

## Proposed ISQC 2<sup>1</sup> – Issues Paper

### Objectives of this Session

The objectives of this Agenda Item are:

1. To update the IAASB on actions taken since this project was last discussed by the IAASB in September 2017.
2. To seek the IAASB's views on the draft exposure draft of proposed ISQC 2 (set out in **Agenda Item 6–A**) and the extracts of the draft exposure draft of proposed ISQC 1 (Revised) relevant to engagement quality reviews<sup>2</sup> (set out in **Agenda Item 6–B**).

## Section I Introduction

### A Background

1. In December 2015, the IAASB issued an Invitation to Comment (ITC), “Enhancing Audit Quality in the Public Interest – A Focus on Quality Control, Professional Skepticism and Group Audits.” Responses to the ITC highlighted the need to address engagement quality control reviews as an important feature of a quality management system.
2. The Audit Quality Enhancements Coordination Working Group reported at the June 2016 IAASB meeting that there was ongoing support for the importance of engagement quality control reviews as a key quality control measure, while maintaining balance and perspective relative to the role of the engagement partner, who is ultimately responsible for audit quality.
3. The Task Force last presented the draft exposure draft (ED) of proposed ISQC 2 (and related amendments to ISQC 1) for engagement quality (EQ) reviews to the Board at the September 2017 IAASB meeting. Extracts from the minutes of that meeting, as well as minutes of other past IAASB meetings reflecting decisions made related to EQ reviews, are included in Appendix B to this agenda item. Relevant extracts from the September 2017 minutes are also referenced within this paper. The agenda papers for the September 2017 IAASB meeting may be found under **Agenda Item 3** at: [www.iaasb.org/meetings/new-york-usa-16](http://www.iaasb.org/meetings/new-york-usa-16).
4. Extracts of the quality control project proposal related to EQ reviews are included in Appendix C. As significant time has elapsed since this was last discussed, Board Members are encouraged to read these appendices in preparing for this meeting, to familiarize themselves with past decisions taken by the Board.
5. In the process of progressing the draft ED of proposed ISQC 2, the Task Force has also aligned terms and concepts with related terms and concepts used in the ISQC 1 and ISA 220 projects. Coordination between the Task Forces is discussed in Appendix A.
6. A link to the IAASB project page may be found at: [ISQC 2](#).

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<sup>1</sup> Proposed ISQC 1 (Revised), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*.

<sup>2</sup> See paragraph 18–19 for discussion of the change from “engagement quality control review” to “engagement quality review.”

## **B Overview**

7. This paper should be read in conjunction with **Agenda Item 6–A**, a clean draft of the ED of proposed ISQC 2 and with **Agenda Item 6–B**, a clean draft of the extracts from the ED of proposed ISQC 1 (Revised) relevant to EQ reviews.
8. Section II of this paper addresses the following key issues on which the IAASB’s views are sought:
  - Linkages to proposed ISQC 1 (Revised) (see Section II.A)
  - Authority of proposed ISQC 2 (see Section II.B)
  - Definitions (see Section II.C)
  - Scope of engagements subject to an engagement quality review (see Section II.D)
  - Eligibility of the engagement quality reviewer (including cooling-off period) (see Section II.E)
  - Performance of an engagement quality review (see Section II.F)
  - Consultation between the engagement team and the engagement quality reviewer (see Section II.G)
  - The engagement quality reviewer’s overall conclusion (see Section II.H)
  - Documentation (see Section II.I)
9. A listing of the public interest issues identified in the project proposal is provided in Section II.J.

## **C Joint Working Group with IESBA**

10. The Joint Working Group (JWG),<sup>3</sup> has also met to address the objectivity of the EQ review. The results of this meeting are described in Section II.E.

## **D Material Provided**

11. The agenda material presented is as follows:
  - Draft ED of Proposed ISQC 2 – Clean version – See **Agenda Item 6–A**
  - Extracts of the draft ED of proposed ISQC 1 (Revised) relevant to EQ reviews – See **Agenda Item 6–B**
  - For information, a table that displays the requirements and related application material in the draft ED of proposed ISQC 2 side-by-side – See **Agenda Item 6–C**
  - A table setting out the location of requirements pertaining to the EQ review in extant ISQC 1 contained in the draft ED of proposed ISQC 1 (Revised) and the draft ED of proposed ISQC 2 – See **Agenda Item 6–D**
  - A markup of the draft ED of proposed ISQC 2 wording from the September 2017 IAASB meeting – See **Agenda Item 6–E**
  - A markup of the extracts of the draft ED of proposed ISQC 1 (Revised) relevant to EQ reviews from the September 2017 IAASB meeting – See **Agenda Item 6–F**

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<sup>3</sup> The Joint Working Group comprises two members of the IAASB’s ISQC 2 Task Force, two members of the IESBA, and is chaired by the Chair of the ISQC 2 Task Force.

- A comparison of the extracts of the draft ED of proposed ISQC1 (Revised) relevant to EQ reviews and the draft ED of proposed ISQC 2 to material relevant to the EQ reviewer in extant ISQC 1 and ISA 220 – See **Agenda Item 6–G** (for reference only)
- A comparison of the extracts of the draft ED of proposed ISQC 1 (Revised) relevant to EQ reviews and the draft ED of proposed ISQC 2 to PCAOB Auditing Standard (AS) 1220, *Engagement Quality Review* – See **Agenda Item 6–H** (for reference only)

Note: The Board discussion will refer to the clean versions of the draft ED of ISQC 2 and the extracts of the draft ED of from ISQC 1 (Revised) related to engagement quality reviews (that is, **Agenda Items 6–A and 6–B**).

## Section II Proposed ISQC 2 and Relationship to Proposed ISQC 1 (Revised)

### A Linkages to Proposed ISQC 1 (Revised)

12. As the draft ED of proposed ISQC 1 (Revised) establishes the firm’s responsibilities for its system of quality management and requires the firm to establish policies or procedures regarding EQ reviews, the draft ED of proposed ISQC 2 needs to be read in the context of the draft ED of proposed ISQC 1 (Revised).
13. The table below shows the linkages between paragraph 43(e) of the draft ED of proposed ISQC 1 (Revised) (see **Agenda Item 6–B**) and the draft ED of proposed ISQC 2 (see **Agenda Item 6–A**).

