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Explanatory Memorandum

ISQM 2 Engagement Quality Reviews

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EXPLANATORY MEMORANDUM

ISQM 2 Engagement Quality Reviews

Introduction

1. The International Auditing and Assurance Standards Board (IAASB) has issued for public comment three exposure drafts (EDs) on interrelated proposed auditing standards that address quality management at the engagement and firm level. This explanatory memorandum represents the Australian exposure of one of those standards, Proposed International Standard on Auditing *ISQM 2 Engagement Quality Reviews* (ED ISQM 2).
2. This Explanatory Memorandum is to be read in conjunction with the overarching Explanatory Guide *Exposure of the IAASB's Proposed Quality Management Standards in Australia*. The Explanatory Guide provides stakeholders with an overview of the approach to exposing the proposed international quality management standards in Australia, and details of the process the AUASB will apply to exposing other IAASB EDs in future.

Overview

3. This Explanatory Memorandum gives Australian stakeholders an overview of:
 - (a) Request for comments – IAASB questions and additional Australian questions;
 - (b) Background to the matters identified for further consideration by the AUASB during the review of the proposed international standard;
 - (c) How to provide comments and the Australian comment date; and
 - (d) Planned outreach in Australia to gather feedback on the proposed standards.
4. ED ISQM 2 is included as an attachment to this Explanatory Memorandum, and can also be obtained on the [IAASB's website](#).

Request for Comments

5. Stakeholders are directed to the Request for Comments section below which comprises IAASB and Australian specific questions. Stakeholder responses to both sets of questions will be used to inform the AUASB in their response to the IAASB on the Quality Management Exposure Drafts.

IAASB Questions

Stakeholders are asked to respond to the AUASB on the following questions derived from the IAASB's Explanatory Memorandum for ED ISQM 2 in order to inform the AUASB's formal response to the IAASB on their ED:

NB: There are no variations between the questions below and those in the IAASB's Explanatory Memorandum, but for completeness and ease of use by respondents they are replicated in the Australian Explanatory Memorandum for ED ISQM 2.

1. Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED ISQM 2 should deal with the remaining aspects of engagement quality reviews?
2. Are the linkages between the requirements for engagement quality reviews in ED ISQM 1 and ED ISQM 2 clear?

3. Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?” Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?
4. Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED ISQM 2?
 - a. What are your views on the need for the guidance in proposed ED ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?
 - b. If you support such guidance, do you agree that it should be located in proposed ED ISQM 2 as opposed to the APESB Code?
5. Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?
6. Do you agree that the engagement quality reviewer’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional scepticism? Do you believe that ED ISQM 2 should further address the exercise of professional scepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?
7. Do you agree with the enhanced documentation requirements?
8. Are the requirements for engagement quality reviews in ED ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?

Australian specific questions

Matters for further consideration in relation to the Quality Management Standards

Stakeholders are asked to respond to the following specific questions included to reflect matters for further consideration identified by the AUASB during its deliberations on the IAASB’s development of the Quality Management standards.

9. Do you consider the definition of engagement teams has been consistently applied across the suite of Quality Management Standards? (Refer matters identified by the AUASB, matter number 4, table 1)
10. In relation to engagement quality reviews (Refer to matters identified by the AUASB, matter number 2 and 4, table 1):
 - (a) Do you agree with the definition of Engagement Quality Reviews/Reviewer and do you consider the term to be clear and capable of application in a consistent way across engagements?
 - (b) Do you agree that engagement quality reviews should also be performed for audits of financial statements of entities that the firm determines are significant public interest entities?
 - (c) Has the term “significant public interest entity” clear and capable of application in a consistent way across engagements?

Matters for further consideration in relation to ISQM 2

Stakeholders are asked to respond to the following specific questions included to reflect matters for further consideration identified by the AUASB during its deliberations on the IAASB’s development of ED-ISQM 2. Further information about the matters related to each of the questions can be found in Table 1 below.

11. Do you agree that the “cooling-off period” should apply to engagements on non-audit services e.g. related services engagements? (Refer to matters identified by the AUASB, matter number 6, table 1)
12. Do you think the requirement for an engagement quality reviewers overall conclusion in paragraph 24 adds value to the performance of the engagement quality review as a whole? (Refer to matters identified by the AUASB, matter number 9, table 1)

Considerations related to Australian Principles and Practices and Laws and Regulation

Stakeholders are asked to respond to the following AUASB specific questions which reflect considerations for ISQM 2 related to the Australian regulatory environment and principles and practices considered appropriate in Australia.

