

SPOTLIGHT

Inspection Observations Related to Engagement Quality Reviews

October 2023

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OVERVIEW

When an engagement quality review (EQR) is required, a well-performed EQR serves as an important safeguard against erroneous or insufficiently supported audit opinions and as a meaningful check on the work performed by engagement teams. The objective of the EQR reviewer is to perform an evaluation of the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement. [AS 1220, Engagement Quality Review](#), (“AS 1220”)¹ was adopted to increase the likelihood auditors will identify significant audit deficiencies before issuing their audit or attestation report. Auditors who fail to follow AS 1220 deprive investors of that PCAOB-mandated safeguard. In addition, we consider the EQR reviewers’ evaluations to be an important part of an audit firm’s quality control (QC) system.

Our review procedures of an audit or attestation engagement of a public company, broker, or dealer may result in one or more deficiencies relating to engagement performance (typically, Part I.A findings in our inspection reports). Engagement level performance deficiencies are also evaluated to determine if there is an indication of noncompliance with other PCAOB standards, including AS 1220 related to EQR. Where these violations of AS 1220 represent a sufficiently pervasive failure, a comment form² is issued as a [QC 20, System of Quality Control for a CPA Firm’s Accounting and Auditing Practice](#), (“QC 20”) criticism for the audit firm.

These QC criticisms are included in Part II in the inspection report. The information and statistics discussed in this Spotlight pertain to comment forms for QC criticisms related to EQRs.

As noted in previously issued “Staff Update and Preview” Spotlights (2017-2023), we continuously monitor areas with recurring deficiencies. The PCAOB staff has observed high and increasing rates of audit deficiencies related to EQRs, the trend of which is troubling considering the important role that the EQR reviewer plays in evaluating whether significant aspects of the audit have been performed in accordance with PCAOB standards before an audit firm issues its audit report. Among PCAOB-inspected audit firms, the percentage with at least one comment form with an EQR deficiency climbed from 37% in 2020 to 42% in 2022. Most notably, the U.S. Global Network Firms (GNF) had a 33-percentage point increase in the number of audit firms with an EQR deficiency from 2021 to 2022, followed by the Non-Affiliate Firms (NAF) Annual program seeing a 21-percentage point increase across audit firms during the same period.

To assist auditors of public companies and broker-dealers in complying with the requirements of AS 1220, this Spotlight highlights recent staff observations from our inspections on the performance of EQRs. Our observations, including common audit deficiencies, good practices, and other reminders, can help audit firms ensure EQRs are properly performed.

¹ Amendments to paragraphs .02 and .10A of AS 1220 have been adopted by the PCAOB and approved by the U.S. Securities and Exchange Commission (SEC). The standard as amended will be effective for audits of fiscal years ending on or after December 15, 2024. See [PCAOB Release No. 2022-002 Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm](#) (Jun. 21, 2022) and [SEC Release No. 34-95488 Public Company Accounting Oversight Board; Order Granting Approval of Amendments to Auditing Standards Governing the Planning and Supervision of Audits Involving Other Auditors and Dividing Responsibility for the Audit with Another Accounting Firm](#) (Aug. 12, 2022).

² A “comment form” is the initial communication to audit firms of observed deficiencies from our inspections. In the context of this Spotlight, the comment forms under discussion are QC criticisms that would be discussed in Part II of the inspection report. Please refer to [Basics of Inspections](#) for additional information.

Audit committees and management may also find this information useful for engaging their auditors in meaningful discussions about EQRs, which are vital to high-quality audits.

When Is an EQR Required?

Under PCAOB standards, an EQR and the EQR reviewer's concurring approval of issuance of the engagement report³ are required for the following:

- An audit engagement.
- A review of interim financial information; and
- An attestation engagement performed pursuant to **Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers** ("AT 1"), or **Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers** ("AT 2").⁴

WHAT IS REQUIRED?

In accordance with AS 1220, in an audit or attestation engagement, the EQR reviewer should evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement and in preparing the engagement report. To evaluate such judgments and conclusions, the EQR reviewer should (1) hold discussions with the engagement partner and other members

of the engagement team and (2) review the engagement team's audit documentation.

In an audit engagement, the EQR reviewer should evaluate whether the engagement documentation that he or she reviewed when performing the procedures required by AS 1220.10, among others:

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

In an audit or attestation engagement, the EQR reviewer may provide concurring approval of issuance only if, after performing with due professional care the review required by AS 1220, he or she is not aware of a significant engagement deficiency.

