

# Agenda Item H.1

## Quality Management (Firm level), Including Engagement Quality Control reviews

### Objective of the IAASB Consultative Advisory Group (CAG) discussion

The objective of this Agenda Item is to obtain the Representatives' input on the Quality Control Task Force's (QCTF) proposals in relation to the restructure of ISQC 1<sup>1</sup> to incorporate a quality management approach (QMA), thereby improving the scalability of ISQC 1. Furthermore, this Agenda Item explores the QCTF's recommendations in relation to improving the robustness of the requirements relating to engagement quality control (EQC) reviews.

The input from the Representatives on these matters will assist the QCTF in further exploring the revisions to ISQC 1.

### Introduction

1. The IAASB's Invitation to Comment (ITC), [Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits](#), highlighted that one of the key challenges of ISQC 1 is addressing the diverse needs of a broad range of stakeholders, i.e., the need to improve the robustness of the requirements in relation to firms performing audits of listed entities, or entities of public interest, but at the same time addressing the concerns of small-and-medium sized practitioners (SMPs) in relation to the relevance of ISQC 1.
2. Accordingly, in the ITC it was proposed that a new approach, referred to as a QMA, could be developed, to accommodate improvements to the robustness of the standard, while at the same time it would provide the necessary flexibility to facilitate the application of ISQC 1 by firms of all sizes and who perform a variety of engagements, including to a wide range of entities.
3. This Agenda Item explains the QCTF's proposals to integrate a QMA within ISQC 1 and focuses on the structure of ISQC 1 and how the scalability<sup>2</sup> principles of a QMA could be encapsulated in the standard, while maintaining the robustness of ISQC 1. These proposals were discussed by the IAASB at its December 2016 meeting.
4. Furthermore, in order to support an understanding of the possible revisions to ISQC 1, this Agenda Item explains certain aspects of ISQC 1, including:
  - Governance and leadership, organization, culture and strategy that foster quality;
  - Information and communication; and
  - The quality management process (this is a new component that would be introduced to ISQC 1 and comprises activities involving establishing the firm's quality objectives, performing an

<sup>1</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements*

<sup>2</sup> The QCTF recognizes that there are different interpretations of the meaning of the terminology "scalability" and "proportionality." For the purposes of this paper, the term "scalability" has been used to represent both scalability and proportionality, and therefore scalability means (i) whether or not the requirement applies to the firm based on its circumstances; and (ii) if the requirement applies, the extent to which the requirement can be applied in a manner commensurate with the size and complexity of the firm.

assessment of the risks to quality, designing and implementing responses to quality risks and monitoring and remediation).

5. This Agenda Item also includes the proposed revisions to ISCQ 1 in relation to EQC reviews. The QCTF presented certain proposals to the IAASB CAG at its September 2016 meeting, and has since progressed these proposals and discussed them with the IAASB at the IAASB's September and December 2016 meetings.

## **Incorporating Quality Management in ISQC 1**

### *Overview of Feedback from Respondents*

6. Respondents to the ITC generally supported the IAASB moving forward and continuing to explore the development of a QMA and incorporating it into a revised ISQC 1. However, the IAASB was cautioned that the development of a QMA and incorporating it into ISQC 1 would need to be subject to further consideration by stakeholders given that the ITC had only provided limited information for respondents about the proposed approach.
7. Respondents generally agreed with the IAASB's view that a QMA would likely enhance the scalability of ISQC 1, however indicated that guidance and examples would be necessary to support the implementation of the QMA to demonstrate scalability. In addition, the IAASB was cautioned that revisions to ISQC 1 to incorporate a QMA should not simply result in add-ons to the existing requirements that may result in compliance with the standard becoming more onerous. There were also concerns from regulators and audit oversight authorities that a QMA should not diminish the robustness of extant ISQC 1.

### *Task Force Recommendations*

8. In integrating a QMA within ISQC 1, there are several issues that need to be considered:
  - (a) How would the structure of ISQC 1 be revised to incorporate a QMA?
  - (b) How would the existing requirements in ISQC 1 fit within the revised structure?
  - (c) How would the robustness of the requirements in ISQC 1 be maintained, while at the same time introducing scalability?
- A. The Revised Structure of ISQC 1
9. The following depicts the various components of the firm's system of quality management and it demonstrates how they interrelate. These components would be relevant to all firms and would need to exist in order to achieve the overall objective of ISQC 1. The components are described in further detail below.



