events procedures.

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- The firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process,
  - The company's business, recent significant activities, and related financial reporting issues and risks, and
  - The nature of identified risks of material misstatement due to fraud.
- b. Perform the procedures described in paragraphs 10.c through 10.f.
  - c. Read the interim financial information for all periods presented and for the immediately preceding interim period, management's disclosure for the period under review, if any, about changes in internal control over financial reporting, and the related engagement report, if a report is to be filed with the SEC.
  - d. Read other information in documents containing interim financial information to be filed with the SEC<sup>7/</sup> and evaluate whether the engagement team has taken appropriate action with respect to material inconsistencies with the interim financial information or material misstatements of fact of which the engagement quality reviewer is aware.
  - e. Review the engagement completion document and confirm with the person who has overall responsibility for the engagement that there are no significant unresolved matters.

16. *Evaluate Engagement Documentation.* In a review of interim financial information, the engagement quality reviewer should evaluate whether the engagement documentation that he or she reviewed when performing the procedures required by paragraph 15 –

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

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<sup>7/</sup> See paragraph .18f of AU sec. 722, *Interim Financial Information*; AU sec. 711, *Filings Under Federal Securities Statutes*.

## RELEASE

17. *Concurring Approval of Issuance.* In a review of interim financial information, the engagement quality reviewer may provide concurring approval of issuance only if, after performing with due professional care the review required by this standard, he or she is not aware of a significant engagement deficiency.

Note: A *significant engagement deficiency* in a review of interim financial information exists when (1) the engagement team failed to perform interim review procedures necessary in the circumstances of the engagement, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client.

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

### Documentation of an Engagement Quality Review

19. Documentation of an engagement quality review should be included in the engagement documentation and should contain sufficient information to identify:

- a. The engagement quality reviewer and others who assisted the reviewer,
- b. The documents reviewed by the engagement quality reviewer and others who assisted the reviewer,
- c. The significant discussions held by the engagement quality reviewer and others who assisted the reviewer, including the date of each discussion, the specific matters discussed, the substance of the discussion, and the participants, and
- d. The date the engagement quality reviewer provided concurring approval of issuance or, if no concurring approval of issuance was provided, the reasons for not providing the approval.

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