

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: New York, United States of America
Meeting Date: March 10–11, 2020

Agenda Item G

Proposed ISQM 2¹ – Cover

Objectives of Agenda Item

1. The objectives of this agenda item are to:
 - (a) Report back on comments of the IAASB CAG Representatives on this project as discussed at the September 2019 meeting (see **Appendix B** to this paper).
 - (b) Obtain Representatives' views on the ISQM 2 Task Force's (Task Force) proposed revisions relating to:
 - (i) Engagements subject to an engagement quality (EQ) review in proposed ISQM 1;² and
 - (ii) The objectivity of the EQ reviewer, including a mandatory cooling-off period for individuals moving into the role of EQ reviewer after having served as the engagement partner in proposed ISQM 2.

Project Status

2. Since the September 2019 IAASB CAG meeting, the IAASB has further considered the matters discussed with the CAG and other matters raised by respondents to ED-ISQM 2 (which were discussed at the December 2019 IAASB meeting).
3. At the March 2020 IAASB meeting, the Task Force Chair will present:
 - (a) The Task Force recommendation relating to the scope of engagements subject to an EQ review as discussed in **Section I of Agenda Item G.2**. The Task Force has provided the clean version of paragraph 41A(e) of proposed ISQM 1 in **Agenda Item G.3**.
 - (b) The revised draft of proposed ISQM 2. The Task Force has provided the clean version of proposed ISQM 2 in **Agenda Item G.4**.

IAASB Interaction with the IAASB CAG with Respect to Draft ISQM 2

4. The substantive issues being raised for the purposes of the March 2020 IAASB meeting are included

¹ Proposed International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*

² Proposed ISQM 1 (Previously International Standard on Quality Control 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 41A(e)

in this paper and **Agenda Items G.1-G.4**. Accordingly, this serves as the final discussion of proposed ISQM 2 prior to its anticipated approval by the IAASB in June 2020.

5. Representatives and Observers may wish to take this opportunity to comment on the IAASB's interaction with the CAG during the development and finalization of proposed ISQM 2.

IAASB CAG Discussion in March 2020

6. For the purposes of the IAASB CAG discussion, the Task Force Chair will present the Task Force's proposed revisions to address the matters highlighted in paragraph 1(b) above (see **Section I** of **Agenda Item G.2** that accompanies this cover note, and **Section II-B** of [Agenda Item 8](#) of the December 2019 IAASB meeting). Representatives will then be asked to provide input on the questions outlined in this paper.
7. **Agenda Item G.2**, which accompanies this cover note, is **Agenda Item 5** of the March 2020 IAASB meeting papers. **Section I** of **Agenda Item G.2** describes the recommendation of the Task Force relating to engagements subject to an EQ review in accordance with paragraph 41A(e) of proposed ISQM 1, and the proposed revisions to align the wording and structure of the related application material with proposed ISQM 1.
8. Since **Agenda Item G.2** is an IAASB Board paper, in navigating the document, Representatives are requested to note the following:
 - (a) The questions in **Agenda Item G.2** are those that will be posed to the IAASB. Therefore, Representatives are not being asked to respond to these questions. The **Matters for IAASB CAG Consideration** are outlined below.
 - (b) **Agenda Item G.2** includes references to a variety of other agenda items that will be presented at the March 2020 IAASB meeting. These agenda items have not been provided for the purposes of the IAASB CAG discussion, but are available at: <https://www.iaasb.org/meetings/iaasb-board-meeting-new-york-usa-2>.
9. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and IAASB on proposed ISQM 2, including links to the relevant IAASB CAG agenda papers and minutes of meetings.
10. **Appendix B** to this paper includes extracts from the draft minutes of September 2019 IAASB CAG meeting, as well as an indication of how the Task Force or IAASB has responded to the Representatives' comments.

Matters for IAASB CAG Consideration

1. What are the Representatives' views on the revised requirements and application material relating to the scope of engagements subject to an EQ review, as presented in **Agenda Item G.3**?
2. What are the Representatives' views on the revised requirements and application material relating to objectivity, including a mandatory cooling-off period, as presented in paragraphs 16A and A17A-A17B of **Agenda Item G.4**?
3. Representatives are asked whether there are any other matters that should be considered by the Board before finalizing proposed ISQM 2.

