

Meeting: IAASB Consultative Advisory Group (CAG)

Meeting Location: Virtual Zoom Meeting

Meeting Date: September 8-9, 2020

Agenda Item B2

Proposed ISQM 2¹ – Cover and Report Back

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 March 2020 meeting (refer to **Appendix B** to this paper).
 - (b) Obtain the Representatives' views about any other matters for consideration by the Board before finalizing the requirements and application material for:
 - (i) Engagements subject to an engagement quality (EQ) review in proposed ISQM 1;² and
 - (ii) Proposed ISQM 2.

Project Status

Activities of the IAASB and the ISQM 2 Task Force (the Task Force) and Coordination Activities with Other Relevant Task Forces³

2. Since the March 2020 IAASB CAG meeting, the IAASB has further considered the matters discussed with the CAG, the Board and other relevant Task Forces. Coordination activities during the period included the alignment of the relevant requirements and application material across the three quality management standards.
3. At the September 2020 IAASB meeting, the Task Force Chair will present:
 - (a) The revised draft of the requirements and related application material on engagements subject to an EQ review in proposed ISQM 1. The Task Force has provided the clean version of the provisions relating to engagements subject to an EQ review in proposed ISQM 1 in **Agenda Item B2.3**.
 - (b) The revised draft of proposed ISQM 2. The Task Force has provided the clean version of proposed ISQM 2 in **Agenda Item B2.4**.

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 34(f)

³ These include the IAASB's ISQM 1, ISA 220 and ISA 600 Task Forces and the IESBA's EQR Objectivity Task Force.

4. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and the IAASB on this topic, including links to the relevant IAASB CAG documentation.

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

5. There are no substantive issues being raised for purposes of the September 2020 IAASB meeting. The Task Force considers that the drafts of the provisions relating to engagements subject to an EQ review in proposed ISQM 1 (as presented in **Agenda Item B2.3**) and proposed ISQM 2 (as presented in **Agenda Item B2.4**), reflect all significant matters raised in the course of the project. Accordingly, this serves as the final discussion of the proposed ISQM 2 prior to its anticipated approval by the IAASB in September 2020.
6. 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. The Task Force wishes to note its appreciation for the guidance and support received throughout the life of this project from the Chair and all CAG Representatives.

CAG Discussion in September 2020 and Navigation of Papers

7. For the purposes of the IAASB CAG discussion, the Task Force Chair will present the Task Force's proposed revisions to address the matters previously discussed with the IAASB CAG (see **Section II of Agenda Item B2.2**). Representatives will then be asked to provide input on the question outlined in this paper.
8. **Agenda Item B2.2**, which accompanies this cover note, is **Agenda Item 3** of the September 2020 IAASB meeting papers. **Section II of Agenda Item B2.2** addresses the changes to the provisions for engagements subject to an EQ review in proposed ISQM 1, and proposed ISQM 2. Such changes resulted from the alignment of the relevant requirements and application material across the three quality management standards. Refer to **Appendix B** of this paper for information about how the Task Force or the IAASB has responded to the Representatives' comments on the matters included in the table below.

Sections of the Standard	Requirements	Application Material
Engagements subject to an EQ review in proposed ISQM 1	Paragraph 34(f) of Agenda Item B2.3	Paragraphs A133–A137 of Agenda Item B2.3
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	Paragraph 19 of Agenda Item B2.4	Paragraphs A17–A18 of Agenda Item B2.4

9. Since **Agenda Item B2.2** is an IAASB Board paper, Representatives are requested to note the following in navigating the document:
- (a) The questions in **Agenda Item B2.2** are those that will be posed to the IAASB. Therefore,

Representatives are not being asked to respond to these questions. The **Matter for IAASB CAG Consideration** is outlined below.

- (b) **Agenda Item B2.2** includes references to a variety of other agenda items that will be presented at the September 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-virtual-videoconferencing-1>.

10. **Appendix B** to this paper includes extracts from the draft minutes of the March 2020 IAASB CAG meeting, as well as an indication of how the Task Force or IAASB has responded to the Representatives' comments.

Matter for IAASB CAG Consideration

1. Do Representatives have any other matters for consideration by the Board before finalizing the requirements and application material for engagements subject to an EQ review in proposed ISQM 1 (as presented in **Agenda Item B2.3**), and for proposed ISQM 2 (as presented in **Agenda Item B2.4**)?

Materials Presented – IAASB CAG Papers

- | | |
|-------------------------|-------------------------------------------------------------------------------------|
| Agenda Item B2.1 | Presentation – Proposed ISQM 2 |
| Agenda Item B2.2 | Agenda Item 3 – Proposed ISQM 2 – Issues and Recommendations |
| Agenda Item B2.3 | Agenda Item 3-A – Draft of the Scope of Engagements Subject to an EQ Review (Clean) |
| Agenda Item B2.4 | Agenda Item 3-B – 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)) ⁴		October 2018

⁴ Paragraph 43 was renumbered as paragraph 37(e) in ED-ISQM 1 and now is renumbered as paragraph 34(f) 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 March 2020	September 2019 December 2019 March 2020 June 2020

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 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> <p><u>March 2020</u></p> <p>See IAASB CAG meeting material and CAG meeting minutes (Agenda Item G)</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-3</p>

Appendix B

Report Back on Matters Discussed at the March 2020 CAG Meeting

Extracts from the draft minutes of the March 2020 IAASB CAG meeting, and an indication of how the Task Force or the IAASB has responded to the Representatives' comments, are included in the table below.

