

Meeting: IAASB Consultative Advisory Group
(CAG)

Meeting Location: New York, United States of America

Meeting Date: March 5–6, 2019

Agenda Item H-2

QUALITY MANAGEMENT

ISQM 2, *Engagement Quality Reviews*¹ – Report Back

Objectives of Agenda Item

1. The objective of this agenda item is to provide a report back on IAASB CAG Representatives' comments on this project as discussed at the September 2018 IAASB CAG meeting.

Project Status – What Have We Done Since We Last Met?

2. Since the September 2018 IAASB CAG meeting, the IAASB approved an Exposure Draft (ED) of International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews* (ED-ISQM 2) in December 2018.
3. In addition to ED-ISQM 2, the IAASB also published:
 - Overall Explanatory Memorandum, *The IAASB's Exposure Drafts for Quality Management at the Firm and Engagement Level, Including Engagement Quality Reviews*
 - ED-ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*
 - ED-220, *Quality Management for an Audit of Financial Statements*
 - Draft Examples – *How the Nature and Circumstances of the Firm and the Engagements It Performs Affect the Implementation of Proposed ISQM 1*
 - *Draft Frequently Asked Questions Regarding Proposed ISQM 1*
4. The Overall Explanatory Memorandum addresses conforming amendments to other International Standards arising from the proposed quality management standards. It also gives details about the proposed effective dates and implementation periods.
5. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and IAASB on this topic, including links to the relevant IAASB CAG documentation.

¹ At the September 2018 IAASB meeting, the Board agreed to change the term “engagement quality control review(er)” to “engagement quality review(er).”

Feedback – What Did We Hear Last Time We Met?

6. Extracts from the draft minutes of the September 2018 IAASB CAG meeting, as well as an indication of how the Task Force or IAASB has responded to the IAASB CAG Representatives' comments, are included in the table below. Where applicable, references have been updated to align with ED-ISQM 2 and ED-ISQM 1. Furthermore, references to proposed ISQC 2 and ISQC 1 (Revised) in the September 2018 minutes have been changed to proposed ISQM 2 and proposed ISQM 1 in the table below, as the IAASB resolved to change the name of the two standard subsequent to the last discussion with the CAG.²

Representatives' Comments	Task Force/IAASB Response
GENERAL	
Engagements subject to engagement quality review:	
Mr. Hansen expressed support for the proposed scope of engagements for which an engagement quality (EQ) review would be required. He noted that the firm's risk assessment process should be the primary driver of whether an engagement is subject to an EQ review.	<p>Point noted.</p> <p>ED-ISQM 1, paragraph 37(e) addresses engagements subject to engagement quality review.</p> <p>In addition to requiring an engagement quality review for audits of financial statements of listed entities, ED-ISQM 1 requires engagement quality reviews for audits of financial statements of entities that the firm determines are of significant public interest; and audits or other engagements for which an engagement quality review is required by law or regulation; or the firm determines that an engagement quality review is an appropriate response to assessed quality risks.</p>
Mr. Pavas indicated that the scoping criteria would be hard to apply in developing nations due to differences in how entities raise capital. For example, in Latin America, financing is usually obtained through banks and entities raising money through banks would not be captured by the proposed criteria.	<p>Point noted.</p> <p>Application guidance added in ED-ISQM 1, paragraph A102 to indicate that certain banks would be included as entities of significant public interest.</p> <p>Further, ED-ISQM 1, paragraph 37(e)(iii)(b) requires an engagement quality review for audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to assessed quality risks. Banks may also fall into that category.</p>

² At the September 2018 IAASB meeting, the Board proposed to change the title "International Standard on Quality Control" to "International Standard on Quality Management."