Significant Engagement Deficiency

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 audit firm is not independent of its client (AS 1220.12).

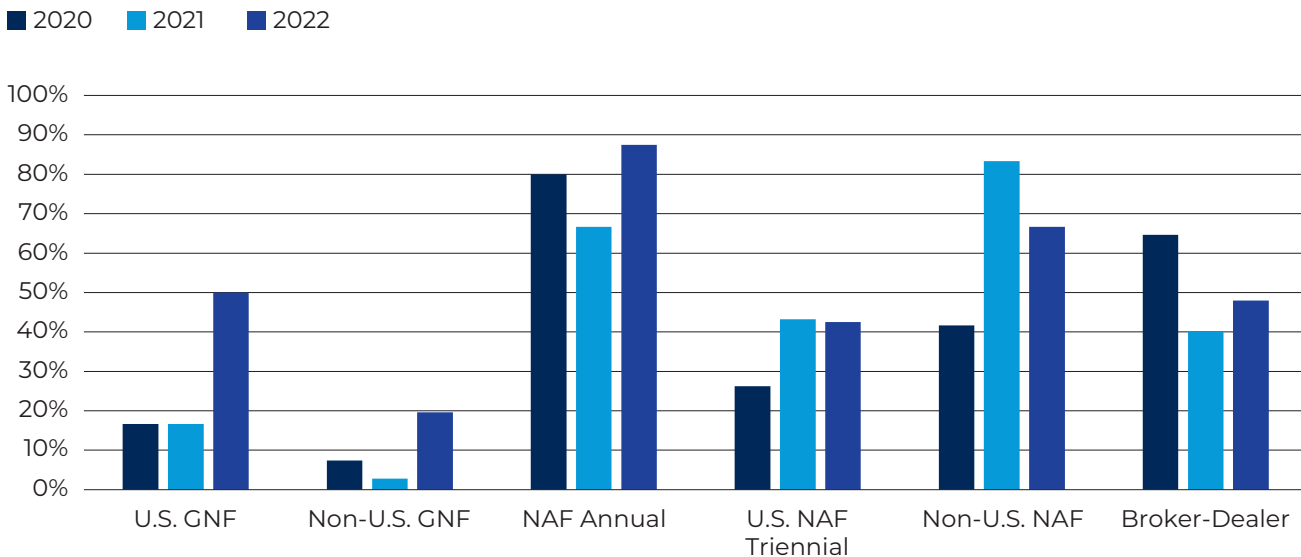
³ In the context of an audit, "engagement report" refers to the audit report (or reports if, in an integrated audit, the auditor issues separate reports on the financial statements and internal control over financial reporting). In the context of an engagement to review interim financial information, the term refers to the report on interim financial information (or the communication of the engagement conclusion if no report is issued).

⁴ For purposes of this Spotlight, references to "attestation engagements" refers only to attestation engagements performed pursuant to AT 1 and AT 2.