Representatives' Comments	Task Force / IAASB Response ⁵
SCOPE OF ENGAGEMENTS SUBJECT TO AN EQ REVIEW	
<ul style="list-style-type: none"> Mr. Dalkin reiterated that the CAG was fully supportive of the direction of proposed ISQM 2 from its inception. In addition, Messrs. Dalkin, Orth and Ruthman also noted that the proposed revisions relating to the third bucket provided a good "catch-all" category and provided a balanced and workable approach (for example, in the public sector), in determining engagements for which an EQ review is an appropriate response to assessed quality risks. 	<p>Support noted.</p> <p>The Task Force clarified that the third category of engagements subject to an EQ review in paragraph 34(f)(iii) of proposed ISQM 1 relates to audits or other engagements for which the firm determines that an EQ review is an appropriate response to address one or more quality risk(s).</p>
<ul style="list-style-type: none"> Mr. Orth suggested considering including in the first bucket (i.e., audits of financial statements of listed entities) entities going public with an initial public offering. 	<p>Mr. Vanker confirmed that the related application material for the third category of engagements subject to an EQ review (as noted above) included 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>
<ul style="list-style-type: none"> Mr. Thompson recognized the ISQM 2 Task Force's efforts to engage with the IFAC SMP Committee and suggested that the ISQM 2 Task Force continues to coordinate with IESBA in relation to its project on the Definitions of Listed Entity and Public Interest Entity. 	<p>Mr. Vanker confirmed that the ISQM 2 Task Force will continue to coordinate with the IESBA on this project and noted the IAASB has two correspondent members on the IESBA Definitions of Listed Entity and Public Interest Entity project's task force.</p>

⁵ Where applicable, references have been updated to align with **Agenda Items B2.3** and **B2.4**.

Representatives' Comments	Task Force / IAASB Response ⁵
OBJECTIVITY AND COOLING-OFF PERIOD	
<ul style="list-style-type: none"> Messrs. Dalkin and Hansen noted that an EQ review is an important aspect of audit quality and expressed support for the cooling-off period in proposed ISQM 2. Ms. Wolf noted the proposed revisions relating to objectivity and a cooling-off period in proposed ISQM 2 are reasonable (resource constraints notwithstanding). 	<p>Support noted.</p> <p>Mr. Seidenstein highlighted that comments received during the exposure period relating to public interest and investor perspectives fully supported a mandatory cooling-off period in proposed ISQM 2.</p>
Other comments and suggestions included:	
<ul style="list-style-type: none"> Ms. Landell-Mills noted that the mandatory two-year cooling-off period may be too short and suggested clarifying how the independence of the EQ reviewer is addressed in proposed ISQM 2. 	<p>Point noted.</p> <p>The independence of the EQ reviewer is addressed in paragraph 18(b) of proposed ISQM 2, which requires that the firm shall establish policies or procedures that set forth the criteria for eligibility to be appointed as an EQ reviewer. Those policies or procedures shall require that the EQ reviewer not be a member of the engagement team, and complies with relevant ethical requirements, including in relation to threats to objectivity and <i>independence of the EQ reviewer</i> (emphasis added).</p>
<ul style="list-style-type: none"> While agreeing that the proposed revisions are sensible measures from an investor and a regulatory perspective, Ms. Robert and Mr. Orth raised concerns about the impact or constraint of an additional mandatory cooling-off period in proposed ISQM 2 on the existing internal engagement partner rotation and external firm rotation requirements (e.g., in the European Union). Mr. Norberg also raised concerns about how this would impact engagements performed for European businesses. 	<p>Points noted.</p> <p>While the IAASB recognizes the impact or constraint of the mandatory cooling-off period in proposed ISQM 2 on the engagement partner rotation and firm rotation requirements, the objectivity of the EQ reviewer is an important criterion for eligibility of an individual to be appointed as an EQ reviewer as it is foundational to the objective of the standard and the definition of an EQ review (i.e., an <i>objective</i> (emphasis added) evaluation of the significant judgments made by the engagement team and the conclusions reached thereon).</p> <p>In the case of an individual being appointed as an EQ reviewer after previously serving as the engagement partner, it is the separation from the previous involvement in making significant</p>

Representatives' Comments	Task Force / IAASB Response ⁵
	<p>judgments as the engagement partner that is necessary for the EQ reviewer to objectively evaluate the significant judgments made by the engagement team and the conclusions reached thereon.</p> <p>It is only for such cases that proposed ISQM 2 requires that the firm's policies or procedures specify a 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>In addition, the IAASB provides guidance in paragraph A13 of proposed ISQM 2 that relevant ethical requirements may include specific independence requirements that would apply to individual professional accountants, such as an EQ reviewer. Relevant ethical requirements may also include provisions that address threats to independence created by the long association of personnel with an audit or assurance client.</p> <p>The application of any such provisions dealing with long association (that addresses threats to independence created by the long association of personnel with an audit or assurance client) is distinct from, but may need to be taken into consideration in applying, the required cooling-off period in proposed ISQM 2 (that addresses threats to objectivity created by an individual being appointed as an EQ reviewer after previously serving as the engagement partner).</p>
<ul style="list-style-type: none"> Mr. De Tullio suggested carving out the mandatory cooling-off period in proposed ISQM 2 for small- and medium-sized practices. Ms. Zietsman noted that it was important to have the requirements for the EQ reviewer in one location but suggested exploring a similar exemption provided for smaller firms in the PCAOB standard for EQ reviews. 	<p>Points not accepted.</p> <p>The IAASB's believes that threats to the objectivity of an engagement partner stepping into the role of EQ reviewer also apply to smaller firms.</p> <p>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 one or more quality risk(s), if appropriate. However, when an EQ review is</p>

Representatives' Comments	Task Force / IAASB Response ⁵
	required or has been determined by the firm to be the appropriate response, then the same requirements should apply in all cases.