<b>Proposed ISQC 1 (Revised), Para. 43</b>	<b>Proposed ISQC 2</b>
(e) Establishing policies or procedures addressing engagement quality reviews regarding:	Requirements for the EQ reviewer:
(i) The scope of engagements subject to an engagement quality review, including requiring an engagement quality review to be performed for: (Ref: Para. A100–A102) <ol style="list-style-type: none"> <li>a. All audits of financial statements of listed entities and of other entities that are of significant public interest; and (Ref: Para. A100)</li> <li>b. Engagements for which an engagement quality review is required by law or regulation; and</li> <li>c. Other engagements or classes of engagements for which the firm has determined that an engagement quality review is an appropriate response to a quality risk identified by the firm because of the reasons for the assessment given to the quality risk or for other reason(s).</li> </ol>	N/A – Firm-level only
(ii) The appointment of engagement quality reviewers to perform engagement quality reviews, including:	N/A – Firm-level only

<b>Proposed ISQC 1 (Revised), Para. 43</b>	<b>Proposed ISQC 2</b>
a. The assignment of responsibility for the appointment of engagement quality reviewers to an individual with the competence and capabilities, including objectivity and appropriate authority within the firm, needed to assume the responsibility; (Ref: Para. A104)	
b. The criteria for eligibility to perform, or participate as an assistant in, the engagement quality review that fulfill the requirements in ISQC 2 <sup>4</sup> , including limitations on the eligibility of individuals as engagement quality reviewers who previously served as engagement partner on the engagement subject to the review; and (Ref: Para. A105-A106C)	See paragraphs 20 and 22
c. The replacement of the engagement quality reviewer when the reviewer's ability to perform the engagement quality review is impaired. (Ref: Para. A106D)	See paragraph 21
(iii) The responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review that fulfill the requirements of ISQC 2. <sup>5</sup>	See paragraphs 23–26
(iv) The responsibilities of the engagement partner in relation to the engagement quality review, including prohibiting the engagement partner from dating the engagement report until the completion of the review. (Ref: Para. A108–A108A)	N/A – Firm-level only
(v) Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer. (Ref: Para. A109)	See paragraph A15
(vi) Communication of responsibilities for engagement quality reviews to, as applicable: a. Individuals involved in appointing engagement quality reviewers;	N/A – Firm-level only

<sup>4</sup> Proposed ISQC 2, paragraph 20 and 22

<sup>5</sup> Proposed ISQC 2, paragraphs 23–26

Proposed ISQC 1 (Revised), Para. 43	Proposed ISQC 2
<p>b. Engagement quality reviewers and individuals who assist engagement quality reviewers in performing such reviews; and</p> <p>c. Engagement partners and members of engagement teams on engagements subject to engagement quality review.</p>	

*Objectives of Proposed ISQC 2*

14. The objectives relating to an EQ review in the draft ED of proposed ISQC 2 include both the objectives pertaining to the eligibility criteria and the performance of the EQ review. The Task Force considered whether the firm’s objective related to the EQ review should reside in the draft ED of proposed ISQC 1 (Revised) or in the draft ED of proposed ISQC 2. The Task Force thought it important to clearly highlight that some of the firm’s responsibilities related to the EQ review are contained in the draft ED of proposed ISQC 2 and, therefore, the objectives of the draft ED of proposed ISQC 2 need to refer to both the firm’s objectives and the EQ reviewer’s objectives (see paragraph 15 of **Agenda Item 6–A**).

**Matter for IAASB Consideration**

1. The IAASB is asked whether it supports the revised objective in the ED of proposed ISQC 2 to include the objectives of both the firm and the engagement quality reviewer.

**B Authority of Proposed ISQC 2**

15. The authority of the draft ED of proposed ISQC 1 (Revised) is described in paragraphs 13–17 of **Agenda Item 2-A**. The Task Force considered whether these paragraphs, as drafted, would be adequate to describe the authority of the draft ED of proposed ISQC 2. This approach was used in the ISAE 3000 (Revised) suite of standards, where the authority of the ISAEs is described in ISAE 3000 (Revised),<sup>6</sup> which is required to be complied with when performing any engagement under the ISAEs. The Task Force concluded that, since paragraph 13 of the draft ED of proposed ISQC 1 (Revised) refers only to firms, because the objective of the draft ED of proposed ISQC 1 (Revised) is the objective of the firm, and because there are no requirements directed at the EQ reviewer in the draft ED of proposed ISQC 1 (Revised), it would be difficult to extend the authority of the draft ED of proposed ISQC 1 (Revised) to also cover EQ reviews. As such, the Task Force concluded that the relationship between the two standards is not directly analogous to that between, for example, ISAE 3000 (Revised) and ISAE 3402<sup>7</sup>. (See Section II.A)
16. Accordingly, the Task Force determined that as the draft ED of proposed ISQC 2 is, in effect, a stand-alone ISQC, the draft ED of proposed ISQC 2 should include its own Authority section that addresses the objectives of the firm and the EQ reviewer in relation to EQ reviews, as opposed to seeking to rely on elements of the Authority in the draft ED of proposed ISQC 1 (Revised).

<sup>6</sup> ISAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

<sup>7</sup> ISAE 3402, *Assurance Reports on Controls at a Service Organization*

**Matter for IAASB Consideration**

2. Does the IAASB agree with the Task Force’s view that a separate Authority section is needed for the draft ED of proposed ISQC 2?

**C Definitions**

17. **Agenda Item 6–A** contains definitions of an EQ review, an EQ reviewer, and relevant ethical requirements.
18. The Task Force considered whether it was appropriate to continue to refer to “engagement quality control review/reviewer” in light of the proposed change in the draft ED of proposed ISQC 1 (Revised) to refer to quality management rather than quality control.<sup>8</sup>
19. Accordingly, the Task Force proposes removing the reference to “control” in those terms, and changing them to “engagement quality reviewer” and “engagement quality review.” The Task Force considered that some national auditing and assurance standards and some law or regulation, as well as the IESBA Code,<sup>9</sup> refer to “engagement quality control review” (and “reviewer”) and that making this change could result in the need for conforming amendments in several IAASB and related national standards, law or regulation, as well as coordination with IESBA. The Task Force believes the change is appropriate; however, the Task Force seeks the Board’s views on whether the proposed change is appropriate in the context of the changes needed in response to a new suite of the draft EDs of proposed ISQC 1 (Revised), proposed ISQC 2, and proposed ISA 220 (Revised), the positive change in mindset and the balance of benefits versus costs of the conforming amendments necessary.
20. The Task Force also streamlined the definitions in the draft ED of proposed ISQC 2 (see paragraph 16 of **Agenda Item 6–A**) of the EQ review and EQ reviewer. The Task Force did not consider it necessary to include in the definitions details that repeat requirements of the standard.
21. The Task Force aligned the definition of “relevant ethical requirements” with the definition in the draft ED of proposed ISQC 1 (Revised) and in the draft ED of proposed ISA 220 (Revised) and tailored the definition so that it would apply only to relevant ethical requirements to which the EQ reviewer is subject.

**Matter for IAASB Consideration**

3. Does the IAASB support:
  - (a) The change in terminology from “engagement quality control review/reviewer” to “engagement quality review/reviewer”?
  - (b) The other definitions in the draft ED of proposed ISQC 2?

<sup>8</sup> Under the draft ED of proposed ISQC 1 (Revised), an engagement quality review is one response to identified quality risks. The draft ED of proposed ISQC 1 (Revised) does not refer to the engagement quality review (or any other prescribed responses) as a “control.”

<sup>9</sup> International Ethics Standards Board for Accountants (IESBA), *International Code of Ethics for Professional Accountant (including International Independence Standards)*.

## **D Scope of Engagements Subject to an Engagement Quality Review**

### *Highlights of the September 2017 IAASB Minutes*

22. At the September 2017 IAASB meeting, the Board asked the Task Force to consider various improvements to the requirements and application material addressing the scope of engagements subject to an EQ review (see Appendix B).