10. The components are similar to those proposed in the ITC, however were refined in response to various comments from respondents to the ITC and the feedback from the IAASB at the December 2016 meeting. The components include:

- (a) *Governance and Leadership, including Organization, Culture and Strategy*<sup>3</sup>: Establishing governance principles would provide a consistent guideline for firms in creating an environment that sustains and improves quality. Accordingly, the QCTF proposes the introduction of governance principles in ISQC 1 that are principles-based and focus on the outcome of what they intend to achieve, thereby allowing firms the flexibility to implement the most appropriate actions to suit their firm. The governance principles would incorporate the concepts of organization, culture and strategy that foster quality.

Responsibility for establishing the organization, culture and strategy that fosters quality would exist at a firm leadership level, and the culture would be extended into the firm through the mechanisms that embed this culture. Accordingly, the QCTF proposes improving the requirements regarding firm leadership's responsibility, including accountability for quality and resources. This is further explained in paragraphs 22–28.

- (b) *Information, communication and documentation*: Information and communication is the continual, iterative process of obtaining, providing and sharing information in order to support the functioning of the firm's system of quality management, and includes both internal and external communication. Although communication and documentation are addressed in extant ISQC 1, the QCTF proposes enhancing these requirements. This is further explained in paragraphs 29–33.

<sup>3</sup> At their December 2016 meeting, the QCTF had proposed that "organization, culture and strategy that fosters quality" would be a subcomponent of "governance and leadership", i.e., it wouldn't have been in the title of the component but would be addressed by the requirements in the component. The IAASB were of the view that there should be a separate component for "organization, culture and strategy that fosters quality" given its importance to creating an environment that supports quality. The QCTF considered this feedback, however due to the strong interconnectedness of "governance and leadership" and "organization, culture and strategy that fosters quality", determined that it would not be practical to separate the two. Accordingly, the QCTF have determined that the title of the component would instead be clear that "governance and leadership" includes "organization, culture and strategy".

- (c) *The process of managing quality*: This process encompasses the ongoing activities that support a risk-based approach to managing quality in the context of the overall quality objectives. The activities within this process would include determining quality objectives, performing an assessment of the risks to quality (referred to as “perform quality risk assessment”), designing and implementing responses to quality risks and monitoring and remediation. This is further explained in paragraphs 34–46.
  - (d) *Applying the quality management process*: This component incorporates the elements of ISQC 1<sup>4</sup> and demonstrates how the QMP applies to each of the elements. The requirements in this section would drive firms to establish minimum quality objectives and quality risks in relation to each element and would include essential responses to address the quality risks, in addition to compelling the firm to identify other relevant responses to address these risks. This is further explained in paragraph 13.
11. Accordingly, the structure of ISQC 1 would be revised in order to accommodate these components as follows:
- (a) Governance and leadership, including organization, culture and strategy.
  - (b) Communication, information and documentation.
  - (c) Quality management process (QMP):
    - (i) Determine quality objectives;
    - (ii) Perform quality risk assessment;
    - (iii) Design and implement responses to quality risks; and
    - (iv) Monitor and remediate.
  - (d) Applying the QMP:
    - (i) Law, regulation and relevant ethical requirements;
    - (ii) Acceptance and continuance of client relationships and specific engagements;
    - (iii) Resources; and
    - (iv) Engagement performance.
- B. Including the Existing Requirements of ISQC 1 in the Components of Quality Management
12. As is evident from the revised structure set out above, many of the existing requirements in ISQC 1 would remain, albeit that they would be adapted to accommodate a QMA. For example, monitoring would form part of the QMP and the requirements would be enhanced to incorporate the recommendations in the ITC and the feedback from respondents.

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<sup>4</sup> The elements comprise (i) law, regulation and relevant ethical requirements, (ii) acceptance and continuance of client relationships and specific engagements, (iii) resources, and (iv) engagement performance. These elements are largely consistent with those in extant ISQC 1.

