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**OBSERVATIONS RELATED TO THE IMPLEMENTATION OF THE AUDITING  
STANDARD ON ENGAGEMENT QUALITY REVIEW**

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## **Executive Summary**

This report provides information regarding firms' implementation of, and compliance with, Auditing Standard No. 7, *Engagement Quality Review* ("AS No. 7"), based on 2011 inspections of registered public accounting firms by the Public Company Accounting Oversight Board ("PCAOB" or "Board"). AS No. 7 became effective for audits and interim reviews for fiscal years beginning on or after December 15, 2009.

In 2011, PCAOB Inspections staff conducted inspections of 213 firms and reviewed portions of approximately 820 audit engagements. The inspections identified approximately 310 engagements where the firm, at the time it issued its audit report, had failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and/or on the effectiveness of internal control over financial reporting ("ICFR"). For 141 of the 213 firms inspected, Inspections staff reviewed the relevant provisions of firms' methodologies and assessed whether the methodologies were consistent with the requirements of AS No. 7. In addition, in some of the engagement reviews, Inspections staff assessed whether deficiencies that it viewed as resulting in an insufficiently supported opinion should have been identified by the engagement quality reviewer before the firm issued its opinion. Inspections staff evaluated that issue for each of the 111 audits performed by seven large domestic firms in which it identified such deficiencies, as well as for a portion of such audits performed by other firms.

### **Overall Findings**

Inspections staff found that, generally, firms' methodologies were consistent with the requirements of AS No. 7. This did not, however, always translate into an appropriately executed engagement quality review. In a number of the engagements, including approximately 39 percent of the 111 audits of seven large domestic firms in which the Inspections staff identified that the audit opinion was insufficiently supported, Inspections staff concluded that the audit deficiency should have been identified by the engagement quality reviewer. For example, Inspections staff noted instances where an engagement quality reviewer reviewed significant judgments made by an engagement team but failed to detect deficiencies in those significant judgments. Observations from the Board's 2012 inspections indicated that audit deficiencies and the related deficiencies in engagement quality reviews continued to be high.

## **Actions Needed**

All registered firms should review this report and consider whether the types of deficiencies that the Board's Inspections staff has observed related to AS No. 7 could manifest themselves in their practices. Firms should be proactive in considering how to prevent these or similar issues, through implementing strong monitoring of the effectiveness of engagement quality reviews, providing robust training and guidance, and holding engagement quality reviewers accountable for their work.

Engagement quality reviewers should take steps to ensure that they have a sufficient understanding of AS No. 7 to be able to complete the required procedures. They should also ensure that they allot to the review the time necessary to complete the procedures appropriately. In carrying out the review, they should ensure that they have obtained a sufficient understanding of the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion.

This report may be useful to audit committees in fulfilling their oversight responsibilities, including by helping to prepare them for meaningful discussions with their auditors about the engagement quality review component of their audit.

This report may also give investors, audit committees, and others the benefit of certain information and analysis concerning certain highlighted audit issues, or the inspection program.