### *Task Force Views*

23. The Task Force considered whether the draft ED of proposed ISQC 1 (Revised) should mandate additional circumstances when an EQ review would be required—beyond audits of listed entities, engagements that require an EQ review pursuant to law or regulation and other engagement the firm determines should have an EQ review in response to a quality risk.
24. The Task Force noted that paragraph 43(e)(i) of the draft ED of proposed ISQC 1 (Revised) does not include audits of public interest entities. The Task Force considers that because the term “public interest entity” is not a defined term in the IAASB International Standards,<sup>10</sup> the nature of entities that may be considered to be included in this category may not be consistent across jurisdictions. However, the Task Force is of the view that it is in the public interest that EQ reviews should also be required for audits of other entities that are of significant public interest. This is consistent with the views of certain respondents to the ITC, particularly regulators and audit oversight bodies.
25. The Task Force also noted that the ISQC 1 Task Force has progressed its development of requirements on communication of information to parties external to the firm to include specific consideration of the extent to which the firm performs engagements for entities that have a significant public interest with supporting application material explaining the nature of such entities. (Agenda Item 2-A, paragraph 45(b)(iii) and A130).
26. The Task Force considered whether the requirement for the firm to determine whether an EQ review is an appropriate response to a quality risk identified by the firm is sufficient to capture entities of significant public interest. Application material in paragraph A101 of the draft ED of proposed ISQC 1 (Revised) includes characteristics of engagements that the firm may identify to be subject to engagement quality review due to the quality risks related to quality objectives.
27. The Task Force concluded that it is in the public interest to include entities that are of significant public interest as part the scope of engagements subject to an EQ review.
28. Accordingly, the Task Force has extended the scope of engagements subject to an EQ review, as part of paragraph 43(e)(i) of the draft ED of proposed ISQC 1 (Revised), to include all audits of financial statements of other entities that are of significant public interest. This is supported by application material in paragraph A100 of the draft ED of proposed ISQC 1 (Revised) that describes the types of entities that may be of significant public interest (e.g. banks, insurance companies and pension funds). The Task Force will continue to discuss whether the engagement quality reviews should be performed for all audits of financial statements of listed entities and of other entities that are of significant public interest, or whether it should be limited to audits of general purpose financial statements only (that is, excluding special purpose financial reports).
29. Paragraph A103 of the draft ED of proposed ISQC 1 (Revised) also contains specific application material related engagements for public sector entities.

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<sup>10</sup> The Glossary in the IESBA Code defines public interest entities.

**Matter for IAASB Consideration**

4. The IAASB is asked for its views on whether:
- (a) The intended scope of the engagements subject to EQ reviews is clear and sufficiently robust in the public interest;
  - (b) The changes made in the draft ED of proposed ISQC 1 (Revised), paragraph 43(e) and related application material address the issues identified at the September 2017 meeting; and
  - (c) The approach taken to require EQ reviews for audits of entities of significant public interest is appropriate, or whether it would be sufficient to rely on the firm's risk assessment process to capture entities of significant public interest.

**E Eligibility of the Engagement Quality Reviewer (Including Cooling-off Period)**

*Highlights of the September 2017 IAASB Minutes*

30. At the September 2017 IAASB meeting, the Board asked the Task Force to explain in the draft ED of proposed ISQC 1 (Revised) how the appropriate combination of criteria may be attained in determining eligibility of the EQ reviewer (see Appendix B).

*Task Force Views*

31. The Task Force did not take this to mean that there is a trade-off between, for example, objectivity and competence, but rather, that the requirements should identify the EQ reviewer's qualifications and application material should provide further explanation of how the person appointing the EQ reviewer would apply the eligibility criteria in selecting EQ reviewers for individual engagements.
32. Paragraphs 20–22 of Agenda Item 6–A address the EQ reviewer's qualifications, including competence, capabilities and the appropriate authority and compliance with ethical requirements. In brief, these paragraphs require that the EQ reviewer cannot be a member of the engagement team, needs to have the necessary objectivity, competence, capabilities and appropriate authority, and complies with relevant ethical requirements, relevant firm policies and procedures, and relevant law or regulation (see paragraph 20 of the draft ED of proposed ISQC 2). These paragraphs also address the circumstance when the EQ reviewer becomes aware of circumstances that would impair their eligibility (paragraph 21 of the draft ED of proposed ISQC 2) and eligibility requirements for individuals assisting the EQ reviewer (paragraph 22 of the draft ED of proposed ISQC 2).
33. The Task Force is of the view that the eligibility criteria, as drafted, allow the appointer of EQ reviewers to use professional judgment in considering candidates' qualifications. The criteria are not so restrictive that they would inappropriately limit the pool of eligible individuals such that it would be difficult for firms to appoint EQ reviewers to all engagements that require such reviews.
34. The issue of a cooling-off period before an engagement partner can act as an EQ reviewer is being coordinated with IESBA through a Joint Working Group. A supplemental paper will address the progress and preliminary views of the Joint Working Group.

**Matter for IAASB Consideration**

5. The IAASB is asked for its views on the eligibility criteria for EQ reviewers (paragraph 20 of the draft ED of proposed ISQC 2) and for individuals who assist the EQ reviewer (paragraph 22 of the draft ED of proposed ISQC 2).

## F Performance of an Engagement Quality Review

### *Highlights of the September 2017 IAASB Minutes*

35. The Board asked that the draft ED of proposed ISQC 2:
- Improve the focus on significant judgments and clarifying what these may be, as well as how the EQ reviewer may identify significant judgments;
  - Clarify the difference between ‘significant matters’ and ‘significant judgments;’ and
  - Clarify that the EQ reviewer evaluates the engagement team’s process for making significant judgments and the professional skepticism applied by the engagement team (see Appendix B).

### *Task Force Views*

36. The Task Force has included paragraph 23 in the draft ED of proposed ISQC 2 to set expectations for the nature, timing and extent of the procedures performed by the EQ reviewer. The application material explains that the engagement quality reviewer’s review of engagement documentation is less extensive than the engagement partner’s (see paragraph A27).
37. The Task Force has proposed amendments to strengthen and clarify the EQ review procedures, supported by application material. The EQ reviewer is required to read and understand relevant information and discuss significant matters with the engagement partner (and, if applicable, other members of the engagement team). This allows the EQ reviewer to identify the significant judgments made, or that ought to have been made by the engagement team (see paragraphs 24(a)–(c) of the draft ED of proposed ISQC 2). Paragraph 24(d) then requires the EQ reviewer to review selected engagement documentation of significant judgments made by the engagement team, including significant judgments made in relation to significant matters. This includes an evaluation of the engagement team’s basis for making such significant judgments, including, when applicable, the appropriate exercise of professional skepticism. The Task Force discussed whether the EQ reviewer’s review of selected engagement documentation of significant judgements should be over all significant judgments or over a sub-set thereof (i.e., significant judgments made in relation to significant matters). Although the Task Force has not reached a consensus on the issue, and there are differing views on the issue, there are Task Force members who support retaining the EQ review focusing on “significant judgments” as required in extant ISA 220.
38. The application material provided in paragraph A28 of the draft ED of proposed ISQC 2 provides examples of matters that may be considered to be significant judgments made by the engagement team. The Task Force seeks the Board’s direction on the extent to which other specific areas are expected to be significant judgments made by the engagement team.
39. The ISA 220 Task Force has sought to clarify the nature of significant judgments in audits of financial statements (see paragraph A19A of **Agenda Item 4–B**). The Task Force needs to coordinate with the ISA 220 Task Force so that the examples of significant judgments in the draft ED of proposed ISQC 2 are consistent with those in the draft ED of proposed ISA 220 (Revised) when appropriate.
40. In addition, the Task Force needs to further consider whether other significant judgments for other engagements need to be identified in the application material.
41. Paragraph 24(e) of the draft ED of proposed ISQC 2 contains an audit-specific requirement that the EQ reviewer review whether the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement.

