

Meeting: IESBA CAG

Meeting Location: Virtual

Meeting Date: March 10, 2021

Agenda Item

A-5

Objectivity of an Engagement Quality Reviewer and Other Appropriate Reviewers

Objective of Agenda Item

1. To report back on the discussions at the September 2020 CAG meeting relating to the Task Force's proposals addressing the objectivity of an engagement quality reviewer (EQR) and other appropriate reviewers.

Background, Project Status and Timeline

2. The IAASB issued the exposure draft (ED) [Proposed International Standard on Quality Management \(ISQM\) 2, Engagement Quality Reviews](#) in February 2019. The Explanatory Memorandum (EM) accompanying the ED of proposed ISQM 2 included a specific request to respondents for input on whether there is a need for guidance in the proposed ISQM 2 to address the matter of cooling off as an eligibility requirement for the EQR. This would be in circumstances where the individual served as the engagement partner on the audit engagement immediately prior to being appointed to the EQR role. Respondents were also asked whether such guidance should be located in proposed ISQM 2 or the Code.
3. At the September 2019 IESBA meeting, the IESBA liaison member to the IAASB, Sylvie Soulier, presented a high-level overview of respondents' feedback on ED-ISQM 2.
4. On the matter of requiring a "cooling-off" period for individuals moving into the role of EQR, the IESBA was briefed on the options presented by the ISQM 2 Task Force and the strong support for a cooling-off requirement expressed by the respondents to the ED.
5. The IESBA agreed that the matter of EQR objectivity should be addressed in the Code. Some views were expressed that any discussion about a cooling-off period should be in the Code, although there were other views that there should be a proper articulation of the threats that are created and how they might be evaluated and addressed, consistent with the Code's conceptual framework.
6. The IESBA agreed to take up the issue in the Code as a matter of priority to try to align as much as possible with the IAASB's timeline for approval of ISQM 2 in June 2020. At its December 2019 meeting, the IESBA approved the [project proposal](#). As part of its deliberations, the IESBA also considered comments raised by the CAG at its December 2019 meeting.
7. In January 2020, the IESBA released the Exposure Draft (ED), [Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers](#), which was open for public comment until March 16, 2020.

8. At its June 2020 meeting, the IESBA considered significant [matters](#) raised by respondents to the ED, the Task Force’s responses and proposed revisions to the text of the ED.
9. At the [September 2020](#) IESBA meeting, the IESBA considered the Task Force’s final revisions to the proposals. After agreeing the necessary changes to the proposed text as well as key comments raised at the [September 2020](#) CAG meeting, the IESBA approved the final revisions to the Code addressing the Objectivity of an Engagement Quality Reviewer and Other Appropriate Reviewers.
10. The IESBA set the effective date of the final provisions to be aligned with the effective date of ISQM 2, i.e., under Part 4A, for audits and reviews of financial statements for periods beginning on or after December 15, 2022. For Part 4B, the provisions are effective for assurance engagements beginning on or after December 15, 2022. Finally, for all other engagements within the scope of Part 3, the provisions are effective for engagements beginning on or after December 15, 2022.
11. The IESBA resolved to allow early adoption. The [final pronouncement](#) was issued on January 14, 2021.

Report Back on September 2020 CAG Discussion

12. Below are extracts from the draft minutes of the September 2020 CAG meeting¹ and an indication of how the Task Force or the IESBA has responded to the CAG’s comments.

Matters Raised	Task Force/IESBA Response
LOCATION OF THE COOLING-OFF REQUIREMENT AND BROADENED SCOPE OF THE GUIDANCE	
<p>Mr. Dalkin expressed support for having the cooling-off requirement in ISQM 2 on the grounds that this is a matter that relates more to quality management. He commented that, based on his experience dealing with similar issues concerning the objectivity of a reviewer, he has endeavored to take a principles-based approach to the matter. However, he noted that there had been inconsistencies regarding the characteristics of individuals appointed as reviewers. He therefore emphasized the importance of guardrails around objectivity. Regarding Section 325, he accepted that these guardrails have been provided but noted that they are in the Code. He therefore wondered whether users would need to turn to the Code for guidance regarding the objectivity of reviewers and whether that would unintentionally create more confusion.</p>	<p>Support noted.</p> <p>Given that an EQR meets all the attributes of an appropriate reviewer as described in the Glossary, and is therefore an example of such a reviewer, the IESBA determined that the scope of the guidance addressing the objectivity of an EQR should be broadened to encompass any individual who serves in the capacity of an appropriate reviewer for purposes of implementing a safeguard against identified threats.</p> <p>With regard to the location of the guidance addressing objectivity, users would indeed need to turn to the Code for such guidance given that objectivity is an ethical concept. However, to make sure they such guidance is not missed from the perspective of an audit engagement, a cross-reference to the guidance in the Code addressing the objectivity of an EQR has been added in paragraph A15 of ISQM 2.</p>

¹ The draft September 2020 minutes will be approved at the March 2021 IESBA CAG meeting.