Representatives' Comments	Task Force/IAASB Response
	Finally, ED-ISQM 1, paragraph A101 notes that the categories of engagements for which an engagement quality review is required are not mutually exclusive. For example, many listed entities may be considered to be of significant public interest.
Mr. Yoshii noted that “other types of engagements” other than listed entities is not clear, and that financial thresholds could be another criterion for requiring an EQ review.	Point accepted. ED-ISQM 1 , paragraph 37(e) clarifies the various categories of engagements subject to engagement quality review. Application guidance in paragraph A102 includes “size of the business” as a consideration in determining whether the entity is of significant public interest. Application guidance in paragraph A103 includes “a specified asset threshold” as an example of a criterion for audits of entities that may require an engagement quality review under law or regulation.
“Significant public interest” was used as a criterion rather than the term “public interest entity”:	
Mr. Fortin and Mr. Koktvedgaard noted that the IESBA Code refers to public interest entities and that there is benefit in using consistent terminology across the two Boards. Mr. Fortin suggested the Task Force look at how ISA 701 ³ addressed the various categories of entities subject to the requirements. Mr. Koktvedgaard noted that if “significant public interest” is retained, more granular guidance would be needed on circumstances when an entity of significant public interest is not a public interest entity, and when a public interest entity is not an entity of significant public interest. Mr. Koktvedgaard noted that the proposed standard considered the importance of entities scoped from the firm’s view and that, from the network perspective, many individual entities would not be significant, but grouped and considered together, could be of “significant public interest”.	In response, Prof. Schilder and Mr. Vanker noted that the IAASB had previously decided that the term “public interest entity” would not be an appropriate criterion due to different interpretations of what the term means in different jurisdictions. Mr. Vanker indicated that the Task Force had looked at other ways of responding to prior requests to broaden the scope of engagements subject to EQ reviews. Prof. Schilder noted that in developing ISA 701, a similar approach is used in determining entities for which key audit matters are reported. Mr. Vanker also noted that engagements related to small entities would be scoped in under the other criteria, such as when the engagement is required under law or regulation or when the firm has determined an EQ review is the appropriate response to a particular risk. ED ISQM 1, paragraphs A102 and A106 (for public sector organizations) provide guidance to assist firms in determining which of their audit

³ ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

Representatives' Comments	Task Force/IAASB Response
	<p>engagements are for entities of significant public interest.</p> <p>In addition, ED-ISQM 1, paragraphs 58–62 (of the Explanatory Memorandum) describe the Board's views on why the term 'significant public interest' was used. Paragraph 61 notes that if respondents have views on this topic, it would be helpful for these views to be included in their responses to Question 1.</p>
Mr. N. James questioned why the Task Force proposed using a different term than public interest entity. He also noted that it was not clear how the proposed new term would reduce variability when implemented in practice.	Point noted and addressed as described above.
Mr. Dalkin noted that the term “significant” may be inconsistently applied in practice, and guidance would be helpful. Mr. Milholland noted that the concept of “public interest” is pervasive and broad-based in its application.	Point noted and addressed as described above.
Messrs. Ruthman and Dalkin expressed concerns with applying the “significant public interest” criterion in the public sector, as public interest can be seen as pervasive in the public sector.	<p>Mr. Vanker noted that application material may be required about how public sector entities fit within the scoping criteria.</p> <p>Guidance on how the criterion “significant public interest” is applied in the public sector was added in ED-ISQM 1, paragraphs A106–A107.</p>
Eligibility criteria for engagement quality reviewers:	
Ms. Vanich agreed that the EQ reviewer should have appropriate authority and the ability to “push back.” She encouraged the Task Force to revisit the application material in paragraphs A10 and A11 in proposed ISQM 2 to avoid diminishing the authority of the EQ reviewer requirement. She also noted that guidance is needed on how SMPs ⁴ can meet the requirement and asked the Task Force to consider whether the firm should have a requirement to not use an individual as an EQ reviewer if they have received a negative inspection finding.	<p>Point accepted.</p> <p>ED-ISQM 2, paragraph A10 highlights that the firm’s culture, which is addressed in ED-ISQM 1, can enhance the authority of the engagement quality reviewer by creating a culture of respect for the role of the engagement quality reviewer, which also reduces the likelihood that the engagement quality reviewer experiences pressure from the engagement partner or other personnel to inappropriately influence the outcome of the engagement quality review. In addition, ED-ISQM 2, paragraph A10 notes that the firm’s policies or</p>