**Matter for IAASB Consideration**

6. IAASB views are sought on whether paragraphs 23–25 of Agenda Item 6–A provide sufficient clarity on the engagement quality reviewer’s responsibilities. Input is also sought on whether the scope of focusing on “significant judgments” is adequately and appropriately explained.

**G Consultation between the Engagement Team and the Engagement Quality Reviewer**

*Highlights of the September 2017 Meeting*

42. At the September 2017 IAASB meeting, the Board asked the Task Force to reconsider how the standard addresses consultation with the EQ reviewer because encouraging engagement team consultation with the EQ reviewer may not be appropriate (see Appendix B).

*Task Force Views*

43. The Task Force focused on the potential threat to the EQ reviewer’s objectivity that may arise if the EQ reviewer is “consulted”<sup>11</sup> on a matter that would also be subject to the EQ review. Accordingly, the Task Force has distinguished between the need to encourage open discussions between the EQ reviewer and the engagement team, which aids in the performance of a higher quality engagement, from the formal “consultations” the engagement team may be required to make under the firm’s policies or procedures.
44. In some cases, the EQ reviewer may also be the most appropriate person to involve in a consultation for the engagement (as he or she may have special expertise in, for example, a particular subject matter). In such circumstances, the firm may develop policies or procedures that respond to the threat to the EQ reviewer’s objectivity, such as involving an additional individual from the firm in the consultations or appointing another individual to conduct the EQ review of that area of the engagement. See paragraph A17 of the draft ED of proposed ISQC 2 and paragraphs 43(e)(v) and A109 of the draft ED of proposed ISQC 1 (Revised).

**Matter for IAASB Consideration**

7. Does the IAASB agree with how the Task Force has dealt with the risk of consultations impairing the objectivity of the EQ reviewer?

**H The Engagement Quality Reviewer’s Overall Conclusion**

*Highlights of the September 2017 Meeting*

45. The Board recommended strengthening the requirement in relation to the EQ reviewer’s evaluation of the sufficiency and appropriateness of the procedures and including a requirement for the EQ reviewer to conclude overall (i.e., similar to the conclusion in AS 1220<sup>12</sup>) (see Appendix B).

*Task Force Views*

46. In response, the Task Force has added a requirement in paragraph 25(a) of proposed ISQC 2 that the EQ reviewer shall evaluate whether, on or before the date of the engagement report, the requirements of the draft ED of proposed ISQC 2 have been fulfilled, taking into account the firm’s policies or procedures that address the requirements and the objective of the draft ED of proposed ISQC 2 has been achieved.

<sup>11</sup> “Consulted” within the meaning of the draft ED of proposed ISQC 1 (Revised), paragraphs 43(c) and A96–A97.

<sup>12</sup> Public Company Accounting Oversight Board (PCAOB) Auditing Standard (AS) 1220, *Engagement Quality Review*

**Matters for IAASB Consideration**

8. The IAASB is asked whether it agrees with the Task Force's proposals in paragraph 25(a) of Agenda Item 6–A.

**I Documentation**

*Highlights of the September 2017 Meeting*

47. The September 2017 draft ED of proposed ISQC 1 (Revised) (see **Agenda Item 6–F**) required the firm to document:
- (a) The policies or procedures in relation to engagements that require an engagement quality control review to be performed that shall be sufficient to enable a consistent understanding and application of the firm's policies or procedures; and
  - (b) The selection of individual engagements subject to engagement quality control review (see Appendix B).
48. The Board broadly supported the proposals and, in addition to various drafting recommendations, suggested:
- Placing more focus on what should be documented in relation to the performance and outcome of the EQ review, instead of what the firm policies or procedures should address;
  - Refocusing the documentation requirement in the draft ED of proposed ISQC 1 (Revised) on documenting the reasons for the selection of classes of engagements subject to EQ review; and
  - Clarifying that the EQ reviewer, and not the engagement team, is responsible for the documentation of the EQ review.

*Task Force Views*

Firm-level Documentation (Draft ED of proposed ISQC 1 (Revised))

49. Paragraph 69 of the draft ED of proposed ISQC 1 (Revised) (see **Agenda Item 2–A**) requires the firm's documentation to include:
- (a) The firm's quality objectives and quality risks;
  - (b) A description of the responses and how the firm's responses address the quality risks;
  - (c) In relation to the monitoring and remediation process:
    - (i) Evidence of the monitoring activities performed;
    - (ii) The evaluation of the findings from the monitoring activities, results of external inspections and other relevant information, including the identified deficiencies and their related root cause(s);
    - (iii) Remedial actions to address deficiencies and the evaluation of the design and implementation of such remedial actions;
    - (v) Communications about monitoring and remediation;
    - (vi) The basis for the evaluation of whether the system of quality management provides the firm with reasonable assurance in relation to the objectives described in paragraph 19(a) and (b).

50. The Task Force discussed whether to:
- Require firm-level documentation for each of the required policies or procedures related to the EQ review in a separate subparagraph (perhaps similar to those for the firm's monitoring and remediation process in paragraph 69(c)); or
  - Include a specific reference to the EQ review, as an example to subparagraph (b) or as a separate subparagraph (d) in paragraph 69.
51. The Task Force considered the requirements in the draft ED of proposed ISQC 1 (Revised) and is of the view that the broad requirements in subparagraphs (a) and (b) of paragraph 69 sufficiently address firm-level documentation of EQ reviews and that no specific documentation requirements for EQ reviews are needed for the following reasons:
- An EQ review is only one type of response to quality risks and other types of responses may be equally or more effective in addressing the quality risks, including other forms of reviews, and, therefore, should not be highlighted in the firm-level documentation requirements.
  - Any relevant documentation specific to the EQ review performed would be captured by the EQ reviewer documentation required by the draft ED of proposed ISQC 2.
  - Detailed requirements or providing the EQ review as a specific example would not align with the nature and extent of the other documentation requirements in paragraph 69 of the draft ED of proposed ISQC 1 (Revised).

Engagement-level Documentation (Draft ED of proposed ISQC 2)

52. The Task Force considered the required documentation for EQ reviews in light of the other changes made in the standard to address the Board's direction from September 2017. Based on its discussions, the Task Force updated the documentation requirements in paragraph 26 of proposed ISQC 2 to require the EQ reviewer to prepare documentation that includes describes the nature, timing and extent of the procedures performed by the EQ reviewer, identifies the engagement documentation reviewed and includes the basis for the conclusions made in paragraph 25 of the draft ED of proposed ISQC 2 (that is, the EQ reviewer's overall conclusions about the EQ review) (see Section H).

**Matters for IAASB Consideration**

9. IAASB is asked whether:
- (a) It agrees that the documentation requirements in the draft ED of proposed ISQC 1 (Revised) should not specifically address EQ reviews.
  - (b) It agrees with the documentation requirements in paragraph 26 **of Agenda Item 6–A**.

