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The Latest From the PCAOB

by Mark Crowley and Jennifer Haskell, Deloitte & Touche LLP

The Public Company Accounting Oversight Board (PCAOB) has been busy over the past few months. The following are some of the Board's more significant recent activities:

- [Proposal of a new auditing standard \(PCAOB Proposed Auditing Standard, *Engagement Quality Review — and Conforming Amendment to the Board's Interim Quality Control Standards*\)](#) related to engagement quality review that would supersede the PCAOB's [interim concurring partner review requirements](#).
- [Amendment of the existing tax services rule for auditing firms \(PCAOB Rule No. 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*\)](#).
- [Adoption of a new ethics and independence rule \(PCAOB Rule No. 3526, *Communication With Audit Committees Concerning Independence*\)](#).

The PCAOB is seeking comments on the proposed auditing standard, which, as currently drafted, would be effective for audit reports issued on or after December 15, 2008. The amended tax rule will be effective upon approval by the Securities and Exchange Commission (SEC). The new ethics and independence rule will become effective on the later of September 30, 2008, or 30 days after SEC approval.

Read on for additional details about each of these items.

Proposed Auditing Standard

The PCAOB's proposed auditing standard on engagement quality review would supersede the current interim concurring partner review requirements. The proposed standard contains several new requirements for engagement quality reviews focusing on the following:

- Applicability.
- Qualifications of an engagement quality reviewer (EQR).
- Engagement quality review process.
- Concurring approval of issuance.
- Documentation of an engagement quality review.

The proposed standard covers all engagements performed under PCAOB standards, including integrated audits of financial statements, audits of financial statements only, and reviews of interim financial information. It also applies to other audit and attestation engagements performed under PCAOB standards.

One of the more significant changes in the proposed standard is the EQR's conclusion and the extent of work necessary to reach such a conclusion. As currently drafted, the proposed standard requires the EQR **not** to provide concurring approval of issuance if the EQR **knows or should know**, on the basis of the requirements of the proposed standard, one or more

The proposed standard requires the EQR to perform more in-depth procedures, perform additional detailed reviews of audit documentation, and document the engagement quality review process more fully.

of the following (as listed in paragraph 12 of the proposed standard):

- The engagement team failed to obtain sufficient competent evidence in accordance with the standards of the PCAOB.
- The engagement team reached an inappropriate overall conclusion on the subject matter of the engagement.
- The firm's report, if a report is to be issued, is not appropriate in the circumstances.
- The firm is not independent of its client.

These requirements would significantly change the current conclusion reached by EQRs (i.e., no matters have come to the EQR's attention that would cause the EQR to believe that the financial statements are not in conformity with generally accepted accounting principles or that the audit was not conducted in accordance with PCAOB standards).

In general, the proposed standard requires the EQR to perform more in-depth procedures, perform additional detailed reviews of audit documentation, and document the engagement quality review process more fully. These additional procedures, as proposed, would require more effort from the EQR; the extent of such additional effort is still to be determined. As a result, the proposed standard is a focus of discussion among auditors, their clients, and regulators.

The proposed standard, as currently drafted, would be effective, subject to SEC approval, for reports issued on or after December 15, 2008.

Comments on the proposed standard are due by May 12, 2008. Written comments can be submitted to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803, or by e-mail at comments@pcaobus.org. Comment letters submitted will be available to the public on the PCAOB's Web site after May 12 for those interested in reading others' points of view on the proposed standards.

Amendment to Tax Services Rule

On April 22, 2008, the [PCAOB announced](#) the adoption of an amendment to Rule 3523, noting that the adoption reduces "the likelihood that a company's choice of auditor will be unnecessarily restricted." Under the amended rule, an accounting firm's independence will not be impaired if tax services for a person in a financial reporting oversight role,¹ or for any of his or her immediate family members, are terminated before the accounting firm is engaged to perform the audit under PCAOB standards or begins to provide services under that engagement.

The current rule requires a registered public accounting firm ("accounting firm" or "firm") to be independent of an audit client if it provided tax services to the client's personnel, or to any of their immediate family members, in a financial reporting oversight role during the audit **and** professional engagement periods. In this context, the audit period is the period covered by the financial statements being audited (i.e., the entity's fiscal year) and the professional engagement period is the period that begins when the firm signs the engagement letter to perform an audit under PCAOB standards or begins audit procedures under that engagement letter (whichever comes first). In evaluating this rule, the PCAOB concluded that providing tax services to a person in a financial reporting oversight role, or to any of his or her immediate family members, before the beginning of the professional engagement period for a new audit client or an audit client in an "initial public offering" would not necessarily impair the accounting firm's independence;

¹ PCAOB Rule 3501 defines financial reporting oversight role as "a role in which a person is in a position to or does exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position."

therefore, the PCAOB decided to remove “audit period” from the tax rule.

This rule will be effective immediately once approved by the SEC.

Adoption of New Ethics and Independence Rule

On April 22, 2008, the PCAOB also announced (in the same [press release](#) in which it announced the amendment to the tax service rule) the adoption of Rule 3526 to enhance accounting firms’ communications with audit committees regarding independence.

The new rule will require an accounting firm to communicate all relationships between the firm, the potential client (including any affiliates), and the potential client’s personnel (in a financial reporting oversight role) that may have an impact on the accounting firm’s independence. The communication should be made in writing to the audit committee and the effects of the reported items should be discussed with the audit committee of a potential new audit client **before** the firm can be appointed as the company’s auditor. Discussions between the audit committee and the accounting firm should be documented. This documentation should illustrate that the audit committee was well informed about the accounting firm’s independence before the firm was hired as the company’s auditor.

Once an accounting firm has been appointed as the company’s auditor, a similar communication is required annually to reconfirm that no independence-impairing relationships exist between the accounting firm and audit client.

This rule will supersede the PCAOB’s interim requirement, [Independence Standards Board Standard No. 1, *Independence Discussions With Audit Committees*](#), and will become effective, if approved by the SEC, on the later of September 30, 2008, or 30 days after SEC approval.

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