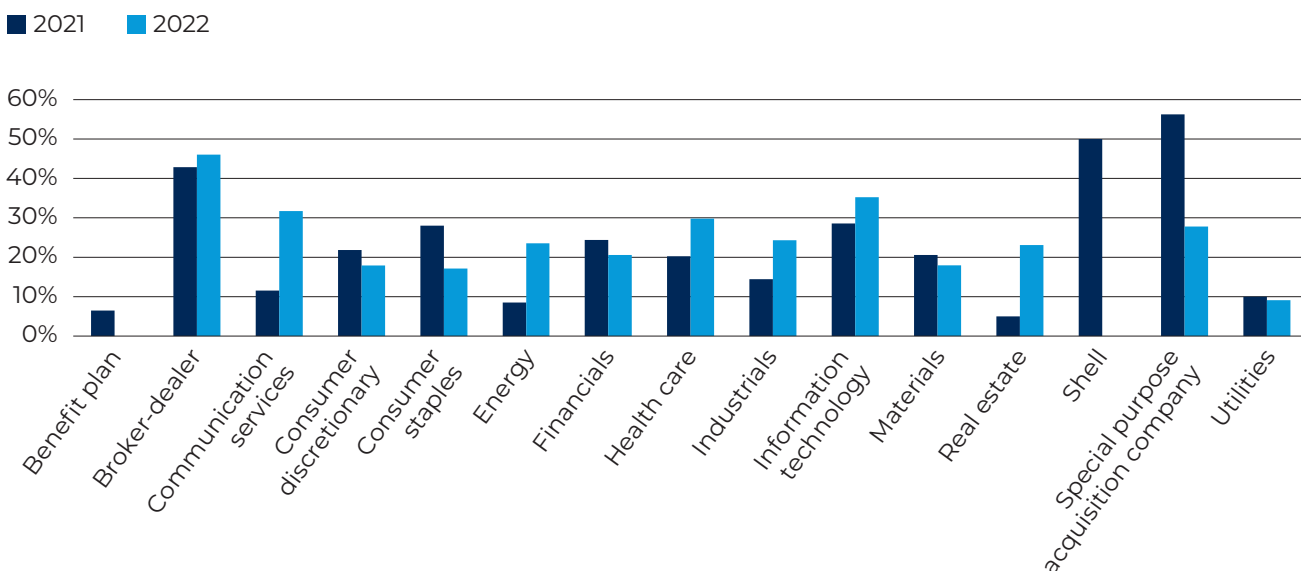
COMMON DEFICIENCIES RELATED TO EQRS

We continue to identify EQR deficiencies in many of our inspections.⁵ As depicted in the accompanying graphs, the deficiencies are not limited to a single type or size of audit firm, nor are they limited to a specific inspection program or a particular industry sector.

Percentage of Audit Firms With EQR Deficiencies



Percentage of Engagements Reviewed With an EQR Deficiency by Industry Sector



⁵ Our selection of audit and attestation engagements for review does not necessarily constitute a representative sample of the audit firm's total population of engagements. Additionally, our inspection findings are specific to the portions of the engagements reviewed and are not an assessment of all of the audit firm's procedures.

This section summarizes deficiencies identified in our 2021 and 2022 comment forms issued to audit firms related to the EQR process and/or the EQR reviewer specifically.

Note: The percentages below add up to more than 100% because a comment form can have more than one deficiency identified in the EQR process. The percentages represent the proportion of the total EQR comment forms issued.

Failing To Identify Certain Engagement Level Performance Deficiencies in the Audit

82% of EQR Comment Forms

Applicable Standards	PCAOB Observation
<p>In accordance with QC 20, policies and procedures should be established to provide the audit firm with reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory requirements, and the audit firm's standards of quality which includes those policies and procedures that should address EQRs pursuant to AS 1220.</p> <p>Additionally, in accordance with AS 1220, in an audit (or attestation engagement), the EQR reviewer should evaluate whether the engagement documentation that he or she reviewed when performing the procedures required by AS 1220.10 indicates that the engagement team responded appropriately to significant risks, and supports the conclusions reached by the engagement team with respect to the matters reviewed.</p>	<p>We have identified deficiencies where the audit firms' QC system did not provide reasonable assurance that the reviews performed by the audit firms' EQR reviewers for audit and attestation engagements would meet the requirements of AS 1220.</p> <p>This contributed to EQR reviewers not identifying deficiencies in audit responses to areas of significant risks, including fraud risks, that were subsequently identified by PCAOB staff.</p>

Failing To Provide Competent, Knowledgeable EQR Reviewer

6% of EQR Comment Forms

Applicable Standards	PCAOB Observation
<p>In accordance with QC 20, the audit firm should establish policies and procedures that should address EQRs pursuant to AS 1220.</p> <p>Additionally, AS 1220 notes that the audit firm's quality control policies and procedures should include provisions to provide the audit firm with reasonable assurance that the EQR reviewer has sufficient competence, independence, integrity, and objectivity to perform the EQR in accordance with the standards of the PCAOB.</p> <p>AS 1220 also states that the person who served as the engagement partner during either of the two audits preceding the audit subject to the EQR may not be the EQR reviewer.</p>	<p>We have identified deficiencies where the audit firms' QC system did not provide reasonable assurance that EQR reviewers had sufficient competence, independence, integrity, and objectivity to perform the EQR, as the audit firms' policies and procedures did not:</p> <ul style="list-style-type: none">• Ensure that the EQR reviewer possessed the level of knowledge and competence related to accounting, auditing, and financial reporting required to serve as the EQR reviewer; or• Appropriately address the objectivity of individuals assigned to serve as the EQR reviewer. <p>We have also identified deficiencies where the audit firm did not ensure that the EQR reviewer had not served as the engagement partner during either of the two audits preceding the audit subject to the EQR.</p>

