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# **Basis for Conclusions** **Auditing Standard ASQM 2** *Engagement Quality Reviews*

Prepared by the **Auditing and Assurance Standards Board**



**Australian Government**

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**Auditing and Assurance Standards Board**

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### **Contact Details**

Auditing and Assurance Standards Board  
Podium Level 14, 530 Collins Street  
Melbourne Victoria 3000  
AUSTRALIA

Phone: (03) 8080 7400  
E-mail: [enquiries@auasb.gov.au](mailto:enquiries@auasb.gov.au)

**Postal Address:**  
PO Box 204, Collins Street West  
Melbourne Victoria 8007  
AUSTRALIA

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## Basis for Conclusions ASQM 2 Engagement Quality Reviews

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Basis for Conclusions ASQM 2 Engagement Quality Reviews has been prepared by the Technical Staff of the Auditing and Assurance Standards Board (AUASB) to provide the background and rationale for the development and approval of the Standard by the AUASB. The Basis for Conclusions relates to, but does not form part of, ASQM 2.

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### BASIS FOR CONCLUSIONS

#### *ASQM 2 Engagement Quality Reviews*

This Basis for Conclusions has been prepared by the Technical Staff of the AUASB to provide the background and rationale for the development and approval of ASQM 2 Engagement Quality Reviews, by the AUASB. The Basis of Conclusions relates to, but does not form part of ASQM 2, and is not a substitute for reading the Standard.

#### Background

1. In accordance with its mandates under section 227 of the *Australian Securities and Investments Commission Act 2001* and the Financial Reporting Council's *Strategic Direction*, the AUASB's policy is to adopt the International Auditing and Assurance Standards Board (IAASB) ISAs, unless there is a compelling reason not to do so. In addition the AUASB is required to make such amendments to the ISAs to ensure the Australian Auditing Standards both exhibit and conform to the Australian regulatory environment and statutory requirements. Further amendments are made where there are compelling reasons to do so, and are made with a public interest focus. Refer paragraph 12 of this Basis of Conclusions document for further detail on compelling reason amendments.
2. The IAASB issued ISQM 2 *Engagement Quality Reviews* and conforming and consequential amendments in December 2020.
3. The IAASB's project to develop ISQM 2 had an overall objective to separate the engagements that may require a quality review into ISQM 1 and develop a separate standard ISQM 2 to address the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review. ISQM 2 was developed as a separate standard to focus specifically on the role of engagement quality reviewer and the critical importance of the objective nature of this role in quality management. The purpose of the engagement quality review is to evaluate the significant judgments made by the engagement team.
4. The IAASB released an exposure draft of proposed ISQM 2 in February 2019.
5. In March 2019 the AUASB exposed the IAASB exposure drafts, to gather feedback from Australian stakeholders to inform its submission to the IAASB on proposed ISQM 2. The AUASB received comment letters **from 3 stakeholders** and held roundtables in Sydney, Melbourne, and Brisbane which were attended by over 50 stakeholders representing assurance providers from a range of audit firms, professional accounting bodies, academics, those charged with governance and preparers of financial statements.
6. Based on the feedback received the AUASB provided a submission to the IAASB in July 2019. Refer to [AUASB's full submission](#).
7. The AUASB monitored the development of ISQM 2 *Engagement Quality Reviews* to ensure that the issues included in the submission to the IAASB were appropriately addressed. Further details regarding the development of ISQM 2 and how the IAASB addressed feedback on their exposure draft can be found in [ISQM 2 Basis for Conclusions](#) on the IAASB's website.

#### Scope

8. This Basis for Conclusions applies to ASQM 2 primarily, but is also relevant to ASA 2021-2 which contains the consequential and conforming amendments to:
  - *ASA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*