Matters Raised	Task Force/IESBA Response
<p>Ms. Zietsman observed that broadening the scope from EQR to AR represented a significant shift from a targeted project to one that is quite broad. She queried whether there would be some unintended consequences as a result. She referred to the issues paper that provided the example where more experienced engagement team members reviewing work of less experienced team members would be considered ARs. She indicated that it was not clear from the proposed Section 325 that the concept of an AR would include those more experienced engagement team members. Accordingly, she flagged that there might be some questions about who would be scoped in.</p> <p>Ms. Robert emphasized the same point as Ms. Zietsman with regards to the broadening of the scope to ARs when the objective was originally to address the objectivity of an EQR. She shared her concern about the potential for unintended consequences. She felt that there was an undue focus on the objectivity of ARs as opposed to their other essential attributes. She also inquired about which stakeholders had supported, in their responses to the ED, an extension of the scope to ARs.</p>	<p>Point accepted.</p> <p>As noted above, the IESBA determined that the guidance might also apply to an appropriate reviewer as described in paragraph 300.8 A4 of the Code because an EQR is an example of an appropriate reviewer. However, to minimize the potential for unintended consequences, the IESBA determined that the applicability of the guidance should be limited to only circumstances where an appropriate reviewer is used as a safeguard in the Code. (See paragraph 325.4 in the final pronouncement.)</p> <p>In all other circumstances, the conceptual framework in the Code will apply with respect to identifying, evaluating and addressing threats to objectivity.</p>
<p>Mr. Hirai echoed the same sentiment. He noted that the concept of an AR in the Code was developed to serve as one possible safeguard to address threats to compliance with the fundamental principles or to independence. With the concept now broadened to cover relationships within an engagement team, he wondered whether this would create confusion in practice. He suggested that should the Board support the broadening of the scope to AR, there should be clarity in the Code itself rather than in the Basis of Conclusions as to the individuals who might be captured.</p>	<p>Point accepted.</p> <p>Given that an EQR meets all the attributes of an appropriate reviewer as described in the extant Code, and is therefore an example of such a reviewer, the IESBA determined that the scope of the guidance addressing the objectivity of an EQR should be broadened to encompass any individual who serves in the capacity of an appropriate reviewer for purposes of implementing a safeguard against identified threats. As noted above, the IESBA determined not to extend the scope of the guidance to include appropriate reviewers used in contexts other than as a safeguard in the Code. The IESBA believes this will minimize the potential for unintended consequences.</p> <p>In all other circumstances, the conceptual framework in the Code will apply with respect to</p>

Matters Raised	Task Force/IESBA Response
	identifying, evaluating and addressing threats to objectivity.
PIOB PUBLIC INTEREST ISSUES	
<p>Mr. Kashiwagi noted that the PIOB is predominantly concerned with three main public interest issues which are:</p> <ul style="list-style-type: none"> The existence of two different cooling-off requirements addressing long association and objectivity of EQR in two different locations, which the PIOB feels might create confusion in practice. The PIOB is of the view that including further explanations in the Basis of Conclusions document and IESBA Staff Frequently Asked Questions (FAQs) would not be sufficient as these documents are non-authoritative. Mr. Kashiwagi felt that inclusion of explicit material in the Code would be needed. 	<p>Point taken into account.</p> <p>To minimize the potential for confusion with the long association cooling-off requirements, the IESBA determined to make clear in paragraph 325.8 A4 that the cooling-off period required by ISQM 2 is distinct from, and does not modify, the partner rotation requirements in Section 540. A similar provision has been added in Section 540, paragraph 540.14 A1, cross referring to paragraph 325.8 A4.</p>
<ul style="list-style-type: none"> On the location of the cooling-off requirement, whilst he appreciated that the Board wished to maintain a principles-based approach in the Code, Mr. Kashiwagi noted that a precedent already exists in Section 540 where the Code sets out explicit cooling-off requirements. He was concerned that the proposed guidance in Section 325 did not amount to a requirement, but only highlighted cooling off as a possible safeguard and hence seemed weak. He felt that safeguards to address threats to objectivity is an ethical matter that the Code should address. 	<p>Point taken into account.</p> <p>The IESBA acknowledged the clear support from stakeholders for a cooling-off requirement to address circumstances where an individual is being considered for appointment to the EQR role immediately after having served as the EP on the engagement. However, given the balance of respondents' views on the location of the cooling-off requirement and following further coordination with the IAASB, the IESBA reaffirmed that the Code should establish the principles-based guidance as a foundation to support the establishment of the cooling-off requirement in ISQM 2.</p> <p>Nevertheless, to recognize the importance of the cooling-off requirement, the IESBA determined to:</p> <p>(a) Add a clear cross-reference in Section 325 to ISQM 2 indicating that ISQM 2 requires the firm to establish policies or procedures that specify, as a condition for eligibility, a cooling-off period of two years before the engagement partner can assume the role of</p>