⁴ Small and Medium-Sized Practices

Representatives' Comments	Task Force/IAASB Response
<p>Mr. Hansen noted the importance of an EQ reviewer's "stature" within the firm to withstand challenges from those with greater authority or oversight of the EQ reviewer. He also noted the importance of reinforcing the EQ reviewer's independence from the client (e.g., the role of the client in determining who is appointed as the EQ reviewer).</p> <p>Ms. Wei reiterated the importance of independence of the EQC reviewer to being able to perform an objective review. Mr. Pavas commented that most firms in his jurisdiction are small firms and face the challenge of finding professionals to perform EQ reviews.</p>	<p>procedures addressing differences of opinion, which are required by ED-ISQM 1, may also enhance the authority of the engagement quality reviewer and may include actions the engagement quality reviewer may take when a disagreement occurs between the engagement quality reviewer and the engagement team.</p> <p>ED-ISQM 2, paragraph A8 notes that In evaluating the competence and capabilities of an individual who may be appointed as an engagement quality reviewer, the findings arising from the firm's monitoring activities (e.g., findings from the inspection of in-process or completed engagements for which the individual was an engagement team member or engagement quality reviewer) or the results of external inspections may also be relevant considerations.</p> <p>ED-ISQM 2 stresses the importance of maintaining the engagement quality reviewer's objectivity.</p> <ul style="list-style-type: none"> • Paragraphs A-4 and A-5 address limitations on the eligibility to be appointed as the engagement quality reviewer, including providing guidance on a cooling-off period for audits of financial statements. • Paragraphs A-13 to A-16 provide guidance related to objectivity requirements in relevant ethical requirements.
Proposal regarding the use of external engagement quality reviewers:	
<p>Mr. N. James questioned whether an external EQ reviewer could apply the same level of competence regarding the client and insight into the firm's policies or procedures.</p> <p>Ms. Ovuka agreed, noting that an external EQ reviewer may not have sufficient stature within the firm. She noted that the need to use an external party may indicate that the requirements are too stringent.</p> <p>Mr. Koktvedgaard indicated that external parties are needed when firms are too small and that some firms specialize in providing EQ reviews. He noted that the broader experience gained from seeing</p>	<p>Mr. Vanker noted the diverse views around this issue and that the Task Force had noted that stature goes to the heart of the role of the EQ reviewer. He also noted that reliance on an external reviewer is not automatic and that proposed ISQC 1 (Revised) provides guidance on how firms deal with "service providers" such as an external EQ reviewer.</p> <p>ED-ISQM 2, paragraph A4 notes that in some circumstances, there may not be a partner or other individual within the firm who is eligible to perform the engagement quality review and the firm may therefore contract with, or obtain the services of,</p>