- *ASA 210 Agreeing the Terms of Audit Engagements*
  - *ASA 230 Audit Documentation*
  - *ASA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*
  - *ASA 250 Consideration of Laws and Regulations in an Audit of a Financial Report*
  - *ASA 260 Communication with Those Charged with Governance*
  - *ASA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance*
  - *ASA 300 Planning an Audit of a Financial Report*
  - *ASA 320 Materiality in Planning and Performing an Audit*
  - *ASA 330 The Auditor's Responses to Assessed Risks*
  - *ASA 402 Audit Considerations to an Entity Using a Service Organisation*
  - *ASA 500 Audit Evidence*
  - *ASA 501 Audit Evidence – Special Considerations for Inventory and Segment Information*
  - *ASA 505 External Confirmations*
  - *ASA 520 Analytical Procedures*
  - *ASA 530 Audit Sampling*
  - *ASA 540 Auditing Accounting Estimates and Related Disclosures*
  - *ASA 550 Related Parties*
  - *ASA 570 Going Concern*
  - *ASA 600 Special Considerations – Audits of a Group Financial Report*
  - *ASA 610 Using the Work of Internal Auditors*
  - *ASA 620 Using the Work of an Auditor's Expert*
  - *ASA 700 Forming an Opinion and Reporting on a Financial Report*
  - *ASA 701 Communicating Key Audit Matters in the Independent Auditor's Report*
  - *ASA 720 The Auditor's Responsibilities Relating to Other Information*
  - *ASA 800 Special Considerations – Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks*
9. The AUASB has the authority to issue this new standard ASQM 2 under s234 and s 336 of the *Corporations Act 2001* which defines the framework within which the AUASB can formulate and make auditing standards.

## Major Issues raised by Respondents on Exposure

10. The adoption of international standards and any changes to adopted standards are governed by the AUASB’s policies regarding convergence with IAASB standards and harmonisation with the standards of the New Zealand Auditing and Assurance Standards Board. The policies and procedures incorporate “compelling reasons” tests which must be used to support changes to the international standards (refer paragraph 1).
11. The AUASB received feedback from respondents on the Australian exposure of ISQM 2 with the major issues included in the submission to the IAASB relating to:
  - guidance regarding a “cooling off” period should reside in the IESBA Code;
  - the proportionality and clarity around the different roles played by the Engagement Quality Reviewer vis a vis the Engagement Partner; and
  - the inclusion of a “stand back” requirement in ISQM 2.

The AUASB included these issues in its submission to the IAASB. Appendix 1 details all major feedback received from Australian stakeholders which was included in the AUASB’s submission to the IAASB and how the issues have been addressed in the final ISQM 2.

### *Compelling reasons assessment*

12. The adoption of international standards and any changes to adopted standards are governed by the AUASB’s policies regarding convergence with IAASB standards and harmonisation with the standards of the NZAuASB. The policies and procedures incorporate “compelling reasons” tests which must be used to support changes to the international standards. Changes are made only when the AUASB is satisfied that there are compelling reasons to do so. Further to paragraph 1 of this Basis of Conclusions document, compelling reasons fall broadly into two categories: legal and regulatory; and principles and practices considered appropriate in maintaining or improving audit quality in Australia.
13. In considering ASQM 2, the AUASB determined that the majority of the significant matters raised in its submission to the IAASB, as well as those identified through review of subsequent drafts of the standard, have been addressed in the final standard (ISQM 2).
14. The AUASB however concluded that there were several non-judgemental Australian compelling reason amendments to make to the international equivalent version of the standard. Such amendments are prefixed in ASQM 2 as AUS paragraphs and exist for different reasons as summarised in the tables below. *The following introductory paragraphs and definitions are additional to or have been amended from ISQM 2*

	<b>Summary of Change</b>
1	Paragraph Aus 2.1 replaces ISQM 2 introductory paragraph 2. The purpose of the amendment is to introduce ASA 102 <i>Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements</i> . This change has been made to conform with the Australian regulatory environment and statutory requirements.
2	Paragraph Aus 2.2 is additional to ISQM 2, and has been included to serve as a reminder that it is the responsibility of the assurance practitioner to ensure compliance with all relevant legal, regulatory or professional obligations. This change has been made to conform with the Australian regulatory environment and statutory requirements.
3	Paragraph Aus 13.1 replaces ISQM 1 paragraph 13(c) definition of ‘Relevant ethical requirements’. Relevant ethical requirements are defined in ASA 102

	<b>Summary of Change</b>
	<i>Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements.</i> This change has been made to conform with the Australian regulatory environment and statutory requirements.

- 15. The IAASB has committed to providing implementation support materials including a first time through guide to assist practitioners with the adoption of ISQM 2. The AUASB will monitor all IAASB implementation support materials to consider if further implementation support is required locally to address implementation issues.
- 16. Appendix 1 details all major feedback received from Australian stakeholders which was included in the AUASB’s submission to the IAASB and how the issues have been addressed in the final ISQM 2. Further detail on the how the IAASB have addressed comments on their exposure draft is included in the [IAASB’s Basis for Conclusion](#).