13. The existing elements of ISQC 1<sup>5</sup> would also remain, however these would be adapted to reflect the principles of quality management. For example, in relation to acceptance and continuance:
- (a) The firm would be required to identify quality objectives related to acceptance and continuance and ISQC 1 would set out some of these objectives in the form of the existing requirements that exist in extant ISQC 1. However, the firm would be expected to still consider whether there are any additional objectives that may be relevant to the firm in relation to acceptance and continuance.
  - (b) The firm would then be required to identify quality risks in relation to the quality objectives identified in respect of acceptance and continuance. ISQC 1 would set out some of these quality risks, however the firm may identify additional quality risks.
  - (c) The firm would be required to identify responses to address the quality risks in respect of acceptance and continuance. ISQC 1 would include standard responses that all firms would be expected to implement, based on the existing requirements in extant ISQC 1. However, the firm may need to identify additional responses when these standard responses are not sufficient to fully address the quality risks.
14. This section containing the requirements for each of the elements would be referred to as “applying the QMP”, since it demonstrates how the principles of determining quality objectives, performing the quality risk assessment and designing and implementing responses to quality risks applies to each of the elements.
15. It is noted that the element of resources encompasses more than human resources and includes other resources such as intellectual resources, financial resources and technology resources. The QCTF recognizes that resources are necessary for a proper functioning of the firm’s system of quality management, and may be relevant across all of the components of the firm’s system of quality management. As the requirements in ISQC 1 are further developed, the QCTF will give further consideration to the most effective way to integrate resources, for example, establishing a requirement for leadership to be responsible for obtaining and allocating resources appropriately.
- C. Maintaining the Robustness of the Requirements and Introducing Scalability
- Robustness
16. As discussed in the previous section, the existing requirements of ISQC 1 would be retained and adapted to reflect the principles of quality management, thereby retaining the robustness of ISQC 1. Furthermore, the QCTF notes that many of the requirements in ISQC 1 will be enhanced in accordance with the proposals in the ITC, for example, as highlighted in paragraph 10 it is proposed that governance principles will be incorporated into ISQC 1 and the responsibilities of leadership will be strengthened, thereby strengthening the environment supporting the firm’s system of quality management.
17. The QCTF are of the view that incorporating a QMA in ISQC 1 will also improve the robustness of the firm’s system of quality management, because firms would be required to consider their circumstances and environment and be responsive to the quality risks that would result in firms focusing their efforts on addressing those risks, rather than a “checklist-based” approach of

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<sup>5</sup> The existing elements of ISQC 1 comprise “relevant ethical requirements”, “acceptance and continuance of client relationships and specific engagements” and “engagement performance”.

implementing quality controls that could be redundant to the firm and are not reevaluated for their effectiveness.

18. The QCTF recognizes that the robustness of ISQC 1 is dependent on the firm properly applying the QMP and noted the views of respondents that there needs to be a common understanding of the QMP in order for it to be applied effectively. Accordingly, requirements would be introduced in relation to the QMP, i.e., the firm would be required to determine quality objectives, perform an assessment of the risks to quality etc. These requirements would be supported by extensive application material to clearly explain the requirements and demonstrate their application. Paragraphs 34–46 include an overview of how the QCTF envisages these requirements would be established.
19. Furthermore, it would be necessary for ISQC 1 to address the risk of an error or omission at the risk assessment stage. This would largely be addressed through a requirement for the firm to reevaluate its objectives, risks and responses that would also promote a proactive and responsive approach to quality management. The QCTF is considering how this reevaluation would be established, for example, whether it would be appropriate for this reevaluation to be undertaken on a periodic basis. Nevertheless, the firm would be compelled to consider its system of quality management as a result of the outcome of its monitoring activities.

#### Scalability

20. The ITC's key focus regarding introducing the QMA was its value in terms of being scalable to the size, nature and structure of the firm. As discussed in paragraph 7, there were concerns from respondents to the ITC that a QMA would merely be an add-on to the existing requirements of ISQC 1. While the QCTF is still exploring how the requirements in respect of the components would be articulated, the QCTF is of the view that scalability would be incorporated into ISQC 1 as follows:
  - (a) *Governance, leadership, organization, culture and strategy*: As highlighted in paragraph 10(a), the requirements relating to governance would be principles-based, focusing on the outcome of what they intend to achieve. It would be up to the firm to determine how to implement these principles. While specific requirements would be established regarding the assignment of responsibility and accountability to firm leadership, the manner in which leadership fulfills this role would be adaptable to the firm's circumstances.
  - (b) *Information, communication and documentation*: These requirements would be written in the context of being outcome-based, and it would be up to the firm to determine how to achieve that outcome.
  - (c) *QMP*: The requirements would be established on the basis that the firm identifies quality objectives that are relevant to the firm and identifies and assesses the risks of not meeting those objectives (quality risks). The requirements for the design and implementation of responses to quality risks would emphasize that the responses need to be commensurate to the risk. Furthermore, the requirements addressing the firm's monitoring and remediation activities would also emphasize that the nature and extent of the monitoring and remediation would depend on factors such as the size of the firm, the services the firm provides, and the nature of the entities to whom those services are provided. Paragraphs 34–46 include an overview of how the QCTF envisage these requirements would be established.
  - (d) *Applying the QMP*: As explained in paragraph 13, this section would include quality objectives, quality risks and responses in respect of each of the elements. Although all firms would be

required to implement the responses, these responses would be flexible. For example, instead of mandating that firms need to establish *policies and procedures* addressing the quality risk, the QCTF is proposing that the firm needs to establish a *response to address the quality risk*. This response could be a broad range of actions, but would provide the firm with the flexibility to identify the most effective and suitable action in their circumstances. Furthermore, some of the responses included in ISQC 1 as “standard responses” would be established as conditional requirements (e.g., EQC reviews that only apply to audits of listed entities).

