July 28, 2009 OPEN MEETING

AUDITING STANDARD NO. 7 - ENGAGEMENT QUALITY REVIEW

Statement of Daniel L. Goelzer

The adoption of a final standard on engagement quality review -- EQR -- is a milestone in fulfilling the Board's mandate to further the public interest in the preparation of informative, accurate, and independent audit reports.

Congress expressly directed the Board to require a qualified person to provide "concurring approval" of the issuance of every audit report filed with the SEC. Based on six years of inspections experience, it is clear that engagement quality reviews have the potential to improve auditing and promote confidence in audited financial statements. The Board's inspections staff routinely identifies audit deficiencies that a properly performed concurring partner review should have detected and caused to be remedied before the audit report was issued. However, since beginning operations in 2003, the Board has relied on the concurring partner requirements developed in a different environment before the Board's creation. The current rules are not applicable to all firms that prepare audit reports for Commission filers. Auditing Standard No. 7, the Board's new engagement quality review standard, will fill those gaps.

The EQR standard has had a long gestation period. Earlier versions of Auditing Standard No. 7 were published for comment in 2008 and again in March of this year. I think that the time has been well-spent and that the result is a better, more workable standard. For a project of the importance of EQR, we should take all reasonable steps to obtain input on the practical consequences of the standard.

This proceeding has generated a particularly robust comment file. Comments were critical of particular features of the two proposals and argued that certain elements were either not workable or would result in an engagement review process that was more costly and cumbersome than necessary. I believe that Auditing Standard No. 7 addresses these concerns without compromising the goal of increasing the likelihood that reviewers will identify any significant engagement deficiencies before audit reports are issued to the investing public. I want to particularly highlight three issues.

First, commenters have been concerned that the EQR standard could inadvertently drive the engagement reviewer to, in effect, perform a re-audit. In its final form, Auditing Standard No. 7 focuses the reviewer on the engagement team's significant judgments and on the team's responses to the significant risks it identified. While this will require judgment and sophistication on the part of reviewers, the standard makes clear that they are responsible for evaluating how the engagement team identified and responded to risk, not for starting from scratch to assess risk.
independently. This should alleviate the concern that engagement quality review could turn into a re-audit.

Second, the standard that the reviewer must meet in determining whether to provide concurring approval has been a major source of debate. Understandably, reviewers are sensitive to the criterion against which the Board, the SEC, and potentially the courts will measure their work. Under Auditing Standard No. 7, the reviewer may provide concurring approval only if, after performing the required review with “due professional care,” he or she is not aware of a significant engagement deficiency. This tethers the reviewer’s responsibility to his or her performance of the procedures required in the standard, rather than to a free-floating obligation not to concur if he or she “knows or should know” any fact that makes concurrence inappropriate. Further, the concept of acting with due professional care has long been embedded in auditing and should be familiar to the profession.

Third, the extent and nature of the documentation that the reviewer must create to memorialize his or her work has been a major concern. Auditing Standard No. 7 invokes the same principle that governs the audit team’s work paper documentation: The EQR documentation must be sufficient to enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the reviewer. The adopting release makes clear that this requirement is not intended to cause the reviewer’s documentation to duplicate the audit work papers. For example, if the reviewer raises an issue with the engagement team, the reviewer’s documentation only needs to reflect that discussion if it is necessary to an understanding of his work and if it is not fully reflected in the engagement work papers.

I believe that AS No. 7 strikes the right balance in addressing these and other difficult issues that the two comment periods have exposed. The burden will now fall to our inspections staff to monitor how the standard works in practice and how it affects audit quality.

I want to thank Marty Baumann, Greg Scates and Dima Andriyenko in the Office of the Chief Auditor, and Jake Lesser in the Office of the General Counsel, for their diligent and thoughtful efforts in bringing the final standard to the Board.