**J Public Interest Issues**

KEY PUBLIC INTEREST ISSUES <sup>13</sup>	DESCRIPTION OF ISSUE(S) ADDRESSED	REFERENCE TO RELEVANT PARAGRAPHS WITHIN PROPOSED ISQC 2 [AGENDA ITEM 6–A]
<b>Addressing and encouraging appropriate exercise of professional skepticism</b>	The EQ review is one response, among others, to the firm’s identified quality risks that relate to the quality objective in paragraph 42 of the draft ED of proposed ISQC 1 (Revised) that engagement teams exercise professional skepticism in performing engagements.	ISQC 2, paras. 24(d) and A24  The EQ reviewer’s skepticism is also enhanced by taking further actions if needed:  ISQC 2, para 20
	Tight financial reporting deadlines, time, budget or resource constraints, may act as an impediment to the exercise of professional skepticism. Therefore, the EQ reviewer is required to perform the EQ review procedures at appropriate points in time during the engagement. In addition an element of “capabilities” is having the time and resources, including the time to perform the review at appropriate times during the engagement.	The EQ reviewer criteria includes that the EQ reviewer is not subject to threats to objectivity that are not at, or that have not been reduced to, an acceptable level:  ISQC 2, para. 20 (c)
	The EQ reviewer’s review of significant judgements made by the engagement team, including significant judgments made in relation to significant matters, in the engagement highlight those areas of the engagement with higher risk of the existence of unintentional or intentional auditor biases that may act as an impediment to the exercise of professional skepticism.	Greater specificity on the procedures to be undertaken in identifying and evaluating significant judgments:  ISQC 2, paras. 24(a)–(d) and A28  Reviewing whether the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement:  ISQC 2, para. 24(e)  Stand back requirement:  ISQC 2, para. 25
	Consideration of whether EQ reviewer, and any individuals that assist the reviewer, have competence, capabilities and the appropriate authority to evaluate the significant judgments made by the ET and the conclusions reached thereon.	ISQC 2, paras. 20(b), 22 and A7–A11  ISQC 1, para.43(e)(ii)(b)

<sup>13</sup> The issues identified in this table are adapted from the issues identified in the project proposal addressing the revisions of the IAASB’s quality control standards (ISQC 1 and ISA 220) and group audits (ISA 600). The project proposal can be found at the following link [http://www.iaasb.org/system/files/meetings/files/20161205-IAASB\\_Agenda\\_Item\\_9A-GA-and-QC-Project-Proposal-Approved\\_0.pdf](http://www.iaasb.org/system/files/meetings/files/20161205-IAASB_Agenda_Item_9A-GA-and-QC-Project-Proposal-Approved_0.pdf)

<b>KEY PUBLIC INTEREST ISSUES<sup>13</sup></b>	<b>DESCRIPTION OF ISSUE(S) ADDRESSED</b>	<b>REFERENCE TO RELEVANT PARAGRAPHS WITHIN PROPOSED ISQC 2 [AGENDA ITEM 6–A]</b>
<b>Clarifying the EQ reviewer’s responsibilities</b>	Enhancing the requirements and application material to clarify the EQ reviewer’s responsibilities in performing and documenting an EQ review, including determining the nature, timing and extent of EQ review procedures in the circumstances.	Policies or procedures: ISQC 1, para. 43(e)(iii) Performance requirements: ISQC 2, paras. 23–25 and A24–A30
	Enhancing the requirements and application material in relation to the two-way communication necessary between the EQ reviewer and the engagement partner and the engagement team.	Policies or procedures: ISQC 1, para. 43(e)(vi) EQ reviewer’s responsibility to communicate with the engagement partner, and if applicable, other members of the ET: ISQC 2, para. 24(b)

## Appendix A

### ISQC 2 Task Force Activities Including Outreach and Coordination with Other IAASB Task Forces and Working Groups

1. The following sets out the activities of the Task Force, including outreach with others and coordination with other IAASB Task Forces and Working Groups relating to the project since December 2017.

#### Task Force Activities since the last IAASB Discussion

2. Since the September 2017 IAASB meeting, the Task Force has met once in person, and held two teleconferences in order to develop the material in the agenda papers.

#### Coordination with Other IAASB Task Forces and Working Groups and the IESBA

3. This project is closely linked to the draft ED of proposed ISQC 1 (Revised), under which the firm's policies and procedures for EQ reviews are established, and to the draft ED of proposed ISA 220 (Revised), which deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements, and the related responsibilities of the engagement partner.
4. The Task Force will continue to monitor progress on the ISQC 1 and ISA 220 projects, interact with the respective Task Forces and make any changes required to maintain consistency among the standards. Co-ordination will be managed at a staff, Task Force chair, and Task Force level as needed.
5. In addition, the Task Force will continue to liaise with key stakeholders, such as:
  - The JWG, regarding how to best address the cooling-off period;
  - The SMP task force, and the SMP Committee, as required, regarding the scalability of the proposals, in particular those related to the eligibility of the EQ reviewer; and
  - INTOSAI's<sup>14</sup> Auditing Subcommittee for example, regarding the application material on public sector issues in paragraph A15 of the draft ED of proposed ISQC 2 in **Agenda Item 6–A** and paragraph A103 of the draft ED of proposed ISQC 1 (Revised) in **Agenda Item 6–B**;
  - Key regulators, including IOSCO<sup>15</sup> and IFIAR; and
  - Representatives of firms of different sizes and types of engagements conducted (e.g., GPPC, Forum of Firms).
6. The Task Force will provide an update on these activities at the September 2018 IAASB meeting.

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<sup>14</sup> International Organization of Supreme Audit Institutions

<sup>15</sup> International Organization of Securities Commissions

## Extracts of IAASB Meeting Minutes Where ISQC 2 was Discussed

### 1. September 2017 IAASB Meeting Minutes Excerpt

### 3. Engagement Quality Control (EQC) Reviews

Ms. French provided an overview of the proposals in relation to EQC reviews in ISQC 1<sup>16</sup> (**Agenda Item 3–B**) and the newly established standard, proposed ISQC 2<sup>17</sup> (**Agenda Item 3–C**). Although some members were of the view that certain requirements in relation to the firm and relevant application material should be placed in ISQC 1, with ISQC 2 only addressing the responsibilities of the EQC reviewer, the Board on the whole supported the balance of the requirements in ISQC 1 (Revised) and ISQC 2, as presented in **Agenda Item 3–B** and **Agenda Item 3–C**.

The IAASB agreed that the purpose of the EQC review remains appropriate, i.e., that the EQC review should focus on significant judgments made by the engagement team, however recommended that the standard should more clearly explain what is meant by an evaluation of the significant judgments, including that it is broader than significant judgments regarding the evaluation of audit evidence.

In relation to the proposals in general, the IAASB recommended:

- Clarifying in the context of the quality management process that the EQC review is only one type of response to quality risks and that other types of responses may be equally or more effective in addressing the quality risks, including other forms of reviews;
- Evaluating the differences between the proposed requirements and the U.S. Public Company Accounting Oversight Board's (PCAOB) Auditing Standard (AS) 1220;<sup>18</sup> and
- Providing more guidance in the application material for sole practitioners and small-and medium-practices (SMPs), public sector and for EQC reviews performed on engagements other than audits.

#### SCOPE OF ENGAGEMENTS SUBJECT TO AN EQC REVIEW

The Board suggested various improvements to the clarity of the proposed requirements and application material. The Board further encouraged the QCTF to improve the robustness of the requirement in order that entities that are of significant public interest would be captured, and suggested:

- Including in the requirement entities that are undergoing or plan to undergo an initial public offering or admission to public listing; and
- Addressing entities in the public sector.