21. Additional emphasis on the scalability of ISQC 1 would be added in various other ways, for example, the application material supporting the requirements would demonstrate the application of the standard in the context of a smaller firm and a larger, more complex firm. Furthermore, the introductory section of ISQC 1 would explain the concepts of quality management and discuss the scalability of the standard.

#### **Matters for IAASB CAG Consideration**

1. The Representatives are asked for their views regarding:
  - (a) The proposed components of the firm’s system of quality management, and how the structure of ISQC 1 would be revised to reflect these components.
  - (b) The elements of ISQC 1 and how the existing elements would be transposed into the section “applying the QMP”, through converting the requirements in extant ISQC 1 into quality objectives, quality risks and responses.
  - (c) Whether the proposed approach would retain the robustness of the requirements in ISQC 1, and at the same time improve the scalability of ISQC 1.

#### **Governance and Leadership, including Organization, Culture and Strategy**

22. In the ITC, it was noted that ISQC 1 does not address firm governance, including requirements or guidance as to what is expected from firm leadership. In addition, it does not include guidance related to the important role that firm leaders play in sustaining and continually improving audit quality through effective leadership at the firm level, or that addresses the concept of accountability of firm leadership. As a result, it was proposed that ISQC 1 could be enhanced to emphasize the importance of governance and a focus on quality at all levels within a firm, including through the use of a QMA.
23. Respondents to the ITC overall supported the proposed actions, although there was caution that any actions need to be flexible to accommodate different jurisdictions and firm structures.
24. The QCTF is of the view that establishing governance principles would provide a consistent guideline for firms in establishing an environment that sustains and improves audit quality. Accordingly, the QCTF is exploring the introduction of governance principles in ISQC 1 that are principles-based and focus on the outcome of what they intend to achieve, thereby allowing firms the flexibility to implement the most appropriate actions to suit their firm. The QCTF is of the view that these principles need to be internationally applicable and relevant to the overall objective of ISQC 1, i.e., it would be inappropriate to extend the governance principles beyond those necessary to support quality.
25. The governance principles would broadly address the following aspects:
  - (a) The firm’s internal culture, including professional and ethical values, that links to supporting quality and the firm’s public interest role.

- (b) The organization of the firm, i.e., its legal structure, internal structure and assignment of roles of responsibilities.
  - (c) The firm's relationship with stakeholders, both internal and external, and how these promote the development of confidence in the public interest aspects of the firm's decision making.
  - (d) Firm leadership having responsibility and accountability for quality.
26. In addition to the overarching governance principles, firm leadership's responsibilities would be enhanced to further emphasize the importance of quality and to reflect firm leadership's responsibilities with respect to the governance principles. These enhancements may include:
- (a) Acknowledging that firm leadership is responsible for quality.
  - (b) Imposing a requirement on firm leadership to be responsible for the allocation of resources, given the importance of having appropriate resources to support the functioning of the firm's system of quality management and firm leadership's ability to influence how resources are allocated.
  - (c) Emphasizing firm leadership being *accountable* for quality, given the broad support from respondents to the ITC for incorporating a requirement for the accountability of firm leadership for quality.
  - (d) Emphasizing firm leadership's responsibility to act in a way that embeds the firm's culture and to take actions to drive the culture throughout the firm, including through establishing a business strategy that is reflective of the firm's values and the importance of quality.
  - (e) Emphasizing firm leadership's responsibility to organize the firm in a way that allows the firm's system of quality management to function, for example, by establishing an internal structure that is appropriate for the firm and clearly defining roles and responsibilities.
27. The ITC suggested that ISQC 1 could specifically require a firm to identify appropriate personnel within firm leadership to be responsible and accountable for independence matters, however respondents to the ITC had mixed views regarding the appropriateness of this proposal. The QCTF is of the view that a single person could not be solely responsible for compliance with independence policies, as all of the firm's personnel are responsible for complying with the firm's independence policies. Nevertheless, a person within the firm's leadership may be assigned responsibility for the adequate functioning of the firm's process in relation to independence. The QCTF is exploring how best to incorporate this in ISQC 1.
28. The ITC also proposed incorporating the concept of "public interest" into ISQC 1 and emphasizing the importance of relevant public interest considerations in relation to the design of the firm's system of quality management. The QCTF noted respondent's overall mixed views about explicitly referring to the public interest. Nevertheless, the QCTF is of the view that firms should be reminded of their role with respect to the public interest, and actions the firm can take to enhance their consideration of their public interest role. Accordingly, throughout the requirements and application material, the QCTF is considering including references to the firm's public interest role where relevant.