Materials Presented – IAASB CAG Papers

Agenda Item G.1	Proposed ISQM 2 – Presentation
Agenda Item G.2	Agenda Item 5 – Proposed ISQM 2 – IAASB Issues and Recommendations
Agenda Item G.3	Agenda Item 5-B – Draft of Paragraph 41A(e) of Proposed ISQM 1 and Related Application Material – Clean
Agenda Item G.4	Agenda Item 5-E – Draft of Proposed ISQM 2 – Clean

Appendix A

Project History

Project Summary: [ISQM 2](#)

Project Phase	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 ED of Proposed ISQC 1		December 2017
Second Read of Draft ED of Proposed ISQC 1	March 2018	March 2018
Third Read of Draft ED of Proposed ISQC 1 First Read of Draft ED of Proposed ISQC 2	September 2018	September 2018
ISQM 2 Issues Discussion – Engagements for which an EQ Review is Required (ISQM 1 Extract – Paragraph 43(e)) ³		October 2018

³ Paragraph 43 was renumbered as paragraph 37(e) in ED-ISQM 1 and now is renumbered as paragraph 41A(e) in proposed ISQM 1.

Project Phase	IAASB CAG Meeting	IAASB Meeting / Publication
Approval of ED-ISQM 1 and ED-ISQM 2		December 2018
Development of Final Standard	March 2019 (update only) September 2019	September 2019 December 2019

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).</p> <p>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).</p> <p>https://www.iaasb.org/cag/meetings/new-york-usa-5</p>
Information Gathering: Overview of Responses to the ITC, Group Audits and EQC Reviews	<p><u>September 2016</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item G).</p> <p>https://www.iaasb.org/cag/meetings/new-york-usa-6</p>
Project Proposal	<p><u>November 2016</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B).</p> <p>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).</p> <p>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).</p> <p>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</p>

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	<p>Item D).</p> <p>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).</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-0</p>
ISQM 2 Report Back	<p><u>March 2019</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item H-2).</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-1</p>
ISQM 2 Development of Final Standard	<p><u>September 2019</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item J)</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-2</p>

Appendix B

Report-Back on Matters Discussed at the September 2019 CAG Meeting

Extracts from the draft minutes of the September 2019 IAASB CAG meeting, as well as an indication of how the Task Force or IAASB has responded to the Representatives' comments, are included in the table below.

Representatives' Comments	Task Force / IAASB Response
<i>Scope of Engagements Subject to an EQ Review</i>	
<p>The Representatives were supportive of the ISQM 2 Task Force's proposals on the scope of the engagements subject to an EQ review. Mr. Dalkin noted that there was confusion relating to the proposal in the ED regarding entities that the firm determines are of 'significant public interest' (SPI) and hoped that the proposal to add a requirement for an EQ review for engagements for which the firm determines is appropriate due to the nature of the entity will provide clarity.</p> <p>Mr. Ruthman noted that the ISQM 2 Task Force proposals represented an elegant solution to the concerns raised, particularly the concept of SPI, and that the requirements as redrafted would be functional in the public sector. Mr. Dalkin agreed.</p>	<p>As part of the firm's risk assessment process (FRAP) in proposed ISQM 1, the firm is now required to understand factors that may adversely affect the achievement of a firm's quality objectives, including those relating to the 'nature and circumstances of the firm' and the 'nature and circumstances of the engagements' performed by the firm subject to the system of quality management. The introduction of such factors in the FRAP has raised questions from IAASB members about the distinction between the category of engagements subject to an EQ review as 'an appropriate response to assessed quality risks' (i.e., 3rd category), and the category of engagements subject to an EQ review 'due to the nature and circumstances of the engagement or the entity' (i.e., 4th category).</p> <p>In view of these changes to proposed ISQM 1 (which are to be considered by the IAASB at its March 2020 meeting), the Task Force is recommending that the separate category of engagements subject to an EQ review due to the nature and circumstances of the engagement or the entity be absorbed into the broader category of engagements for which the firm determines an EQ review is an appropriate response to assessed quality risks. For more details of the Task Force's discussions and recommendations regarding this proposal, please refer to Section I of Agenda Item G.2.</p>
Mr. Hirai expressed support for the proposals but noted the importance of the objective of extending EQ reviews to more engagements and asked whether the	Mr. Vanker noted that, in his view, the revised proposals will result in significantly more engagements scoped in compared to extant

