



AUASB Board Meeting Summary Paper

AGENDA ITEM NO. **4.5**
Meeting Date: 11 September 2019
Subject: ISQM 2
Date Prepared: 3 September 2019

Action Required

For Information Purposes Only

A. Background

- 1 The IAASB issued ED-ISQM 2 in February 2019, with a comment period ending 1 July 2019.
- 2 The AUASB did extensive outreach on this Exposure Draft and submitted a response to the IAASB.
- 3 The ISQM 2 Taskforce has commenced their review of comments received.

B. What the Audit Technical Group (ATG) is seeking from the AUASB at the September 2019 AUASB meeting

- 4 The purpose of this Agenda Item is to update the AUASB as to the feedback received from respondents to the IAASB ED; and to update the AUASB as to the taskforces proposed way forward and revised timelines.
- 5 In section D.1 – D.2 the ATG has highlighted the respondents’ key concerns and the taskforces current thinking. The ATG have highlighted (in a box) the questions that the IAASB will consider at the forthcoming September 2019 IAASB meeting. In line with the AUASB international influencing strategy, AUASB members are encouraged to comment on any of these questions to inform the AUASB Chair of their views. The AUASB is specifically directed to the questions under paragraph 14 and 17.

C. Summary IAASB issues paper – feedback on ED-ISQM 2:

- 6 91 letters received, supportive of the concepts of a Engagement Quality Reviews (EQR), that is designed and implemented by the firm to address quality risks.
- 7 The ISQM 2 taskforce at the September 2019 IAASB will cover the questions on exposure that address the two key issues raised:

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- (a) Scoping of engagements subject to an EQR in accordance with paragraph 37(e) of proposed ISQM 1 in particular, the concept of “significant public interest;” and
- (b) The objectivity of the EQR, including a cooling-off period for individuals moving into the role of EQR after having served as the engagement partner.

D. The way forward:

- 8 The IAASB has indicated that the timing for approval of these QM standards has been pushed out to June 2020.
- 9 In general, there was support for establishing a system of quality management, including the new quality management approach (QMA), and strong support for EQRs as a response, among others, that is designed and implemented by the firm to address quality risks.

D.1 Scope of Engagements subject to an EQR

10 *Respondents specific comments on exposure and task forces suggestions:*

- (a) There was strong support from a Monitoring Group member to strengthen the EQ review standard, identifying the expanded scope of engagements for which EQ reviews were required as an area where substantive improvements have been made to the extant standards.
- (b) Respondents noted that ED-ISQM 1 already requires a risk-based approach to determining engagements subject to an EQ review. In this regard, one respondent indicated that engagements of SPI would likely already be covered by other parts of the requirement in paragraph 37(e).
- (c) The concept of SPI cannot be consistently interpreted, and therefore may be confusing or may result in inconsistent application of the requirements.
- (d) Additional guidance about how SPI relates to PIE in the International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code) should be provided. Respondents encouraged the IAASB to work closely with the IESBA to align a common definition of SPI / PIE where appropriate, or clarify differences in terminology as needed.

11 **Proposed Changes to ISQM 2 Scope**

12 The TF proposes to:

- (a) Remove the requirement in paragraph 37(e)(ii) of ISQM 1 for an EQ review for audits of financial statements of entities that the firm determines are of SPI.
- (b) Add a requirement for audits or other engagements for which the firm determines that an EQ review is appropriate due to the nature of the entity (i.e., not in response to an assessed quality risk).

- (c) Change the order of the requirements in paragraph 37(e) to better reflect those engagements for which an EQ review is required (i.e., listed entities or by law or regulation) versus those for which the firm determines that an EQ review is appropriate (i.e., in response to an assessed quality risk, or due to the nature of the engagement).

13 Proposed Changes to the Requirement in para 37 (and related application material) ISQM 2:

37. In designing and implementing responses to address the quality risks identified and assessed by the firm relating to the engagement performance quality objectives, the firm shall include the following responses:

...