**Matters for IAASB CAG Consideration**

- 2. The Representatives are asked to share their views regarding the appropriateness of incorporating governance principles within ISQC 1.



3. The Representatives are asked to share their views regarding the possible enhancements to the responsibilities of firm leadership.

### Information and Communication

29. In the ITC, it was noted that one of the components of the firm's system of quality management would include "inform, communicate and document", as this enables the functioning of the firm's system of quality management. Under extant ISQC 1, the requirements addressing communication are specific in relation to matters that the firm needs to communicate, for example, the firm's policies and procedures, matters related to independence, the engagement partner's responsibilities, and identified deficiencies.
30. Accordingly, the QCTF are of the view that ISQC 1 needs to be enhanced to:
- (a) Ensure a firm identifies, captures, and communicates relevant quality management information in a time frame that enables individuals to carry out their responsibilities and that supports the functioning of the firm's system of quality management.
  - (b) Ensure a firm establishes and implements communication mechanisms appropriate to the size and nature of the firm.
31. Communication is the continual, iterative process of providing, sharing and obtaining necessary information. Under extant ISQC 1 the focus is on the firm's communication down to personnel, and gives little acknowledgement of the iterative nature of communication and the fact that information may come from a variety of sources. Accordingly, the QCTF is considering how to reflect the iterative nature of information and the importance of two-way communication in the requirements, which may include:
- (a) Recognizing the various stakeholders in relation to the firm's internal communications, including engagement teams, firm leadership and personnel performing functions in relation to the firm's system of quality management.
  - (b) Recognizing the importance of communication with parties external to the firm, which may include the network, network firms, external oversight authorities, users of the firm's reports or the firm's clients, external service organizations or the firm's legal counsel.
  - (c) Including requirements for the firm to communicate with these stakeholders, focusing on the information needs of such stakeholders. For example, the firm needs to communicate information to engagement teams that is needed in order to perform the engagements or the firm needs to communicate information to personnel performing functions in relation to the firm's system of quality management in order that they understand their roles and responsibilities and are able to perform these functions.
  - (d) Including specific requirements for the firm to establish processes related to receiving information, to acknowledge the importance of two-way communication and establish a clear channel of communication for the firm's personnel.
32. The QCTF recognizes that the other components of the firm's system of quality management may need to contain specific requirements regarding communication. For example, under extant ISQC 1 there are various communication requirements in relation to monitoring, including establishing

policies and procedures to address complaints and allegations. The QCTF will evaluate how to connect such requirements with the section on information and communication.

33. It is also essential that communication is effective, and in practice firms may establish communication strategies that take into consideration their environment and help identify the most effective means of communication. The QCTF is of the view that there will need to emphasis that the firm should consider how to communicate information effectively, i.e., who, what, when and how the information should be communicated. Furthermore, it may be appropriate to emphasize that as part of the firm's monitoring and remediation activities, the firm would evaluate the effectiveness of the communication strategy, or consider whether there were any causal factors identified from monitoring activities related to information and communication.

#### **Matters for IAASB CAG Consideration**

4. The Representatives are asked to share their views regarding how the iterative nature of information and the importance of two-way communication would be reflected in ISQC 1.

#### **Quality Management Process (QMP)**

34. The QCTF is of the view that new requirements should be introduced in ISQC 1 for the firm to determine quality objectives, perform an assessment of the quality risks, design and implement responses to the quality risks, monitor the effectiveness of the firm's quality management, and determine the necessary remedial action. Establishing these requirements is essential to creating consistency across firms and incorporating quality management in ISQC 1.
35. The QCTF recommends that application material should explain how to apply these requirements, i.e., how to implement the QMP including through the use of examples. As the requirements and application material are developed, the QCTF will consider whether other forms of guidance outside of ISQC 1 would be helpful or necessary in supporting the implementation of the QMA.
36. The paragraphs below further explain possible aspects that could be included in the requirements.

