

November 6, 2009

Securities and Exchange Commission (the "Commission")
100 F Street, NE
Washington, DC 20549-1090

Via e-mail to rule-comments@sec.gov

Re: Release No. 34-60903; File No. PCAOB-2009-02

We are pleased to take this opportunity to offer our comments for consideration by the Commission with regard to its possible approval of Auditing Standard No. 7 ("AS 7"), *Engagement Quality Review*, adopted by the Public Company Accounting Oversight Board ("PCAOB" or the "Board") July 28, and filed with the Commission, August 4, 2009, along with a related conforming amendment, as proposed rules.

We previously participated in the Board's due process relative to AS 7 by commenting on its two successive proposals on this matter on April 28, 2008, and April 13, 2009. Despite our earlier requests for changes from the proposals, and those of certain others, we continue to be troubled by the Board's conclusions, as now reflected in AS 7, in three areas relative to engagement quality reviews ("EQRs") as follows:

- Qualifications of reviewers
- Documentation of EQRs
- EQRs applied to reviews of interim financial statements

As for the first two of these three areas, our concerns are not with AS 7, *per se*, but rather with the interpretive guidance that resides outside the standard in both the accompanying PCAOB Release 2009-004 and in Item II of the proposed rules ("Item II"). We understand that once approved by the Commission, although somewhat arcane, this interpretive material will have the same weight as the final PCAOB auditing standard and related Commission rules.

Qualifications of reviewers

Our main point: *The interpretive guidance accompanying AS 7 (Item II) should be revised to make it clear that equity ownership is not a required qualification for conducting an EQR.*

In our letters of comment to the Board of April 2008 and 2009, we expressed serious concern about the failure of the proposed standard to state clearly that equity ownership was not to be required for qualification of an engagement quality reviewer ("EQ reviewer"). It is our view (as Item II attributes to certain commenters) "that partners as well as non-partners may be subject to internal pressure within the firm to provide concurring approval of issuance."¹ We believe the relative equity ownership of any one partner in all but the smallest audit firms typically does not result in a level of authority sufficient to cause others to sacrifice their professional integrity and is not likely diminish in any significant way his or her ability to resolve differences objectively without yielding to pressure from the engagement partner or other firm personnel. (In fact, such an equity interest is often rather nominal in relation to the aggregate equity interests of others and significant only with regard the individual partner's income level.)

¹ Release No. 34-60903, page 19.

Although AS 7 continues in its present form to avoid making any clear statement with regard to equity ownership, it appears to permit qualification of a nonequity holding EQ reviewer based on “degree of authority and responsibility,” consistent with Rules 2-01(f)(7)(ii) and 2-01(f)(7)(ii)(B) of Regulation S-X. However, certain language in Item II muddies the issue as it appears to express a biased reluctance on the part of the Board to allow non-partners to conduct EQRs and, together with the long history of the predecessor requirement,² seems readily to permit or even encourage an unjustifiable bias, particularly likely among PCAOB inspectors, to interpret the term “equivalent position” as, in fact, requiring equity ownership.

Such muddying and potentially biasing (and perhaps unintended) restrictive language that appears in Item II consists of “*but a partner is more likely to possess sufficient authority to conduct the EQR than a non-partner*” and more vaguely, “*At a firm that is not organized as a partnership, an individual in an equivalent position is someone with the degree of authority and responsibility of a partner in a firm that is organized as a partnership.*”³ Inconsistent with AS 7, itself, and Rule 2-01(f)(7)(ii) of Reg. S-X, this latter statement inappropriately suggests that in a firm organized as a corporation, only a shareholder can hold a position equivalent to a partner and that no non-partner can do so in a partnership.

Accordingly, to assure a clear understanding of the fact that equity ownership is no longer to be a qualifying requirement for an EQ reviewer, we believe the muddying and potentially biasing and restrictive language in Item II (and the preceding paragraph) should be deleted. Instead, a clear statement should be included that (a) defines or describes the term, “equivalent position,” solely in terms of authority and responsibility specifically as to professional matters, and (b) expressly articulates that it is to be determined without regard to equity ownership.

Documentation of EQRs

Our main point: *The interpretive guidance (Item II) accompanying, and paragraph 19b of, AS 7 should be revised to reduce EQR documentation requirements to be consistent with the relative overall responsibilities of the engagement partner and the EQ reviewer and to eliminate unnecessary requirements that would not contribute any quality but serve to benefit only adversaries.*

With one exception relative to paragraph 19b discussed below, the requirements of paragraph 19 of AS 7 seem reasonable and appropriate. However, once again, Item II contains *de facto* requirements to which we previously objected in our two letters of comment to the Board of April 2008 and 2009 because we believe they would not add any discernable benefit in terms of engagement quality.

Our most serious objections are to the following two statements in Item II: “... *if a reviewer identified a significant engagement deficiency to be addressed by the engagement team, the engagement team should document its response to the identified deficiency in accordance with AS No. 3,*” and “... *the EQR documentation should contain ... the significant deficiency identified, how the reviewer communicated the deficiency to the engagement team, why such matter was important, and how the reviewer evaluated the engagement team's response.*”⁴

We believe the first of these two statements might easily be misread to imply (erroneously) that PCAOB Auditing Standard No. 3 (“AS 3”), *Audit Documentation*, requires documentation of deficiencies identified at any of various levels of engagement review and auditor responses thereto. The second cited

² SECPS §1000.39, Appendix E, incorporated by reference into §1000.08(f) and the PCAOB’s Interim Quality Control Standards Sec. QC 20.18.

