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November 24, 2009

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number PCAOB-2009-02 (Engagement Quality Review)

Dear Ms. Murphy:

We appreciate the opportunity to provide comments on the Securities and Exchange Commission's (the Commission) Release No. 34-60903; File No. PCAOB-2009-02 (the Release), which includes the Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 7, *Engagement Quality Review* (the Standard or AS No. 7).

We agree with the PCAOB that an effective engagement quality review process is paramount to performing a quality audit or interim review. We generally agree that the Standard is consistent with the PCAOB's objective of promoting effective audits. However, we believe that certain aspects of the Release regarding documentation of an engagement quality review will not promote effective audits or interim reviews, or enhance audit quality. In addition, the PCAOB's further explanation regarding due professional care continues to cause concern regarding the engagement quality reviewer's obligation. Our observations with respect to these matters are described in more detail in the following paragraphs.

We appreciate your consideration of the following comments on the Release when finalizing the final Standard and Release as part of the Commission's rule-making process.

Documentation of an Engagement Quality Review

Paragraph 19 of the Standard requires that the documentation of the engagement quality review "should contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the engagement quality reviewer, and others who assisted the reviewer, to comply with the provisions of this standard" We agree that documentation of the engagement quality review is appropriate and is a necessary element to achieving audit quality.

However, page 38 of the Release provides an example illustrating the PCAOB's expectation regarding the documentation of both the engagement team and the engagement quality reviewer when the engagement quality reviewer identifies a significant engagement deficiency. Specifically, the Release indicates that "if a reviewer identified a significant engagement deficiency to be addressed by the engagement team, the



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engagement team should document its response to the identified deficiency in accordance with AS No. 3 [PCAOB Auditing Standard No. 3, *Audit Documentation*]. Because AS No. 7 does not require duplication of documentation prepared by the engagement team, the engagement quality reviewer does not have to separately document the engagement team's response. Rather, the EQR documentation should contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand, e.g., the significant [engagement] 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." As further discussed below, we believe this language may lead to several unintended consequences in the application of the Standard.

We agree with the PCAOB's statement in footnote 23 of the Release that "AS No. 7 does not prohibit the engagement team from consulting with the reviewer ..." and that "... such consultations may contribute to audit quality." Furthermore, we agree that the overall goal of the Standard should be to increase audit quality. However, we are concerned that the discussion on page 38 of the Release may result in an unintended breakdown of the coordination between the engagement quality reviewer and the engagement team, particularly on matters such as whether a matter could be a significant engagement deficiency, and if so, who identified it, the timing of such detection, the status of the audit procedures and any engagement team documentation relative to a potential significant engagement deficiency (e.g., draft or final documentation), and the nature of the resulting documentation.

Previously, an analogous pattern was noted by the PCAOB after the first year of Auditing Standard No. 2 implementation.¹ In the May 16, 2005 PCAOB Policy Statement (Release 2005-009), the PCAOB noted that it was "concerned about a misconception that ... companies may no longer look to their auditors for advice on difficult accounting and internal control issues. This misconception appears to manifest itself in two particularly problematic ways. First, we have heard at the Roundtable and elsewhere that auditors have been unwilling to provide accounting advice to their audit clients; second, auditors have apparently encouraged audit clients to finish their assessments of internal control and their financial statements before the auditor begins audit work to attest to the fairness of those assessments and financial statements. Such practices are neither necessary nor advisable."

We believe that similar misconceptions could arise between engagement teams and engagement quality reviewers if the PCAOB retains the language noted in the Release. Any such misconceptions could have an overall negative effect on the quality of audits and interim reviews.