#### *Establish Quality Objectives*

37. In developing requirements for this section, it would be important to link the quality objectives at the QMP level back to the overall objective in paragraph 11 of ISQC 1, i.e., the quality objectives would need to contribute towards achieving the overall objective of the firm's system of quality management.
38. The requirement for the firm to establish quality objectives would also need to emphasize the importance of these being sufficiently clear – that is, appropriately disaggregated or detailed to enable the identification and assessment of quality risks. This would be important given that the identification of quality risks would be based on appropriate quality objectives; appropriate quality objectives would help drive appropriate risk assessment. Such emphasis could be supported by application material that discusses the attributes of quality objectives (i.e., specific, observable, attainable, relevant and timely), similar to those set out in the COSO Integrated Framework.<sup>6</sup>
39. Requirements and related application material in this section would also need to explicitly indicate the scalability of such requirements. For example, the application material could set out the types of

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<sup>6</sup> Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control – Integrated Framework

factors that may influence the quality objectives that are identified, as well as the process established by the firm for identifying the objectives. Such factors could include, for example, the size and operating characteristics of the firm, whether it is part of a network, the services the firm provides, and the nature of the entities to whom those services are provided. Specific examples to demonstrate how these factors would influence the objectives and the process established by the firm for identifying the quality objectives could be included.

#### *Perform Quality Risk Assessment*

40. Given that the risk assessment would be based on the quality objectives, the requirements would need to refer specifically to risks that could have an effect on the firm's ability to achieve its quality objectives, and the overall objective in paragraph 11 of ISQC 1.
41. The QCTF is of the view that the risk would need to be assessed in respect of (i) the likelihood of an event happening, and (ii) the impact if the event does actually occur. Application material would be developed to support these requirements, providing examples of factors that may create risks to the quality objectives and explaining how the likelihood and impact of these risks could be influenced by the size and complexity of the firm, the services it provides, etc. Furthermore, application material and examples could be included that explain how the firm's process for identifying risks may be influenced by, amongst other factors, its size and complexity.
42. The QCTF has mixed views about whether it would be appropriate to establish a threshold for the risks, in particular, whether there should be a threshold for which no further response or consideration is needed by the firm (e.g., risks which are at an acceptably low level). The QCTF notes that the notion of an acceptably low level is necessary for the operability of the standard. Others suggested that it would be up to the firm to establish their tolerance level for risks and to determine what is acceptably low in the circumstances of the firm. The QCTF will continue to deliberate whether or not such a threshold should be established, and if so, how it could be incorporated into the requirements.

#### *Design and Implement Responses to Quality Risks*

43. The QCTF is of the view that, in order to create the link to the overall QMP, the requirement for firms to design and implement responses to quality risks would need to link back to the requirement to perform the risk assessment. For example, an explicit statement could be included stating that the nature, timing and extent of the policy, procedure or other action needs to be responsive to the quality risk identified. Guidance would be incorporated to emphasize the scalability of the requirements as the responses need to be tailored to the condition, behavior, or other factor that leads to the risk. Application material would explain how the responses would vary depending on the risk, including through the use of examples.
44. The application material would further enhance the explanation of the appropriateness of responses and the scalability of the requirement by:
  - (a) Explaining types of responses that firms may implement, e.g., policies, procedures and other actions, and that some of the responses may be manual and some may be automated. This could also highlight that there are certain monitoring-type procedures that firms may put in place that form part of the responses to the risks, for example pre-issuance reviews, but which are separate from the firm's monitoring and remediation.
  - (b) Describing differences between detective and preventative controls.

- (c) Explaining that one response could address several risks, or that in some cases a number of responses are needed to address a single risk.
- (d) Emphasizing the importance of the timeliness of the responses.

#### *Monitor and Remediate*

- 45. The QCTF has not yet discussed this topic extensively and formulated their recommendations on a way forward. However, requirements and application material would be included to ensure that the effectiveness of the firm's quality management would be monitored by the firm, and the findings from these monitoring activities are considered by firm leadership and used to determine whether remedial action is necessary. In establishing such requirements, the QCTF will further develop and enhance existing requirements and guidance related to monitoring and remediation, taking into consideration the possible actions set out in the ITC and the feedback from respondents.
- 46. The QCTF is also considering how to emphasize that quality management is an ongoing, dynamic process of determining quality objectives, performing quality risk assessments and designing and implementing responses to quality risks. The QCTF is considering the appropriateness of a requirement for the firm to reevaluate its system of quality management and whether such a requirement should specify a fixed period of when this should be performed.

#### **Matters for IAASB CAG Consideration**

- 5. The Representatives are asked to share their views regarding the proposals in relation to how the quality management process would be established in ISQC 1.