Representatives' Comments	Task Force/IAASB Response
<p>how various firms operated could allow the EQ reviewer to challenge firm's internal staff functions. Mr. Hansen and Mr. Pavas noted that external reviews may be appropriate for SMPs and smaller, less complex engagements. Mr. Vanker noted the diverse views around this issue and that the Task Force had noted that stature goes to the heart of the role of the EQ reviewer. He also noted that reliance on an external reviewer is not automatic and that proposed ISQC 1 (Revised) provides guidance on how firms deal with "service providers" such as an external EQ reviewer.</p>	<p>external individuals to perform the engagement quality review and that an external individual may be a partner or an employee of another firm within the firm's network or a service provider. When using such an external individual, the firm is subject to the requirements for network requirements or network services in paragraphs 59–60 of ED-ISQM 1, or the requirements for service providers in paragraph 65 of ED-ISQM 1, respectively.</p>
Performance of the engagement quality review:	
<p>Ms. Vanich questioned whether paragraph 24(a) (iii) of proposed ISQC 2 was intended to apply to all engagements or just the engagement subject to the EQ review.</p> <p>Ms. Vanich believed that the wording "that ought to have been made" was not clear.</p>	<p>[Paragraph 24 of the September agenda papers is paragraph 22 in ED-ISQM 2.]</p> <p>Point accepted. The lead-in to ED-ISQM 2, paragraph 22 has been modified to "In performing the engagement quality review," which provides a clearer link to the information requirements in subparagraph (a).</p> <p>The IAASB agreed to delete references to "that ought to have been made" throughout ED-ISQM 2 when referring to significant judgments.</p>
<p>Ms. Robert suggested that reference to "significant judgments" should be explained further to mean significant to the audit as a whole.</p> <p>Mr. Fortin noted that judgment is a core concept and that the EQ reviewer should look at the judgments that require significant attention, including those that are outside the scope of "significant judgements."</p> <p>Mr. Yurdakul noted that limiting the EQ review to significant judgments within context of an audit could mean that key components of audits may not be included, such as the audit methodology. He noted that the scope of review should be broader for complex engagements and that more than one reviewer may be needed in such cases</p>	<p>Mr. Vanker noted that paragraph A29 is quite broad and that the Task Force will consider whether the EQ review should look beyond significant judgments.</p> <p>In approving ED-ISQM 2, the IAASB noted that the concept of "significant judgments," which is integral to the definition of an engagement quality review, is addressed in ED-220. The IAASB concluded that the engagement quality reviewer's review of the engagement team's significant judgments in ED-ISQM 2 needed to be consistent with the approach taken in relation to the engagement partner's review of audit documentation in ED-220. The concept of "significant matters" is addressed in ISA</p>

Representatives' Comments	Task Force/IAASB Response
	<p>230,⁵ which also relates to audits of financial statements.</p> <p>ED-ISQM 2, paragraphs A29–A30 draw attention to these standards. The concepts of significant judgments and significant matters are not explicitly addressed in the standards for other types of engagements.</p> <p>ED-ISQM 2, paragraph A31 provides guidance for engagements other than audits of financial statements.</p>
<p>Mr. Hirai noted more emphasis should be given to the importance of the review being timely.</p> <p>Mr. N. James noted that the proposed standard creates the impression that the EQ review comes after the significant judgments have been made by the engagement team and questioned how disagreement with judgments already made would be received. He suggested that the timing of the EQ review should accommodate intervention by the EQ reviewer.</p>	<p>Mr. Vanker noted that the comments related to timing are consistent with the Task Force's thinking.</p> <p>ED-ISQM 2, paragraph 21(a) sets forth a new requirement addressing the engagement quality reviewer's responsibility to perform the procedures at appropriate points in time during the engagement. Paragraph A26 provides guidance on what timely review of engagement documentation means.</p>
<p>Mr. Hirai questioned whether the EQ reviewer is required to also communicate with component auditors, or whether the need for the EQ reviewer to communicate directly with component auditors, depends on the firm's policies or procedures.</p>	<p>Mr. B. James indicated that proposed ISQC 2 does not change the interaction between the EQ reviewer and component auditors. He also noted that it is unlikely that there would not be any significant judgments in relation to a group audit based on the requirements in paragraph 24 of proposed ISQC 2.</p>
<p>Ms. Weng questioned whether, when the auditor determines that an EQ review is required, the engagement team should inform the client so that the client is aware that more information may be required from the company.</p>	<p>Point noted.</p> <p>The IAASB notes that requirements regarding the engagement team are in ISA 220.</p>
<p>Mr. Hirai questioned whether the EQ review documentation is to be included with ET documentation and whether it is the responsibility of the engagement team.</p>	<p>Point accepted.</p> <p>ED-ISQM 2, paragraph 26 requires documentation of the engagement quality review to be included with the engagement documentation.</p> <p>ED-ISQM 2, paragraph 25 requires the engagement quality reviewer to take responsibility</p>