Failing To Properly Document the EQR

6% of EQR Comment Forms

Applicable Standards	PCAOB Observation
<p>In accordance with AS 1220.11, in an audit (or attestation engagement), the EQR reviewer should evaluate whether the engagement documentation that he or she reviewed when performing the procedures required by AS 1220.10:</p> <ul style="list-style-type: none"> Indicates that the engagement team responded appropriately to significant risks, and Supports the conclusions reached by the engagement team with respect to the matters reviewed. <p>In addition, AS 1220.19 states that the documentation of an EQR should contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the EQR reviewer, and others who assisted the reviewer in complying with the provisions of AS 1220.</p> <p>Further, documentation of an EQR should be included in the engagement documentation in accordance with AS 1220.20.</p>	<p>We have identified deficiencies where the engagement documentation did not evidence that the EQR reviewer evaluated or reviewed:</p> <ul style="list-style-type: none"> The judgments made about materiality and the effect of those judgments on the engagement strategy. The engagement team’s evaluation of the audit firm’s independence in relation to the engagement; and/or Whether appropriate matters have been communicated, or identified for communication, to the audit committee, and management. <p>In addition, we identified deficiencies where the engagement documentation did not contain sufficient information that would enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the EQR reviewer.</p>

Failing To Provide Concurring Approval

6% of EQR Comment Forms

Applicable Standards	PCAOB Observation
<p>In accordance with AS 1220.17, the EQR reviewer may provide concurring approval of issuance only if, after performing with due professional care the review required by AS 1220, he or she is not aware of a significant engagement deficiency.</p> <p>Additionally, in an audit (or attestation engagement), the audit firm may grant permission to the client to use the engagement report only after the EQR reviewer provides concurring approval of issuance.</p>	<p>We have identified deficiencies where audit firms did not obtain concurring approval from an EQR reviewer prior to issuance of the engagement report (or communicate an engagement conclusion to its client, if no report is issued).</p>

Failing To Provide an EQR

5% of EQR Comment Forms

Applicable Standards	PCAOB Observation
<p>In accordance with AS 1220.01, EQR and concurring approval of issuance are required for the following engagements conducted pursuant to the standards of the PCAOB:</p> <ul style="list-style-type: none">• An audit engagement.• A review of interim financial information; and• An attestation engagement.	<p>We have identified deficiencies where audit firms did not have an EQR reviewer perform an EQR on the audit and/or attestation engagement.</p>

Enforcement Actions Related to EQRs

EQR reviewers' failures to conduct their reviews with due professional care resulted in recent enforcement actions that were published on the PCAOB website during:

- **October 2022:** The PCAOB found that an audit firm failed to obtain EQRs on an audit for three years. On each audit, the audit firm improperly permitted the issuance of its audit reports without obtaining concurring approval of issuance.
- **December 2022:** The PCAOB found that the engagement team failed to document the EQR reviewer's concurring approval of issuance for nine audits. In each audit, the documentation of the EQR did not contain sufficient information to enable an experienced auditor having no previous connection with the engagement to understand the date that EQR reviewer provided concurring approval of issuance. In two of the audits, the EQR reviewer assumed the role of an engagement team member and failed to maintain his objectivity with respect to the engagement team by directly performing certain audit procedures and preparing work papers.
- **June 2023:** The PCAOB found that the EQR reviewer provided concurring approval for issuance of multiple audit reports without evaluating, with due professional care, the significant judgments made, and the related conclusions reached, by the engagement teams. The EQR reviewer failed to properly evaluate the engagement teams' significant planning judgments; and the engagement teams' assessments of, and audit responses to, significant risks they identified, including fraud risks associated with significant unusual transactions.
- **June 2023:** The PCAOB found that the audit firm failed to have adequate policies and procedures in place to, among other things, ensure that partner workloads were manageable so that EQR reviewers could discharge their responsibilities with professional competence.

Please visit the **Enforcement Actions page** on the PCAOB website for more information. In addition to enforcement activities at the PCAOB, the SEC may also consider enforcement actions against an EQR reviewer. For further information on SEC enforcement actions, visit **their website**.