#### **Engagement Quality Control Reviews**

- 47. At the September 2016 IAASB CAG meeting, the QCTF presented the respondents' feedback to the ITC in relation to EQC reviews, as well as the QCTF's initial proposals on the way forward. The QCTF also presented the topic of EQC reviews to the IAASB at its September and December 2016 meetings, and has explored revisions to ISQC 1 in relation to:
  - (a) The objective of an EQC review and the related definition;
  - (b) The scope of engagements subject to an EQC review; and
  - (c) The execution of an EQC review.
- 48. At its upcoming March 2017 meeting, the IAASB will consider the QCTF's proposals addressing the eligibility of the EQC reviewer, which includes the QCTF's recommendations to address the time that an individual who had previously been involved in the audit would not be eligible to fill the role of the EQC reviewer (the cooling-off period).
- 49. The sections that follow provide an overview of the discussions and decisions of the IAASB thus far in relation to EQC reviews, and provides an overview of the QCTF's proposals regarding the eligibility of the EQC reviewer that will be presented to the IAASB at their upcoming March 2017 meeting.

### *Objective and Definition of EQC Review*

50. Both the IAASB and CAG Representatives supported pursuing the development of an objective for EQC reviews. At their December 2016 meeting, the IAASB discussed the objective of the EQC review and provided input on the attributes that need to be included in the objective, including the following:
- (a) The EQC review is focused on significant judgments made by the engagement team and the conclusions reached thereon. The IAASB had considered whether to extend the scope of the EQC reviewer's work beyond areas of significant judgment, however it was agreed that this could blur the lines of responsibility between the EQC reviewer and that of the engagement partner and accordingly the concepts in extant ISQC 1 relating to the scope of the EQC review would be retained.
  - (b) The EQC review is an activity that should take place throughout the engagement, and not merely be performed at the end of the engagement. This would be described by indicating that it should be performed at appropriate stages during the engagement, in addition to emphasizing that the EQC review should be completed on or before the date of the report.
  - (c) The circumstances when an EQC review is performed, i.e., explaining that it is a response to the risk of issuing an inappropriate engagement report, particularly in circumstances when there could be significant consequences to the users of the report or other significant consequences (e.g., the reputation of the firm). The QCTF is considering how best to describe this in a succinct way in order to be captured in the objective.
51. Given the proposed inclusion of an objective in relation to the EQC review, the QCTF evaluated whether updates to the definition in paragraph 12(d) of ISQC 1 would be required. In order to reflect the concept of quality management and to establish an appropriate linkage between the definition and the proposed objective, it has been determined that the following amendments would be made to the definition:
- (a) Emphasis that the EQC review is a *firm level* control that operates at the *engagement level*. This is important in clarifying the responsibility and accountability for the performance of the EQC review (i.e., that it is not a responsibility of the engagement partner) and better emphasizes the EQC review as being a firm's response to quality risks, rather than an engagement level response to quality risks.
  - (b) Updates of terminology to reflect the concepts of quality management (i.e., a risk-based approach).
  - (c) Updates to the circumstances when an EQC review is required to be performed.

### *Scope of Engagements Subject to EQC Review*

52. The IAASB and the CAG Representatives supported the expansion of engagements subject to an EQC review to entities other than listed entities. The IAASB did not support the extension of the scope of engagements that should be subject to an EQC review to public interest entities. Instead, the

IAASB advocated a risk-based approach that addresses the impact of a possible audit failure, specifically the impact on the public.

53. Accordingly, the IAASB agreed that following a three-step approach in order to address the scope of engagements that should be subject to an EQC review, would be most appropriate. This approach would be as follows:
- (a) The existing requirement in paragraph 35(a) of extant ISQC 1 would be retained whereby all audits of financial statements of listed entities must be subject to an EQC review.
  - (b) The application material in paragraph A41 of extant ISQC 1 would be elevated to a requirement, i.e., that an EQC review must be performed when required by law or regulation. This requirement would have the effect of imposing an obligation on the firm to comply with the requirements of ISQC 1 regarding the performance of the EQC review (i.e., the procedures to be performed and the selection of the EQC reviewer), and could encourage jurisdictions to make the determination of circumstances when an EQC review is appropriate.
  - (c) The requirement in paragraph 35(b) of extant ISQC 1 would be enhanced, by establishing risk-based criteria to identify any other engagements for which an engagement quality control review should be required. The QCTF is considering how to establish such criteria that would capture engagements with attributes that may be indicative of risks that may necessitate the performance of an EQC review, and in doing so will consider what risks need to be addressed by the EQC review.
54. The IAASB also emphasized the importance of linking the performance of EQC reviews to the firm's system of quality management, through clarifying:
- (a) How engagements that should be subject to an EQC review would be identified as a result of the firm's focus on risk management.
  - (b) The importance of other responses implemented by the firm to address quality risks, i.e., that an EQC review is not always the most appropriate response.