⁵ ISA 230, *Audit Documentation*

Representatives' Comments	Task Force/IAASB Response
	for the documentation of the engagement quality review.
Mr. Hansen noted that in practice, audit reports may be released before the EQ reviewer has signed off. He suggested an explicit requirement that the financial statements should not be released until completion of EQ review.	Point accepted. ED-ISQM 2, paragraph 24 contains a “stand-back” requirement, including that the engagement quality reviewer shall notify the engagement partner that the engagement quality review is complete. ED-220, paragraph 33 includes a requirement that the engagement partner shall not date the auditor’s report until the completion of the engagement quality review.
Mr. Fortin noted that, in EQ reviews in group audit situations, maintaining consistency and quality between jurisdictions can be difficult and suggested that the IAASB could consider some specific guidance in this respect.	Ms. Zietsman agreed and noted that this would be one of the issues addressed in the IAASB’s project to revise ISA 600. ⁶
PIOB REMARKS	
Ms. Diplock noted that to serve the public interest, the scope of engagements subject to EQ reviews needs to extend beyond listed entities and the term “significant public interest” helps in providing clarity and consistency in which entities are covered. She also reiterated previous PIOB comments that the cooling-off period is important for EQ reviewers. Ms. Diplock indicated that the PIOB is of the view that the timing of the EQ review is part of a continuous quality process and should happen at the same time as the audit. She also stressed that scalability of the standard was important for SMPs. ⁷	Point noted. See comments above related to entities of significant public interest.

⁶ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

⁷ Small and medium practices

Appendix A

Project Details and History

Project: Engagement Quality Reviews

Link to IAASB Project Page: [ISQM 2 Project Page](#)

Task Force Members

The ISQM 2 Task Force comprises:

- Imran Vanker, IAASB Member and Task Force Chair (supported by Nicolette Bester, IAASB Technical Advisor)
- Fernando Ruiz (supported by Vivienne Bauer, IAASB Technical Advisor)
- Sarah Ashton, IAASB Technical Advisor
- Jamie Shannon, IAASB Technical Advisor

Summary

	IAASB CAG Meeting	IAASB Meeting / Publication
Project Commencement	March 2015 September 2015 September 2016	June 2014 (Quality Control only) December 2014 March 2015 June 2015 September 2015 December 2015 June 2016 September 2016
Project proposal	November 2016 Teleconference	December 2016
ISQC 1 issues discussion, including ISQC 2 addressing EQC reviews	March 2017 September 2017	December 2016 March 2017 June 2017 August 2017 September 2017
First Read of Draft Exposure Draft of Proposed ISQC 1		December 2017

ISQM 2 – Report Back
IAASB CAG Public Session (March 2019)

	IAASB CAG Meeting	IAASB Meeting / Publication
Second Read of Draft Exposure Draft of Proposed ISQC 1	March 2018	March 2018
First read of Draft Exposure Draft of Proposed ISQC 2	September 2018	September 2018
ISQM 2 issues discussion – engagements for which an engagement quality review is required (ISQM 1 extract – paragraph 43(e)) ⁸		October 2018
Exposure Drafts of ISQM 1 and ISQM 2 approved		December 2018
Exposure Drafts of ISQM 1 and ISQM 2 released for public comment		February 2019

⁸ Paragraph 43 renumbered as paragraph 37 in ED-ISQM 1.

IAASB CAG Discussions: Detailed References

Information gathering: Responding to Calls to Enhance Audit Quality	<p><u>March 2015</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Items B and C). http://www.ifac.org/meetings/new-york-usa-5</p> <p><u>September 2015</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item F). http://www.iaasb.org/cag/meetings/new-york-usa-0</p>
Information gathering: Overview of Responses to the ITC, Group Audits and Engagement Quality Control Reviews	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item G). http://www.iaasb.org/cag/meetings/new-york-usa</p>
Project Proposal	<p><u>November 2016</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B). http://www.iaasb.org/cag/meetings/iaasb-cag-conference-call-november-29-2016-730-am-1030-am-est</p>
ISQC 1 issues discussion, including EQC reviews	<p><u>March 2017</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item H). http://www.iaasb.org/cag/meetings/iaasb-cag-meeting</p> <p><u>September 2017</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item D). http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</p> <p><u>March 2018</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item D). http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny</p>
ISQC 2 issues discussion	<p><u>September 2018</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B). http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-0</p>