Representatives' Comments	Task Force / IAASB Response
<p>proposals would meet this objective.</p>	<p>requirements, and about the same number of engagements in relation to ED-ISQM 1 but with greater clarity and consistency across firms and public sector audit bodies.</p> <p>Furthermore, the Task Force considers that removing the separate category of engagements subject to an EQ review due to the nature and circumstances of the engagement or the entity would not significantly affect the number of engagements subject to an EQ review since relevant aspects of the application material (i.e., factors to be considered in identifying engagements subject to an EQ review due to the nature and circumstances of the engagement or the entity) have been incorporated into the application material for the broader category of engagements subject to an EQ review as an appropriate response to assessed quality risks.</p>
<p>Mr. Hansen suggested that the IAASB consider scoping Public Interest Entities (PIE) first and then adding such entities where an EQ review is appropriate due to its nature. Mr. Hansen further noted that issues related to the scope of engagements subject to an EQ review would benefit from the resolution of IESBA's PIE initiative. Mr. James asked whether the scope of engagements subject to an EQ review can be tied to entities defined by law and regulation as PIEs, in addition to listed entities.</p>	<p>Mr. Vanker noted that the IAASB is unable to use the PIE definition for the purpose of scoping engagements subject to an EQ review because of the varying definitions of PIEs across jurisdictions.</p> <p>Mr. Vanker previously reiterated the Task Force's efforts to align with the PIE concept in the IESBA Code as shown in its September 2019 proposals in paragraph A105A of proposed ISQM 1.</p> <p>Mr. Vanker also recognized the importance of IESBA's PIE initiative, including concerns of pre-empting it, but noted that there is sufficient time for both Boards to determine an appropriate way forward.</p> <p>The Task Force notes that the IESBA's Definitions of Listed Entity and PIE Project is largely focused on audits of financial statements and auditor independence, and is still in its information gathering stages. The Task Force will continue to coordinate with the IESBA on this project by virtue of the IAASB having two correspondent members on that project's task</p>

Representatives' Comments	Task Force / IAASB Response
	force.
Ms. Meng sought clarification about whether entities planning to undertake an initial public offering will be subject to an EQ review.	<p>Mr. Vanker expressed his view that such entities will likely be subject to an EQ review based on the nature of the entity.</p> <p>The Task Force further notes that the related application material for the category of engagements subject to an EQ review as an appropriate response to assessed quality risks includes engagements that involve reporting on financial or non-financial information that is expected to be included in a regulatory filing, or that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus.</p>
<i>Objectivity and Cooling-Off Period</i>	
Ms. Manabat questioned whether the location of a more prescriptive requirement for a specific cooling-off period should be further considered by both the IAASB and the IESBA before the CAG provides its views. Mr. Dalkin noted that the Representatives are free to express their views to help inform the IAASB regarding an appropriate way forward. Ms. Soulier noted that applying the Conceptual Framework of the IESBA Code may lead practitioners to conclude that a cooling-off period may be necessary to protect objectivity. Ms. Soulier further noted that the location of a more prescriptive requirement for a specific cooling-off period is still subject to further consideration by both the IAASB and the IESBA.	On January 30, 2020, IESBA released for public comment the Exposure Draft (ED), Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers . The explanatory memorandum (EM) to the ED noted that “after giving the matter due consideration, the IESBA considers that it would be more appropriate for the IAASB to determine whether a cooling-off requirement should be introduced in proposed ISQM 2, following the proposed guidance set out in Section 120, and if so, the circumstances in which the requirement should apply, to whom it should apply, and what the minimum cooling-off period should be.” For further explanation, please refer to paragraph 17 of the EM to the ED linked above.
Mr. James pointed out that there are jurisdictions where the ISAs are in effect but the IESBA Code is not. Hence, it is important to determine an appropriate location for a more prescriptive requirement for a specific cooling-off period. Mr. Hansen agreed and noted that it is important to have consistent application of standards throughout the world.	In coordination with IESBA Representatives and Staff prior to the release of IESBA's ED as noted above, the Task Force presented proposed revisions at the December 2019 IAASB meeting (see Section II-B of Agenda Item 8 of that meeting) for the firm's policies or procedures to address threats to objectivity created by an individual being appointed as an EQ reviewer