(e) Establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2, and that require an engagement quality review for: (Ref: Para. A101–A107)

(i) Audits of financial statements of listed entities;

(ii) Audits or other engagements for which an engagement quality review is required by law or regulation; and (Ref: Para. A103)

(ii) Audits of financial statements of entities that the firm determines are of significant public interest; and

(iii) Audits or other engagements for which:

a. An engagement quality review is required by law or regulation; or

b. the firm determines that an engagement quality review is:

a. an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks.; or (Ref: A104–A105)

b. Appropriate due to the nature of the entity. (Ref: Para. A105A)

Other Entities for Which the Firm Determines an Engagement Quality Review is Appropriate

A105A. The firm may develop criteria for determining the types of engagements for which an engagement quality review is appropriate due to the nature of the entity. Factors that the firm may consider in developing such criteria include, for example:

- Entities that are characterized as a public interest entity in a particular jurisdiction, and for which an engagement quality review is not otherwise required by law or regulation.*
- Whether relevant ethical requirements for the engagement provide related guidance. For example, the IESBA Code provides a definition of “public interest entity” for purposes of requirements and guidance that relate specifically to such entities, but indicates that firms are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number, and a wide range, of stakeholders.*

Paragraph 400.8 of the IESBA Code further indicates that the factors to be considered include:

o The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples include financial institutions, such as banks and insurance companies, and pension funds.

o Size

o Number of employees.

14 ATG Views

The ATG agree that the proposed new requirement deals with the issue of significant PIE's as addressed in our submission and allows for the firms to determine that an EQR may be appropriate for audits or engagements which they determine is appropriate due to the nature of the entity.

The proposed AM at A105A is useful for the firms to determine which factors may be considered in developing such criteria. These are consistent with the IESBA Code (Code) even though it is unusual to see a reference to the Code within an ISA.

The AUASB is asked for its views on:

- a. The proposed changes to the requirements relating to the scope of engagements subject to an EQ review as described in paragraph 14 above; and
- b. The indicative drafting for the proposed requirements and application material as presented above, including whether the proposed application material in paragraph A105A will be helpful in explaining what is meant by 'appropriate due to the nature of the entity.'

D.2 Objectivity and Cooling-Off Period

15 Respondents specific comments on exposure:

- (a) Overall, respondents agreed that objectivity of the EQ reviewer is critical to the effectiveness of the EQ review (i.e., to an objective assessment of the significant judgments made by the engagement team).
 - (b) Regarding the firm establishing a cooling-off period, the standard should provide flexibility in determining an appropriate period based on the nature and circumstances of the engagement. In particular, respondents noted that a cooling-off period is appropriate for listed entities (and perhaps also for PIEs), but may not be necessary or appropriate for non listed entities. The flexibility implied in paragraph 28 of ED-ISQM 2 was noted as an important aspect of scalability for ISQM 2.
- 16** The TF acknowledges that threats to the objectivity of an engagement partner stepping into an EQR role is an important issue that needs to be addressed in the IESBA Code, or in ISQM 2 if not addressed in the IESBA Code. The TF also reaffirmed its strongly held view that threats to objectivity of the EQR in this circumstance are unique, and that it is unlikely (or certainly less likely) that an EQR would be able to objectively evaluate significant judgments with which he or she had recently been involved as the engagement partner. A specific "time out" after serving as an engagement partner may indeed be necessary so that the evaluation of significant judgments is objective (in fact and in appearance) and therefore an appropriate

response to assessed quality risks. Accordingly, in the absence of a cooling-off period in the IESBA Code, the TF proposes that a new requirement be added to ISQM 2 to address it.

17 ATG Views

The ATG agree that:

- a. Cooling-off period be addressed in ISQM 2 if not dealt with in the IESBA Code. The AUASB's view as stated in our submission was for the issue to be dealt with in the IESBA Code and the IAASB to work with IESBA to resolve appropriately; and
- b. That the cooling-off period should apply to Option 3 b below capturing all engagements for which an EQR is required or the firm has determined is appropriate.

Does the AUASB support the TF's recommendation that:

- a. The cooling-off period be addressed in ISQM 2 if not specifically addressed in the IESBA Code?
- b. If addressed in ISQM 2, firm policies or procedures be required to include an explicit cooling-off period to address threats to objectivity created when an individual steps into an EQR role after serving as the engagement partner?
3. Should a requirement or guidance regarding a cooling-off period apply to:
 - a. Audits of listed entities only, or all PIEs, or all audits?
 - b. Assurance engagements more broadly, i.e., for any engagement for which an EQR is required or for which the firm determines that an EQR is an appropriate response to assessed quality risks or is appropriate based on the nature of the entity?

Material Presented

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Action Required

No.	Action Item	Responsibility	Due Date
1.	Provide feedback to ATG on key TF proposals on ISQM 2.	AUASB	11 Sept 2019