NB: The AUASB is yet to consider Australian modifications to this standards as part of its due process. Refer to paragraph 7 for further information

13. Are there any modifications to the extant ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*, which are still relevant to the ED-ISQM 2?
14. Have applicable laws and regulations been appropriately addressed in the proposed standard? Are there any references to relevant laws or regulations that have been omitted?
15. Whether there are any laws or regulations that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
16. Whether there are any principles and practices considered appropriate in maintaining or improving audit quality in Australia that may, or do, prevent or impede the application of the proposed standard, or may conflict with the proposed standard?
17. What, if any, are the additional significant costs to/benefits for auditors and the business community arising from compliance with the requirements of this proposed standard? If significant costs are expected, the AUASB would like to understand:
 - (a) Where those costs are likely to occur;
 - (b) The estimated extent of costs, in percentage terms (relative to audit fees); and
 - (c) Whether expected costs outweigh the benefits to the users of audit services?
18. Are there any other significant public interest matters that stakeholders wish to raise?

Issues identified by the AUASB

6. As part of its International Strategy, the AUASB reviews the ongoing progress of all IAASB proposed standards over the course of their development. The AUASB’s International Strategy is designed to ensure the AUASB influences international standards and guidance as early as possible, by identifying matters for consideration that achieve public interest outcomes and ensuring they serve as the most effective base for the Australian auditing and assurance standards.

Matters 1-10 in Table 1 have been raised by the AUASB during this review process and have either resulted in additional questions 9-12 above or have been appropriately addressed by an existing IAASB question as noted below.

Table 1 – Matters Identified by the AUASB

Matter #	Para #	Matter Raised	Brief Description
1.	ISQM 1 – para 37(e)	Linkages to proposed ISQM 1 and Scope of engagements subject to EQR	<p>The AUASB notes that this paragraph now sets out the linkages between ISQM 1 and ISQM 2 and specifies all engagements for which an Engagement Quality Review is required to be performed in accordance with proposed ISQM 1 (revised).</p> <p>IAASB have addressed this at Question 1 and 2.</p>
2.	ISQM 1 – para 19 & 37(e)	Scope of engagements subject to Engagement Quality Reviews	<p>The AUASB notes that the scope of engagements subject to Engagement Quality Reviews now includes audits of financial statements of entities that the firm determines are significant public interest entities.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer Question 10:</p> <p><i>In relation to engagement quality reviews:</i></p> <p>(a) <i>Do you agree with the definition of Engagement Quality Reviews/Reviewer and do you consider the term to be clear and capable of application in a consistent way across engagements?</i></p> <p>(b) <i>Do you agree that engagement quality reviews should also be performed for audits of financial statements of entities that the firm determines are significant public interest entities?</i></p> <p>(c) <i>Has the term “significant public interest entity” clear and capable of application in a consistent way across engagements?</i></p>
3.	11	Changes to Key Definitions	<p>The AUASB notes the changes to the terminology from ‘engagement quality control review/reviewer to “engagement quality review/reviewer”. This change is proposed to be consistent with the proposed ISQM 1 (revised) which now refers to quality management rather than quality control.</p> <p>IAASB have addressed this at Question 3.</p>
4.	11	Definition of Engagement Team	<p>The AUASB raises concerns in relation to the definition of the term Engagement Team used across the suite of quality management standards. The AUASB considers that the definitions are not used/defined consistently across the standards and are not clear and accordingly may not be capable of application in a consistent way.</p>

Matter #	Para #	Matter Raised	Brief Description
			<p>The AUASB has included a specific question in the Explanatory Memorandum, refer Question 9:</p> <p><i>Do you consider that the definition engagement team has been consistently applied across the suite of Quality Management Standards?</i></p>
5.	15-20	Eligibility of the engagement quality reviewer (including cooling-off period)	<p>The AUASB notes that these amendments seek to clarify what authority the Engagement Quality Reviewer has, actions to be taken when the Engagement Quality Reviewer’s eligibility is impaired, Engagement Quality Reviewers objectivity including, when applicable, limitations on the eligibility to be appointed an Engagement Quality Reviewer.</p> <p>The AUASB also notes that further work is to be completed on the cooling-off period being coordinated with IESBA through a joint working group.</p> <p>IAASB have addressed this at Question 4.</p>
6.	15-20 & A5	Cooling-off period	<p>The AUASB notes that the cooling-off period now applies to engagements of non-audit services e.g. related services as these engagements apply under proposed ISQM 1 (revised).</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer Question 11:</p> <p><i>Do you agree that the “cooling-off period” should apply to engagements on non-audit services e.g. related services engagements?</i></p>
7.	21-23	Performance of an engagement quality review	<p>The AUASB notes that these amendments seek to clarify the Engagement Quality Reviewers responsibilities in relation to evaluating the engagement team’s significant judgements. For financial statement audits <i>this</i> has now been linked to the requirements in ISA 220 and A80 which provides examples of significant judgements through A29-A30 of ISQM 2. ED ISQM 2 paragraph 22(e) addresses consultation on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations.</p> <p>IAASB have addressed this at Question 5 and 6.</p>
8.	21(c) and A24	Consultation between the engagement team and the engagement quality reviewer	<p>The AUASB notes that this requirement deals with the risk of consultations between the engagement team and Engagement Quality Reviewer about a significant judgement, impairing the objectivity of the Engagement Quality Reviewer and the appropriate actions to take in these circumstances.</p> <p>IAASB have addressed this at Question 5.</p>
9.	24	Engagement quality reviewer’s overall conclusion	<p>The AUASB notes that the requirement in ED ISQM 2 at paragraph 24 addresses that the Engagement Quality Reviewer shall evaluate whether, the requirements of ISQM 2 have been fulfilled, and whether the Engagement Quality Review is complete. This is essentially a “stand back” provision.</p> <p>The AUASB has included a specific question in the Explanatory Memorandum, refer Question 12:</p>