REMINDERS FOR AUDITORS

Audit firms and auditors are encouraged to consider the following reminders:

- It is important that audit firms evaluate the individual EQR reviewer's experience. This may include the EQR reviewer's experience in specific industries (e.g., broker-dealer, financial services, technology, retail, etc.) and the accounting principles used in the relevant industry. In addition, consideration of the EQR reviewers experience with PCAOB auditing and related professional standards.
- An EQR reviewer, including any assistants, must be independent of the public company or broker-dealer, perform the EQR with integrity, and maintain objectivity in performing the review.
- An EQR reviewer may not be the person who served as the engagement partner during either of the two audits preceding the audit subject to the EQR, should not make decisions on behalf of the engagement team or assume any of the responsibilities of the engagement team. This requirement ensures the reviewers can withstand attempts to influence the review from the engagement partner.
- While an EQR may also be an individual from outside the audit firm, such individuals are subject to the same qualification requirements as EQRs employed by the audit firm.
- It is important for the audit firm to ensure that an EQR reviewer has sufficient time scheduled to fulfill his or her responsibilities, including sufficient time for the engagement team to address the EQR reviewer's comments and observations.

EQR Qualified Reviewers

In accordance with AS 1220.03 and .04, to serve as an EQR reviewer, an individual must be an associated person of a registered public accounting firm. An EQR reviewer from the audit firm that issues the engagement report (or communicates an engagement conclusion, if no report is issued) must be a partner or another individual in an equivalent position. The EQR reviewer may also be a qualified individual from outside the audit firm.

In addition, the audit firm's QC policies and procedures should include provisions to provide the audit firm with reasonable assurance that the EQR reviewer has sufficient competence, independence, integrity, and objectivity to perform the EQR in accordance with the standards of the PCAOB.

- Audit firms may grant permission for a public company or broker-dealer to use the audit report only after the EQR reviewer provides concurring approval.
- EQR reviewers must, as part of the review process, document their review. That documentation should include information identifying, among other things, the EQR reviewer (and others who assisted the reviewer) and the documents reviewed by the EQR reviewer. It should also include the date that the EQR reviewer provided concurring approval of issuance or, if no concurring approval was provided, it should communicate the reasons why.

- A well-designed QC system will reduce the likelihood of EQR deficiencies, like those described above. Audit firms are required to implement QC policies and procedures that provide reasonable assurance that EQR reviewers have sufficient competence, independence, integrity, and objectivity to perform the EQR.

Audit Firm's Policies and Procedures

In accordance with QC 20, policies and procedures should be established to provide the audit firm with reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory requirements, and the audit firm's standards of quality. Policies and procedures for engagement performance encompass all phases of the design and execution of the engagement. To the extent appropriate and as required by applicable professional standards, these policies and procedures should cover planning, performing, supervising, reviewing, documenting, and communicating the results of each engagement. These policies and procedures also should address EQRs pursuant to AS 1220.

GOOD PRACTICES

Many audit firms, ranging from large global network firms to sole proprietorships, continue to take steps to improve their QC systems related to EQRs, which we believe positively influences audit quality. Some examples of these good practices include the following:

- **Workload and expertise monitoring.** Some audit firms have programs in place to monitor workloads and areas of expertise to ensure that partners assigned as EQR reviewers will have sufficient time, experience, and knowledge to complete the assigned EQRs. Many audit firms consider seniority and reporting lines, among other characteristics of engagement partners, when assigning EQR reviewers who will be able to competently and objectively evaluate and challenge engagement team judgments. Additionally, some audit firms designate EQR assistants to help manage the workload of EQR reviewers.
- **Timely and increased involvement of EQR reviewers for key audit milestones.** Some audit firms have implemented milestone programs meant to promote the timeliness and quality of audit procedures, including the increased involvement of EQR reviewers. Some audit firms have focused on increasing the EQR reviewer's involvement in the planning discussions and created frameworks to require certain audit documentation to be reviewed by the EQR reviewer. In some instances, audit firms set milestones specific to the EQR. For smaller audit firms, tracking milestones may be done simply through a shared calendar or other collaborative work management programs. Many of these practices can be comprehensive and designed in relation to the audit firm's size and the nature and complexity of its practice.
- **Increased accountability.** Some audit firms have established programs to expand accountability for audit quality to the audit firms' overall audit quality to EQR reviewers, rewarding or penalizing reviewers depending on whether internal or external inspections found engagement deficiencies in the audits in which they performed an EQR.

- **New and revised audit tools and guidance.**

Some audit firms have created or revised tools and clarified guidance for both the EQR reviewer and engagement team to (1) provide more details on the EQR requirements with a focus on the EQR reviewer obtaining a detailed understanding of the conclusions reached at various phases of the audit, (2) help identify circumstances that may require a change in audit approach and evaluating the engagement team's response, and (3) assist engagement teams in organizing their work to facilitate an efficient EQR. As with other practices, any tools and guidance developed for completing an EQR will need to be considered based on the audit firm's size and its needs.