**Conclusion**

- 17. The AUASB voted to approve and issue ASQM 2 on 10 March 2021.
- 18. In reaching its conclusions the AUASB considered:
  - all stakeholder feedback;
  - the IAASB’s due process and consideration as to whether ISQM 2 should be re-exposed;
  - that the amendments made to the standard by the IAASB since exposure, were in response to ED submissions, and have not changed the fundamental approach and principles on which the standard is based, and it was not necessary to re-expose the standard.

\* \* \*



Appendix 1

**HOW MORE SIGNIFICANT ISSUES RAISED IN THE AUASB SUBMISSION TO THE IAASB HAVE BEEN ADDRESSED**

	<i>AUASB Issue</i>	<i>Changes made to ISQM 2</i>
1	Concerns were raised with the ‘cooling off’ period and related application material being retained in ISQM 2 and not residing primarily in the IESBA Code as it relates directly to Independence which is dealt with in the Code.	The IAASB has elevated application material from the ED to a requirement in paragraph 19 relating to the two year ‘cooling off’ period or a longer period if required by relevant ethical requirements in ISQM 2 and related application material in paragraphs A17-A18. The IAASB did work with IESBA on this matter to endeavour to ensure consistency between the standard and the Code. IESBA agreed not to duplicate the requirements of the ISAs in the Code as this may set precedent for other requirements being brought into The Code. IESBA have cross referenced the Independence requirements to the long association requirements within the Code.
2	Concerns were raised with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures specifying the EQR identify instead of evaluate may extend the role of the EQR beyond what is intended?	The suggested changes to the wording in the requirement in paragraph 25 from identify to evaluate were made in paragraphs 25(c) and 25(f) of the standard.
3	Concerns were raised in relation to the engagement quality reviewer’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional scepticism? Consideration of additional application guidance to make it clear how this is appropriately documented in the audit file.	Paragraph A40 has been included in the final standard to endeavour to address this matter:  A40 The firm’s policies or procedures may specify engagement documentation to be reviewed by the engagement quality reviewer. In addition, such policies or procedures may indicate that the engagement quality reviewer exercises professional judgment in selecting additional engagement documentation to be reviewed relating to significant judgments made by the engagement team.
4	Concerns were raised with the requirements of ISQM 2 being appropriate for all engagements to which the standard will apply through ISQM 1 e.g. other assurance and related services engagements and not just audits of a financial report? An example of this may be the “cooling-off periods”.	The IAASB has not specifically dealt with this matter in ISQM 2 as the requirement to include a wide range of engagements under ISQM 1 is dealt with in paragraph 34(f)(ii) of that standard - Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risk(s). No further application material on this matter has been included in ISQM 2. See AUASB Issue 1 above for further comments.

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	<i>AUASB Issue</i>	<i>Changes made to ISQM 2</i>
5	Concerns were raised with the requirement for an engagement quality reviewers overall conclusion and whether this adds value to the performance of the engagement quality review as a whole. The AUASB is supportive of the second limb of the requirement being that the EQR shall notify the engagement partner that the EQR is complete.	The “stand back” requirement has been retained in ISQM 2. The IAASB noted that the stand back provision represents good practice and is consistent with the more recently revised ISAs, and as such has been retained as a requirement in relation to the role of the EQR in ISQM 2.
6	Concerns were raised whether an appropriate balance had been achieved between the role of the engagement partner under ISA 220 and the role of the EQR under ISQM 2. The level of work expected of the EQR in some areas appeared to be at the same level as an EP and, in the view of the AUASB, was not in line with the objectives and proportionate responsibilities of an EQR.	The IAASB considered whether the responsibilities of the engagement partner were appropriate in light of the responsibilities specified for the engagement quality reviewer in ISQM 2. This included the IAASB making some changes to better reflect the differentiation of the roles of the Engagement Partner in that the EP takes responsibility for the overall engagement and the Engagement Quality Reviewer evaluates or challenges the significant judgements made by the engagement team. The IAASB noted that the requirements for an engagement partner go much further because the full suite of ISAs are directed at “the auditor”, the definition of which includes the engagement partner.