Additional suggestions by the Board on the scope of engagements subject to an EQC review included:

- Reconsidering the examples of criteria in the application material, as it was noted that they could scope in engagements for which there is not always an associated quality risk; and
- Addressing how the firm may go about identifying other assurance engagements that should be subject to an EQC review and including examples of criteria that may apply to such engagements.

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<sup>16</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*

<sup>17</sup> Proposed ISQC 2, *Engagement Quality Control Reviews*

<sup>18</sup> PCAOB Auditing Standard 1220, *Engagement Quality Review*

## OBJECTIVE AND DEFINITION

The Board recommended various refinements to the objective and encouraged the QCTF to more broadly capture what the EQC review is expected to achieve.

In relation to the definition of the EQC reviewer, the Board suggested various amendments to further clarify the definition and:

- Recommended relocating all aspects in relation to the eligibility of the EQC reviewer to the requirements; and
- Supported eliminating the “team” from the definition, and recommended:
  - Explaining circumstances when a team may be used, and how they may be directed and supervised, in the application material; and
  - Including eligibility criteria that would be applicable to the members of the team, for example, independence, integrity and objectivity.

## ELIGIBILITY OF THE EQC REVIEWER

With respect to the eligibility of the EQC reviewer, in addition to various drafting and clarity suggestions the Board recommended:

- Explaining how the appropriate combination of criteria may be attained;
- Explaining how the criteria support the ability of the person to challenge the significant judgments;
- Addressing the threats to authority and enhancing the application material in this regard, and further proposed including a requirement for the firm to consider the reporting lines within the firm in determining the authority of the individual; and
- The QCTF reconsider how the standard addresses consultation with the EQC reviewer.

## APPOINTMENT OF THE EQC REVIEWER

The Board supported the requirement for the appointment of the EQC reviewer and recommended improving the robustness of the application material addressing circumstances when the firm uses a suitably qualified external person.

## PERFORMANCE OF THE EQC REVIEW

In addition to various drafting suggestions, including improving the linkage between the requirements and clarifying aspects of the application material, the Board recommended:

- Improving the focus on significant judgments and clarifying what these may be, as well as how the EQC reviewer may identify significant judgments that should be subject to the EQC review;
- Clarifying the difference between ‘significant matters’ and ‘significant judgments’;
- Clarifying that the EQC reviewer evaluates the engagement team’s process for making significant judgments and the professional skepticism applied by the engagement team; and
- Strengthening the requirement in relation to the EQC reviewer’s evaluation of the sufficiency and appropriateness of the procedures, and including a requirement for the EQC reviewer to conclude overall (i.e., similar to the conclusion in AS 1220).

The Board further recommended that ISA 220 include requirements addressing the engagement partner’s responsibility for bringing matters to the attention of the EQC reviewer that could be considered significant judgments.

#### DOCUMENTATION OF THE EQC REVIEW

The Board broadly supported the proposals and in addition to various drafting recommendations suggested:

- Placing more focus on what should be documented in relation to the performance and outcome of the EQC review, instead of what the firm policies or procedures should address;
- Refocusing the documentation requirement in ISQC 1 (Revised) on documenting the reasons for the selection of classes of engagements subject to EQC review; and
- Clarifying that the EQC reviewer, and not the engagement team, is responsible for the documentation of the EQC review.

#### IAASB CAG CHAIR'S REMARKS

Mr. Dalkin noted that the CAG was supportive of establishing a separate standard for EQC reviews that would emphasize the importance of the EQC review. He encouraged the QCTF to address how the standard would apply to the public sector and also indicated his support for the requirements addressing documentation.

#### PIOB REMARKS

Ms. Stothers indicated her support for a new standard addressing EQC reviews and encouraged the QCTF to consider the results of inspection findings in developing the proposals.

#### WAY FORWARD

The QCTF will consider the Board's comments and recommendations and present an updated version of the Exposure Draft to the board in its March 2018 meeting.

## **2. March 2017 Meeting Minute Extracts**

### **6. Eligibility of the Engagement Quality Control (EQC) Reviewer**

Ms. French provided an overview of the Quality Control Task Force's (QCTF) proposals in relation to the eligibility of the EQC reviewer, which included the QCTF's recommendations to address the time that an individual who had previously been involved in the audit would not be eligible to fill the role of the EQC reviewer (the cooling-off period). Ms. French also highlighted the feedback from the CAG Representatives at their recent March 2017 meeting, as well as the views of the SMP Committee.

#### CRITERIA FOR SELECTION OF AN EQC REVIEWER

The Board was supportive of the overall direction proposed by the QCTF and encouraged a principles-based approach. The Board requested the QCTF to further consider:

- Circumstances when the EQC review is performed by a group of reviewers and encouraged the QCTF to acknowledge such circumstances.
- The Board's view that the EQC reviewer's authority is created through the processes established by the firm's system of quality management. The Board indicated that the proposals regarding the relationship between the firm's culture and the EQC reviewer's authority were confusing and therefore encouraged clarity regarding how the firm's culture influences the EQC reviewer's authority. The Board also noted that the chain of command in relation to the EQC reviewer could impact the EQC reviewer's authority and objectivity, and recommended that this be specifically discussed in the standard.

- Clarifying the distinction between technical competence and practical experience, and emphasized the importance of attaining an appropriate balance between the attributes. The Board also noted that in some jurisdictions the EQC reviewer is required to be licensed, which could further limit the number of individuals that are eligible to perform the EQC review. The Board also recommended that the criteria for the eligibility of the EQC reviewer should be linked to the basis for which the engagement is subject to an EQC review, however did not consider that it is always necessary for the EQC reviewer to have experience in relation to listed entities.
- The provisions regarding the degree to which the EQC reviewer may be consulted should be retained, as these had been diluted in the proposed revisions.
- How the proposals would relate to engagements that are non-audit engagements.

#### OBJECTIVITY OF THE EQC REVIEWER

The Board agreed that further coordination with the IESBA should be undertaken, taking into consideration the respective remits of the two Boards. The Board did not support the IAASB undertaking revisions to the IAASB's Standards in the absence of the IESBA taking further steps to address the issue. The Board variously:

- Raised concern that the proposed requirements in relation to the objectivity of the EQC reviewer appear more onerous than the provisions in relation to an engagement partner.
- Noted that not all jurisdictions apply the IESBA Code and therefore cautioned against proposals that would be specific to the IESBA Code.
- That a further understanding is needed regarding the basis for IESBA's cooling-off period of three years in relation to an EQC reviewer. The Board encouraged the QCTF to consider a two year cooling-off period (similar to the period prescribed by the United States Public Company Accounting Oversight Board) and to further understand the effect of the proposed cooling-off period on SMPs.

#### THE PROCESS FOR THE SELECTION OF THE EQC REVIEWER

The Board was supportive of the QCTF's proposals in relation to the firm's selection of the EQC reviewer, however suggested that the exemption, "unless, in exceptional circumstances, it is not practicable", be reconsidered as it is unlikely to be an exceptional circumstance in the case of SMPs.