An audit or interim review, including related engagement quality review procedures and discussions between the engagement team and the engagement quality reviewer, is an iterative process. During the course of an audit or interim review, issues raised by both the engagement team and the engagement quality reviewer are routinely discussed and subsequently addressed by the engagement team. In such instances, it may be difficult, or not practical, for either the engagement team or the engagement quality reviewer to identify whether matters would have risen to the level of a significant engagement deficiency. This identification would be particularly difficult when, for example, the engagement team's audit procedures are in process and its documentation is in draft form, the engagement team holds early

¹ See page 11 of PCAOB Release 2005-009.



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planning or risk assessment discussions with the engagement quality reviewer, or when the engagement team is addressing new accounting or auditing-related matters.

Additionally, the level of documentation relative to an engagement quality review implied by the language on page 38 of the Release is not consistent with the stated objective of AS No. 3. Specifically, AS No. 3 states that “[a]udit documentation is the written record of the basis for the auditor’s conclusions that provides the support for the auditor’s representations ... and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor’s significant conclusions.” Except in specific instances noted in paragraph 8 of AS No. 3, AS No. 3 does not require an audit trail of how the engagement team evaluated and disposed of preliminary conclusions. The Release, however, implies that the documentation resulting from the engagement quality review process should go beyond the requirements of AS No. 3.

In summary, many matters raised as part of an engagement quality review are likely to be based on observations about the engagement that reflect preliminary conclusions or work that is in progress. We are concerned that the example provided in the Release (as referred to above) may indicate that the PCAOB expects an evaluation of such issues and documentation of those that, if unaddressed by the engagement team, would represent significant engagement deficiencies. Evaluations of work that is preliminary or in progress would be inconsistent with the objective of an engagement quality review noted in paragraph 2 of the Standard. Such evaluations would necessarily involve judgments regarding whether the engagement team would have addressed the issues identified during the normal course of an audit, a process which we believe would not provide an incremental benefit to the quality of an engagement quality review and would appear to be inconsistent with the overall objective of an engagement quality review. This inconsistency between the objective of the Standard and its documentation requirements and the example in the Release should be addressed by either the Commission or the PCAOB to eliminate the potential unintended consequences we describe above, thereby allowing the Standard to achieve its stated objective.

Due Professional Care

We welcome the clarification that the PCAOB does not intend to redefine due professional care as described in AU sec. 230, *Due Professional Care in the Performance of Work*, in the context of the Standard. Based on our reading of the Standard, we believe the PCAOB intends this Standard to be a self-contained standard for the engagement quality reviewer to follow in meeting the objective as described in paragraph 2. Therefore, we understand why due professional care would be reintroduced without a different meaning from AU sec. 230, as are other existing audit concepts such as competence, independence, integrity, and objectivity.

However, we continue to believe that the further explanation regarding the due professional care standard provided on page 36 of the Release seems to impose a standard higher than due professional care on the engagement quality reviewer. More specifically, we are concerned with the statement in the Release that “a qualified reviewer who has done so will, necessarily, have discovered any significant engagement deficiencies that could have been discovered if the review had been performed with due professional care in compliance with this standard.” Our concern is that this statement could be read to suggest that the reviewer is responsible for identifying all significant engagement deficiencies. For the reasons identified



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below, we do not believe this is the PCAOB's intent, and we believe it is important to make such intent clear.

The Standard does not require a comprehensive review of all the engagement team's work and contemplates that the reviewer would review only selected areas and selected audit documentation based on the reviewer's judgment considering the particular facts and circumstances. Thus, the Standard implicitly contemplates that there is an acceptable level of risk that the reviewer will fail to identify a significant engagement deficiency. We believe that the words on page 36 of the Release "that could reasonably have been discovered under the circumstances," while intended to convey this acceptable level of risk, nonetheless may introduce some confusion. Accordingly, we recommend that either the Commission or the PCAOB clarify this point.

If you have any questions about our comments, please do not hesitate to contact Jon Fehleison, (212) 909-5491 (jongfehleison@kpmg.com) or Glen Davison, (212) 909-5839 (gdavison@kpmg.com).

Very truly yours,

KPMG LLP

cc:

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