Matter #	Para #	Matter Raised	Brief Description
			<i>Do you think the requirement for an engagement quality reviewers overall conclusion in paragraph 24 adds value to the performance of the engagement quality review as a whole?</i>
10.	25 -27	Documentation	The AUASB notes that ED ISQM 2 has strengthened, clarified and been more specific in the amended documentation requirements. IAASB have addressed this at Question 7.

Consideration of Australian modifications to ASQM 2 from extant ASA 220

7. As outlined in the Explanatory Guide *Exposure of the IAASB’s Proposed Quality Management Standards in Australia*, the AUASB is yet to consider whether any current Australian specific modifications contained in the extant version of ASA 220 (Auditing Standard ASA 220 *Quality Control for an Audit of a Financial Report and Other Historical Financial Information*, last issued in May 2017) are applicable to the proposed ASQM 2. The list of modifications relating to ASQM 2 in the extant ASA 220 summarised in Appendix 1 below will be evaluated for inclusion in the revised ASQM 2 by the AUASB at a later date. However, whilst requesting Australian constituents to comment on this explanatory memorandum, stakeholders are also requested to consider whether these Australian specific modifications are still relevant to the proposed international auditing standard. Refer to Question 16.

Potential Australian modifications arising from proposed ISQM 2

8. As outlined in the Explanatory Guide *Exposure of the IAASB’s Proposed Quality Management Standards in Australia*, the AUASB is yet to consider whether any additional Australian modifications will be required arising from the proposed ISQM 2. This will be considered by the AUASB in due course and as the drafting of proposed ISQM 2 progresses after the IAASB analyses and addresses comments raised on exposure.

Comment Date and How to Comment

9. Comments to the AUASB will close on Wednesday 5 June 2019. This allows for the AUASB Audit Technical Group to analyse stakeholder comments and prepare a draft submission to the IAASB. The AUASB will then deliberate the content of the draft submission at a 26 June 2019 teleconference. The AUASB submission is due to the IAASB on 1 July 2019.
10. Where stakeholders for timing or other reasons cannot share a written submission with the AUASB, we request that feedback is still provided in another form. Where stakeholders are intending to only share feedback directly with the IAASB, we request that the AUASB is still consulted on any major concerns with the exposure drafts and if possible that the stakeholder submits or at least shares their submissions to the IAASB with the AUASB as early as possible.

Planned Outreach in Australia

11. The AUASB plans to hold roundtable events in Sydney, Melbourne and Perth. Additionally the AUASB intends to collaborate closely with the NZAuASB and the professional bodies in their outreach plans; so that we obtain sufficient feedback from the SMP sector. Furthermore, the AUASB expects to host webinars summarising feedback from roundtable sessions, with a view to seeking additional feedback on targeted areas. The timing of outreach events will be finalised by the end of March 2019.

Appendix 1:

Extracts of Australian Amendments relating to ASQM 2 from extant ASA 220

Extant ASA 220 Para #	Australian Text
Aus 21.1	<p data-bbox="328 477 727 506"><i>Engagement Quality Control Review</i></p> <p data-bbox="328 533 1350 651">For audits of financial reports of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:</p> <ul data-bbox="376 680 1366 976" style="list-style-type: none"><li data-bbox="376 680 1366 741">(a) The engagement team’s evaluation of the firm’s independence in relation to the audit engagement;<li data-bbox="376 770 1366 860">(b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and<li data-bbox="376 889 1366 976">(c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgements made and supports the conclusions reached. (Ref: Para. A28-A32)

ATTACHMENT 1 – PROPOSED INTERNATIONAL
STANDARD ON AUDITING ISQM 2