#### IAASB CAG CHAIR'S REMARKS

Ms. Lang highlighted that the CAG Representatives emphasized the importance of achieving an appropriate balance with respect to the criteria for the eligibility of the EQC reviewer and questioned how the proposals would be implemented and enforced. Furthermore, Ms. Lang noted that many IAASB CAG Representatives are also IESBA CAG Representatives, and accordingly were supportive of the cooperation with the IESBA on this topic.

#### PIOB OBSERVER REMARKS

Mr. Holm encouraged the IAASB to further coordinate with the IESBA with respect to the cooling-off period.

#### WAY FORWARD

The QCTF will consider the Board's comments in further addressing the enhancements to EQC reviews. The QCTF will present their recommendations on the EQC review, including the eligibility of the EQC reviewer, to the Board at its September 2017 meeting.

### **3. December 2016 Meeting Minute Extracts**

#### **6. Engagement Quality Control (EQC) Review**

Ms. French introduced the topic of engagement quality control (EQC) reviews and provided an overview of the SMP Committee feedback in respect of the issues presented in **Agenda Item 7-A**. She explained that the SMP Committee was supportive of the proposed changes to the timing of the EQC review, however provided various suggestions and comments on the proposed objective and definition, mostly relating to the clarity and appropriateness of certain aspects of the objective and definition. Ms. French explained that the SMP Committee was concerned with the proposed scope of engagements subject to an EQC review and were of the view that the proposals are going beyond what is needed to address the public interest. She also noted the SMP Committee's views on the execution of the EQC review, in particular that the public interest is a necessary driver of the required review procedures and that the determination of whether further review procedures should be performed should not rest solely with the EQC reviewer. Ms. French also noted the SMP Committee's recommendation to bring more emphasis to the roles and responsibilities of the EQC reviewer.

The Board in general agreed with the direction of the Quality Control Other Working Group's (QCOWG) proposals for EQC reviews and provided the following recommendations:

- In relation to the objective and the definition of the EQC review, reinstate the concept that the EQC review should be completed on or before the date of the report while retaining the proposal that the EQC review should be performed at appropriate stages during the engagement and modify the language to encapsulate all circumstances when an EQC review is performed.
- In relation to the scope of the engagements that are subject to an EQC review:
  - Focus on the risks being addressed by the EQC review in developing the requirements, and that they appropriately capture engagements that have significant judgments, while ensuring that how the requirements are articulated will be understandable in practice.
  - Consider the appropriateness of certain factors proposed, and other factors that may also be relevant in determining when an EQC review should be performed.
  - Bring more prominence to the fact that the EQC review is one of a number of controls that may be implemented by a firm in addressing quality risk.
- In relation to the execution of the EQC review:
  - Modify the requirements to address circumstances where there are no distinct "stages" in performing the engagement and reinstate the extant requirements related to the consideration of the financial statements, or other relevant subject matter.
  - Link the extent of the EQC review to the areas of quality risk that have been identified at the engagement level in accordance with ISA 220,<sup>19</sup> and also take into consideration issues raised by regulators and audit committees.
  - Exercise caution in including examples of significant judgments in the application material to avoid creating a "checklist mentality".
  - Clarify the requirements relating to which documentation should be inspected by the EQC reviewer including that judgment may be applied in selecting that documentation.
  - Enhance the requirements addressing the documentation of the performance of the EQC review.

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<sup>19</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

## PIOB OBSERVER REMARKS

Prof. Van Hulle noted that an audit failure would not only impact the stakeholders of the audited entity, but could also impact the reputation of the firm and of the profession as a whole. Furthermore, he suggested that the category of entities for which EQC review is required be extended to include public interest entities. He explained that financial institutions are by definition in the public interest and, as such, should be subject to an EQC review. He expressed his support for the inclusion of a risk based assessment by firms to determine entities additional to those required by the standard, to be subject to an EQC review.

## WAY FORWARD

The QCOWG will consider the Board's comments in further addressing the enhancements to EQC reviews. The QCOWG will present their recommendations on the eligibility of the EQC reviewer to the Board at its February 2017 teleconference.

## **4. September 2016 Meeting Minute Extracts**

### **7. Quality Control**

Ms. French introduced the topic of engagement quality control (EQC) reviews and provided an overview of the CAG Representatives views in respect of the issues presented in **Agenda Item 5-B**. Ms. French noted that CAG Representatives were supportive of strengthening the requirements for engagements that should be subject to an EQC review, although had mixed views about how this should be operationalized. Furthermore, CAG Representatives agreed that an objective should be established, however had diverse views regarding the depth of the EQC review and whether it should remain focused on significant judgments. CAG Representatives also emphasized the importance of the timeliness of the EQC review, and the selection of an EQC reviewer with the appropriate competencies, authority and independence, noting the importance of the firm's tone and culture towards the EQC review. There were also mixed views by CAG Representatives regarding providing transparency about the EQC review in the auditor's report.

Ms. French provided feedback from the SMP Committee, noting the caution for the IAASB in extending the requirement for an EQC review beyond listed entities to include all public interest entities and supporting the determination of an objective for the EQC review. In addition, Ms. French noted that the SMP Committee also noted that further consideration be given to aspects of the eligibility of the EQC reviewer. The Board provided the Quality Control Working Group (QCWG) with further direction, as set out in the sections below, to address respondent's feedback to the ITC.

## EXTENDING THE REQUIREMENT FOR AN EQC REVIEW BEYOND AUDITS OF LISTED ENTITIES

The Board agreed that the requirement for an EQC review needs to be strengthened, with broad support for the firm to determine which engagements should be subject to an EQC review on the basis of a risk-based approach supported by robust criteria (i.e., in addition to listed entities or those required by law or regulation to be subject to an EQC review). The Board provided the following additional suggestions and matters for consideration:

- Any changes should address the fundamental reason why the EQC review requirement should be extended, i.e., to address the impact of a possible audit failure, specifically the public interest impact.
- Further consideration should be given to how the QMA will also help signal engagements where an EQC review should be performed.

- The EQC review requirements should be addressed in a manner that does not undermine other responses implemented by the firm to address quality risks. Recognition of other forms of reviews that are not strictly EQC reviews may also be appropriate to facilitate more focused reviews on engagements, or areas of those engagements, where risk exists.
- The criteria should not be prescriptive and ought to focus on the public interest aspects (including entities that obtain funds from the public or government). The Board provided some suggestions of possible criteria.
- Appropriate emphasis to circumstances where jurisdictions prescribe entities that should be subject to an EQC review, which could encourage jurisdictions to make such a determination.

#### OBJECTIVE OF THE EQC REVIEW

The Board agreed that the EQC review is a firm level control performed at the engagement level, given the purpose of the EQC review in responding to risks at the firm level and the determination being made by the firm of which engagements are subject to EQC reviews. Furthermore, the Board was of the view that the responsibility for audit quality at the engagement level rests with the engagement partner, and setting the objective as an engagement level control could dilute this responsibility. In establishing the objective, the Board requested that the QCWG further consider:

- Clearly articulating the level at which the control is established in order to make clear where accountability is, while also explaining the nature, timing and extent of the EQC review operates at the engagement level.
- As it relates to the depth of the review, retaining the focus on significant judgments made by the engagement team, although providing clarity about what this means. Ms. Healy recommended that paragraphs A8 to A11 of ISA 230<sup>20</sup> could also be helpful in considering the meaning of “significant judgments.”
- Emphasizing that the EQC review is an activity that should take place throughout the engagement, and not merely be performed at the end of the engagement.
- How to link quality management at the engagement level and the EQC review (i.e., the quality management at the engagement level would facilitate improved information for the engagement partner to engage throughout the audit with the EQC reviewer).