Representatives' Comments	Task Force / IAASB Response
	<p>after previously serving as the engagement partner. Such policies or procedures are required to specify a mandatory cooling-off period of two years, or a longer period if required by relevant ethical requirements, before an engagement partner can assume the role of EQ reviewer.</p> <p>The Board generally supported the Task Force proposal, and also supported applying such requirement to all engagements for which an EQ review is performed.</p> <p>The Board also expressed its appreciation for the IESBA's proposals to address EQ reviewer objectivity in its conceptual framework (i.e., Section 120 of the IESBA Code), with some Board members still noting a preference for objectivity and a cooling-off period to be addressed directly in the IESBA Code.</p>
<p>Ms. McGeachy stated that the required ethical requirements are within the remit of the IESBA and therefore a requirement for a specific cooling-off period within ISQM 2 will be pre-emptive and will be a concern for small- and medium sized practitioners (SMPs). Ms. Robert agreed. Mr. Pavas also recognized the importance of an EQ review but expressed concern about the proposed length of cooling-off period of two years, particularly for SMPs.</p>	<p>Mr. Vanker noted that SMPs benefit from the scalability provided through the scoping requirements because there may be none or only a few engagements subject to an EQ review.</p> <p>In this regard, the Task Force considers that the mandatory cooling-off requirement should apply to all engagements for which an EQ review is performed. The view of the Task Force is that threats to the objectivity of an engagement partner stepping into the role of EQ reviewer are not unique to audits of listed entities only, or to the type of engagement. In reaching this conclusion, the Task Force noted that other than for audits of listed entities or when required by law or regulation, EQ reviews are not mandated for other engagements, and the firm may select responses other than an EQ review to address assessed quality risks, if appropriate. However, when an EQ review is required or has been determined by the firm to be the appropriate response, then the same requirements should apply in all cases. The Task Force considers that a conditional requirement would create a perception of different levels of EQ review for</p>

Representatives' Comments	Task Force / IAASB Response
	different types of engagements, which could lead to inconsistent application in practice and potential confusion in the minds of stakeholders, and therefore would not be in the public interest.
<p>Mr. Ruthman noted the importance of the linkage between the requirements and guidance in proposed ISQM 2 and the IESBA Code but cautioned against delaying the approval of proposed ISQM 2 to allow for this to be resolved. For this reason, Mr. Ruthman was supportive of a cooling-off period in proposed ISQM 2 if it is not addressed in the IESBA Code. This alternative would result in the implementation of a cooling-off period without amending the IESBA Code, or the withdrawal of such requirement in ISQM 2 if the IESBA Code is amended, which helps with speed to market. Mr. Gunn noted that whatever route the IAASB may pursue should be consistent with, and complementary to, the IESBA Code.</p>	<p>Mr. Vanker noted that a key takeaway from Representatives' views was that regardless of how the issues are resolved between the two Boards, it is important that Representatives' and respondents' concerns are addressed clearly and appropriately. Mr. Vanker echoed the views expressed by respondents that threats to objectivity of the EQ reviewer in this circumstance are unique, and that it is unlikely (or certainly less likely) that an EQ reviewer would be able to objectively evaluate significant judgments with which he or she had recently been involved as the engagement partner without a cooling-off period. Mr. Vanker also put into context the issue on objectivity and cooling-off period in relation to the broader EQ review standard and its importance, noting that this issue cannot be allowed to be the biggest obstacle to the passage of an otherwise crucially important EQ review standard responsive to current quality management issues.</p>