³ Release No. 34-60903, page 19.

⁴ Release No. 34-60903, page 38.

statement indicates that similar documentation would be required for issues raised by the EQ reviewer unless already documented by engagement personnel. However, AS 3 contains no language that can be readily interpreted as a requirement to document issues raised by reviewers and their resolution (except for professional disagreements and issues raised after the file has been “locked down”). In fact, AS 3 contains no documentation requirement at all relative to the scope and results of any level(s) of engagement review; it merely requires that a reviewer (and not necessarily all reviewers) and the date of the review be identified on specific documents reviewed.⁵

We firmly believe that documentation of deficiencies encountered by reviewers at any level and their resolution would be of no positive value with regard to engagement quality and more significantly, would pose substantial unwarranted risks to practitioners by leaving a trail enabling litigants and other adversaries to impugn the competency of engagement personnel.

Paragraph 19b of AS 7 would require the EQ reviewer to identify all documents reviewed by the EQ reviewer or assistants in notable contrast to the absence of such a requirement for the engagement partner or other reviewers. In general, we believe that the presence of higher documentation standards applicable to EQ reviewers as compared to other reviewers on the engagement team will likely have the effect of enabling adversaries to view the EQ reviewer as primarily responsible for the quality of the audit rather than the engagement partner. This would be in direct conflict with the basic premise set forth in AS 7 that primary responsibility for the engagement remains with the engagement partner.⁶ In addition, we believe that a requirement to identify every document examined by the EQ reviewer, regardless of the extent of such examination, would be tantamount to requiring the EQ reviewer to take full responsibility for each document so identified and consequently feel obligated to spend more time on it than might otherwise be warranted. For example, to enable his or her association with a particular document, the EQ reviewer might feel a need to reperform such ministerial functions as checking cross-references and mathematical computations thus (a) adding substantial duplicative (and therefore, unnecessary) time and costs to the audit, and (b) considerably slowing down the public release of audited financial information. As a result, such a documentation requirement might likely serve as a disincentive for an EQ reviewer to inspect one or more documents that he or she otherwise might or should inspect, thus reducing the quality of the EQR.

EQRs applied to reviews of interim financial statements

Our main point: EQR requirements should not be extended to interim financial statement reviews because doing so would not significantly improve the reliability of unaudited financial information and would serve only to both raise user expectations unreasonably and add time and costs to the process, thus delaying the timely dissemination of quarterly financial information.

We have stated our objections to the requirement of AS 7 to subject reviews of interim financial statements to EQR in both of our letters of comment to the Board of April 2008 and 2009, and we continue to maintain the same concerns as follows:

- We do not believe the imposition of a mandatory, active EQR of any scope for a review conducted pursuant to PCAOB Interim Auditing Standard (“IAS”) AU Sec. 722 is warranted considering both the limited assurance provided or implied and the nature and extent of the procedures performed in support thereof.⁷ Accordingly, we believe that publicity likely to be directed to the investment

⁵ AS 3, paragraph 6b.

⁶ Paragraph 7.

⁷ This point considers the fact that IAS AU Sec. 722 requires only analytical procedures and inquiries for a review service and does not, in any circumstances, require one to obtain any supporting evidence for client

community of any new EQR requirement applicable to interim financial information will likely lead to widespread misunderstanding and an exaggerated, unwarranted sense of reliability ascribed to such unaudited information that is considerably more than is reasonable in relation to the limited scope of the underlying work currently prescribed under IAS AU Sec. 722.

- We further believe that adding another level of review to interim, unaudited financial information that would necessarily require significant time expenditure by a reviewer would also impair issuers' ability to cope with current constraints resulting from rapidly changing accounting and other financial reporting requirements in the face of increasing pressure both for transparency and for timely interim financial reporting (especially for accelerated filers) with no measurable improvement in the reliability of such reporting.
- Although the authority of the PCAOB to promulgate professional standards under Title I of Sarbanes-Oxley Act of 2002 (the Act)⁸ at its own discretion appears virtually unlimited, it is clear by its language that Congress intended Sec. 103(2)(A)(ii), that requires what is now described by the term, EQR, to apply solely to audits. Therefore, although consistent with the broad authority granted the Board under Title I of the Act, we firmly believe extending the EQR requirement to interim reviews, in addition to being inherently impractical and counterproductive and not meeting any reasonable cost/benefit test, is inconsistent with the apparent intent of the Act.

Accordingly, we continue to believe that the requirement for involvement of an EQ reviewer with regard to interim financial statement reviews should remain limited as it now is to a passive responsibility to participate in timely discussions initiated by engagement team members about matters identified in the review that are perceived to present a significant risk of material misstatement.⁹ We believe such a limitation on the requirement for interim EQ reviewer participation to be consistent with the limited scope of the review service, itself and with reasonable investor expectations based thereon and the time constraints inherent in interim reporting.

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Questions about our comments may be addressed to the undersigned at hlevy@pbt.com or by telephone at 702/384-1120.

Very truly yours,



Howard B. Levy, Sr. Principal and
Director, Technical Services

assertions, a condition not likely to be well-known by financial statement users because review reports are rarely included in filings made with the Commission.

⁸ Sec. 103(a)(1) and Sec. 103(a)(3)(a)(i).

⁹ SECPS §1000.39, Appendix E, item d, incorporated by reference into §1000.08(f) and the PCAOB's Interim Quality Control Standards Sec. QC 20.18.