- **Root cause task force.** Some audit firms have formed a task force or dedicated team to evaluate potential root causes of engagement deficiencies. These root cause evaluations have included analyzing why the EQR reviewer failed to identify a significant engagement deficiency and recommending additional actions on how to improve EQR performance.

Questions Audit Committees May Want To Consider

The following questions may be of interest to audit committees to consider amongst themselves or in discussions with their independent auditors:

- What policies and procedures does the audit firm have in place to provide reasonable assurance that the EQR reviewer has sufficient competence, independence, integrity, and objectivity to perform the EQR in accordance with the standards of the PCAOB?
- Does the audit firm have individuals with experience in their specific industry that have not served as the engagement partner during either of the two audits preceding the current audit, who can serve as the EQR reviewer? If not, will the auditor go outside of the audit firm to fill this role?
- Were there any significant judgments discussed or challenged by the EQR reviewer? What was the outcome of those discussions?
- Has the auditor obtained concurring approval of issuance from the EQR reviewer prior to the issuance of the engagement report (or communicating its conclusion if no report is issued)?

APPENDIX: PREVALENCE OF EQR-RELATED DEFICIENCIES BY PCAOB INSPECTION CATEGORY⁺

2022 Inspection Year			
PCAOB inspection category	Number of audit firms inspected	Number of audit firms inspected with EQR deficiency*	Percentage of audit firms with EQR deficiency
U.S. GNF	6	3	50%
Non-U.S. GNF	51	10	20%
NAF Annual	8	7	88%
U.S. NAF Triennial	80	34	43%
Non-U.S. NAF	12	8	67%
Broker-Dealer	50	24	48%

2021 Inspection Year			
PCAOB inspection category	Number of audit firms inspected	Number of audit firms inspected with EQR deficiency*	Percentage of audit firms with EQR deficiency
U.S. GNF	6	1	17%
Non-U.S. GNF	36	1	3%
NAF Annual	6	4	67%
U.S. NAF Triennial	81	35	43%
Non-U.S. NAF	12	10	83%
Broker-Dealer	50	20	40%

2020 Inspection Year			
PCAOB inspection category	Number of audit firms inspected	Number of audit firms inspected with EQR deficiency*	Percentage of audit firms with EQR deficiency
U.S. GNF	6	1	17%
Non-U.S. GNF	27	2	7%
NAF Annual	5	4	80%
U.S. NAF Triennial	103	27	26%
Non-U.S. NAF	12	5	42%
Broker-Dealer	65	42	65%

⁺ The information presented in these tables was compiled as of September 2023.

^{*} The information presented in these tables represent instances where one or more engagement level performance deficiencies related to the EQR resulted in a QC criticism for the audit firm.

PCAOB Inspection Categories

GNF

U.S. GNF – These audit firms are headquartered in the U.S. and are members of global networks through which they affiliate with audit firms in other countries for various business and client service purposes. Registered public accounting firms provide information about those affiliations in their annual reports on PCAOB Form 2. These U.S. firms are inspected annually.

Non-U.S. GNF – These audit firms are headquartered outside of the U.S. and are members of global networks. Currently, the majority of these audit firms are inspected on a triennial basis because they issue 100 or fewer issuer audit reports per year.

NAF, Annually Inspected

NAF Annual – These audit firms are not part of a global network but are inspected annually because they issue more than 100 issuer audit reports per year. Currently all NAF Annual audit firms are headquartered in the U.S.

NAF, Triennially Inspected

U.S. NAF Triennial – These audit firms are not part of a global network, are headquartered in the U.S., and are inspected on a triennial basis because they issue 100 or fewer issuer audit reports per year.

We Want To Hear From You

The PCAOB strives to improve our external communications and provide information that is timely, relevant, and accessible. We invite you to share your views on this document by filling out **our survey**, which should take no more than two minutes to complete.

Non-U.S. NAF – These audit firms are not part of a global network, are headquartered outside of the U.S., and are generally inspected on a triennial basis because they issue 100 or fewer issuer audit reports per year.

Broker-Dealer Firms

These audit firms, which can also be part of an issuer inspection program as described above, perform audits of broker-dealers. There is no mandated inspection cycle for audit firms of broker-dealers.

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