#### SELECTION OF THE EQC REVIEWER

The Board supported the recommendations of the QCWG as they relate to improving the robustness of the selection of the EQC reviewer, although cautioned that these should not be overly prescriptive resulting in firms having limited suitable resources who are able, or willing, to fulfill the role. The Board was of the view that the selection of the EQC reviewer should be at firm level, rather than the engagement level, given that the EQC review is a firm level control. The Board provided the following additional matters for consideration:

- Emphasizing that the EQC reviewer should have the appropriate authority and status within the firm to enable them to confidently challenge the significant judgments.
- Addressing the appropriateness of the EQC reviewer’s practical experience, for example, circumstances when the EQC review is delegated to a technical resource with limited practical experience.
- Reinforcing that the function of the EQC reviewer is not to override the judgments of the

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<sup>20</sup> ISA 230, *Audit Documentation*

engagement team, but rather for the EQC reviewer to challenge those judgments and for the engagement team to evaluate how best to address the issues raised by the EQC reviewer.

- Addressing the capacity of the EQC reviewer to perform the review, i.e., their time available.
- Carefully addressing the appropriate skills of the EQC reviewer.

The Board was supportive of further liaison with the IESBA on the issue relating to the ‘cooling-off’ period between serving as the engagement partner and the EQC reviewer, although mixed views were expressed regarding whether a prescriptive period should be established. Those in support of a fixed period suggested 3 years or 5 years and indicated that it would prevent inconsistent application by firms, whereas those not supportive of a fixed period were of the view that there is no proper basis for establishing a fixed period.

#### TRANSPARENCY AND INTERACTIONS WITH THOSE CHARGED WITH GOVERNANCE (TCWG)

The Board agreed that transparency in the auditor’s report about the engagement being subject to an EQC review would not be an appropriate requirement, in particular due to the possible misconceptions it could create about the quality of engagements not subject to EQC reviews. However, the Board had the view that it is important to provide transparency more generally about when an EQC review is performed, to enhance stakeholders’ trust and confidence in the audit, in particular given that firms would be making the determination of which engagements should be subject to EQC review (other than for listed entities or as required by law or regulation). Ms. Healy noted that firms’ transparency reporting will still be considered by the Board.

The Board was also supportive of the QCWG’s conclusion that it would not be appropriate to address the EQC reviewer’s interactions with TCWG. The Board further debated the appropriateness of providing transparency to TWCG about the EQC review, recognizing that this information may only be perceived as useful in certain jurisdictions, and encouraged the QCWG to explore how to address the interactions between TCWG and the auditor in the interest of understanding the process of EQC reviews.

#### IAASB CAG CHAIRMAN’S REMARKS

Mr. Waldron noted that the EQC review is a topic that is important to CAG Representatives and generated mixed views and significant interest for some. He highlighted the importance of taking into consideration how the EQC reviewer is assigned, as well as the network’s role in EQC reviews, where applicable. Mr. Waldron specifically noted the CAG’s comments about the importance of the timing of when the EQC review is undertaken.

#### WAY FORWARD

The QCWG will consider the Board’s comments in further developing changes to EQC reviews, and will present their further recommendations to the Board at its December 2016 meeting on the matters discussed at the September 2016 meeting, as well as the nature, timing and extent of the EQC review.

## Project Proposal Extracts

### Outline of the Project

#### Major Issues that Will Be Addressed

...

1. Inspection findings by audit regulatory bodies and audit oversight bodies have consistently highlighted issues with respect to firms' quality control, and audits of group financial statements. The International Forum of Independent Audit Regulators (IFIAR) 2015 Survey of Inspection Findings continues to identify matters relating to Group Audits and Quality Control as areas with higher numbers of inspection findings on public interest entities (PIE) audits (including but not limited to adequacy of supervision and review and engagement quality control reviews).

...

#### How the Project Serves the Public Interest

21. The most significant public interest issues<sup>21</sup> that, in undertaking work in the areas of quality control and group audits, the IAASB will seek to address include:
  - (a) *Fostering an appropriately independent and challenging skeptical mindset of the auditor*—professional skepticism is a fundamental concept and core to audit quality. These projects will further consider how the standards can articulate the requirements for auditors, especially engagement partners, to appropriately demonstrate the application of professional skepticism in carrying out the audit and also how the standards can address the firm's contribution to fostering the appropriate environment for effective application of professional skepticism.
  - (b) *Enhancing documentation of the auditor's judgments*—these projects will consider how auditors can more appropriately demonstrate their decision-making process, essential interactions and communications, to support the auditors' judgments and audit opinion overall.
  - (c) *Keeping the ISAs and ISCQ 1 fit for purpose*—as the standards are revised, consideration will be given to how the standards can, and continue to, be robust and adaptable to a wide range of circumstances in an evolving and increasingly complex environment.
  - (d) *Encouraging proactive management of quality at the firm and engagement level*—consideration will be given to how the quality control standards, ISQC 1 (Revised) and ISA 220, can encourage effective management of quality in the context of the firm and engagement that is fostered by proactive firm leadership and management, reinforced by a firm's culture and strategy.
  - (e) *Exploring transparency and its role in audit quality*—as transparency reporting increases globally, the IAASB will consider further actions in relation to how firms provide transparency about how they support and achieve effective quality management.
  - (f) *Focusing more on accounting firms (including networks) and their internal and external monitoring and remediation activities*—consideration will be given to more explicitly address expected actions to remediate audit deficiencies from inspection findings, and to bring more

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<sup>21</sup> The public interest issues listed are the public interest issues identified in the ITC, and which respondents generally supported.

emphasis to external inspections. The IAASB will also consider how accounting firms communicate, internally, and with other firms in the network, and including how they respond to findings from internal inspections.

- (g) *Reinforcing the need for robust communication and interactions during the audit*—the IAASB will consider how to strengthen the standards in relation to interactions and communications from those involved in the audit.

...

#### **Other Issues Being Addressed in ISQC 1**

33. In revising ISQC 1 for a QMA, attention will be given to particular elements where the requirements can be enhanced or strengthened, taking into consideration their inter-relationship with the principles of quality management. The elements where specific consideration will be given relate to:

- (a) ...
- (b) Engagement quality control (EQC) reviews—enhancing the requirements and application material in relation to the firm’s EQC reviews, including setting more robust criteria for firms to apply when determining which engagements should be subject to an EQC review, establishing the objective of an EQC review, clarifying the nature, timing and extent of the EQC review and enhancing the requirements for the eligibility of the individuals who perform the review. In doing so, consideration will also be given to maintaining the appropriate balance between the respective roles and responsibilities of the EQ reviewer and the engagement partner who retains overall responsibility for the engagement.
- (c) ...

#### *Quality Control at the Engagement Level*

34. Consideration will be given how to revise ISA 220 using an approach that more clearly focuses on identifying, assessing and responding to risks to quality at the engagement level, as well as clarifying and strengthening aspects of ISA 220. Specific consideration will be given to:

- a. ...
- d. Other matters, including:
  - i. ...
  - ii. Considering the interaction of firm quality management with managing quality at the engagement level, for example in relation to monitoring and EQC reviews.