Matters Raised	Task Force/IESBA Response
	<p>EQR. This matches a corresponding cross-reference in paragraph A15 of ISQM 2 to the principles-based guidance in the Code addressing the objectivity of an individual being appointed as an EQR. This cross-reference also has the benefit of acting as a signpost for users looking in the Code as to whether there is a cooling-off requirement addressing this particular issue; and</p> <p>(b) Clearly state that the cooling-off requirement serves to enable compliance with the principle of objectivity and the consistent performance of quality engagements. Such a statement duly recognizes that objectivity has a dual character as an ethical principle and a quality precondition.</p>
<ul style="list-style-type: none"> In relation to paragraph 325.7 A2 as drafted, he wondered if it was clear that cooling-off does not apply to an AR but to an EQR. He felt that there was ambiguity as the first sentence addressed ARs but the second sentence spoke about an EQR. He therefore questioned whether there was also a cooling-off requirement for an AR. 	<p>Point accepted.</p> <p>The final pronouncement (paragraph 325.8 A3) makes it clear that ISQM 2 establishes a cooling-off requirement with respect to an engagement partner before that individual can assume the role of EQR on the engagement.</p>
<p>Regarding the matter of re-exposure, Mr. Kashiwagi felt that the broadening of the scope of the project is a significant issue. He mentioned that he would be interested in hearing the views of CAG representatives.</p>	<p>Point taken into account.</p> <p>After reflecting on the final changes to the text of the ED, the IESBA determined that there was no need to re-expose the proposals.</p>
<p>Ms. Landell-Mills supported the observations made by Mr. Kashiwagi. Referring to stakeholders who had responded to the ED, she expressed disappointment that there was no respondent from the investor community, especially given that they are the beneficiaries of the standards. She felt that from an investor perspective, the level of protection in the proposals in safeguarding the objectivity of the reviewer was weak. She was of the view that two years for the cooling-off period was very short and that she would seek a longer period, and even for the EQR to be an individual outside the firm, as</p>	<p>Point taken into account.</p> <p>The provisions in the final Section 325 have been closely coordinated with the final provisions in ISQM 2 so that they are mutually reinforcing and interoperable. The IAASB has set the cooling-off requirement in the final ISQM 2 at two years, reflecting a balance between the need for objectivity and the fact that individuals with sufficient experience and expertise who can serve in the EQR role are in short supply.</p>

Matters Raised	Task Force/IESBA Response
often the perception of objectivity is more important.	
<p>Mr. Munter observed that the matters raised by the PIOB cut across the observations made by Ms. Zietsman and Mr. Hirai regarding the broadening of the scope to ARs. Referring to the role of an EQR, he noted that there is a specific purpose associated with that role, and therefore the importance of protecting the EQR's objectivity and the appearance of that objectivity. Hence, cooling off is a large part of thinking about safeguarding that objectivity. However, when looking at other review functions beyond an engagement quality review, the appearance of objectivity from an external standpoint is not so relevant as often, these other ARs are more focused internally on a firm's quality processes. Hence, he felt that the question of whether the Code should include a cooling-off requirement is linked to whether the Code should be broad and principles-based, or narrowly focused on the specific issue of EQR objectivity. He was therefore of the view that if the Board chose to go with a broader scope, there would need to be a clear explanation of the thought process in going from EQR objectivity to the objectivity of an AR.</p>	<p>Point taken into account. Please refer to the above responses.</p>
<p>Ms. Meng supported in principle a cooling-off requirement in the Code. However, given the short timeframe to complete the project, she felt that the public interest would be better served if the Task Force could coordinate its efforts with the ISQM 2 Task Force. She suggested that the IESBA could explore having a cooling-off requirement in the Code in the future.</p>	<p>Point accepted. Please refer to the above responses.</p>