As the QCTF develops the requirements in relation to the firm's system of quality management and incorporates a QMA, consideration will be given as to how best to clarify the relationship between the firm's system of quality management and the performance of EQC reviews.

#### *Execution of the EQC Review*

55. Consistent with extant ISQC 1, the IAASB recommended that the EQC review should focus on significant judgments made by the engagement team during the course of the engagement, however the IAASB indicated that clarity is needed as to what constitutes significant judgments to address the varying interpretations in practice. The QCTF recognize that providing lists of significant judgments for consideration by the ECR reviewer may result in a checklist approach being applied, and therefore any requirements would need to emphasize the scalable application of the requirements in the context of the engagement subject to the EQC review.
56. Both the IAASB and the CAG Representatives emphasized the importance of the timeliness of the performance of the EQC review. As highlighted in paragraph 50(b) above, the objective of the EQC review would signal that the EQC review needs to be performed at appropriate stages during the engagement. In addition, paragraph A43 of extant ISQC 1 would be elevated to a requirement to indicate that the firm needs to establish policies and procedures addressing the timing of the EQC

review procedures that include the procedures being performed at appropriate stages during the engagement.

57. Furthermore, in order to encourage the performance of the EQC review at appropriate stages during the engagement and the fact that significant judgements made by the engagement team may relate to a variety of matters (e.g., the identification of risks at the planning stage), the requirements would indicate that the EQC reviewer should consider significant judgments in relation to the various phases of the engagement, for example, establishing the engagement strategy, the execution of the engagement and when evaluating the overall conclusions reached by the engagement team. It is noted that the requirements would need to recognize that in certain cases there may not necessarily be distinct stages in performing the engagement.
58. In order to emphasize that the nature and extent of the EQC review is related to the extent of judgment in relation to the engagement, the requirements regarding the firm's policies and procedures in relation to the nature, timing and extent of the EQC review would indicate that the nature of the matters to be considered by the EQC reviewer and the extent of the procedures to be performed should enable the EQC reviewer to conclude on the appropriateness of the significant judgments made by the engagement team. The application material would also provide examples of factors that may influence the nature and extent of the EQC review to further demonstrate the scalability of the requirements thereby discouraging a checklist approach.
59. The requirements in paragraph 37 and 38 of extant ISQC 1 would be retained (i.e., the discussion with the engagement partner, review of the financial statements and selected engagement documentation and specific requirements for audits of listed entities etc.), although the requirement relating to the inspection of documentation by the EQC reviewer would be clarified and there would be additional emphasis that the EQC reviewer may need to exercise judgment in determining which documentation to review. In addition, paragraph 38(c) of extant ISQC 1 would be amended to apply to all EQC reviews and not only those in relation to audits of listed entities (i.e., that the EQC reviewer needs to evaluate whether the documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached).
60. In addition to these enhancements, the requirements would direct the EQC reviewer to also take into consideration areas of quality risk that have been identified by the engagement partner at an engagement level in terms of ISA 220<sup>7</sup> and information from third party sources (e.g., regulators and audit committees) in determining areas that should be subject to the EQC review.
61. In order to provide clarity regarding what matters would constitute significant judgments made by the engagement team, the QCTF undertook outreach to a selection of firms to understand the types of matters that are prescribed in their policies and procedures that EQC reviewers are required to consider. Furthermore, the QCTF performed an analysis of the ISAs and other sources<sup>8</sup> to identify instances where the terms "significant matter" or "significant judgment" are discussed. Based on its review, the QCTF noted references in the ISAs to significant matters or significant judgments that are not incorporated in the application material in extant ISQC 1, and therefore could be overlooked by

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<sup>7</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

<sup>8</sup> Other sources include Public Company Accounting Oversight Board's (PCAOB) standard on Engagement Quality Control Reviews, Auditing Standard No. 7 (AS 7), [Regulation \(EU\) No 537/2014 of the European Parliament and of the Council](#) (EU Regulation) and the guidance issued by the [United Kingdom Financial Reporting Council \(UKFRC\), Audit Quality Practice Aid for Audit Committees](#)

the EQC reviewer. Accordingly, the application material would include examples of matters that may be significant judgements made by the engagement team, including:

- The materiality level(s) determined by the engagement team.
- The engagement team's consideration of risks identified through the acceptance and continuance process and proposed responses to those risks.
- The engagement team's risk assessment process, including identification of significant risks, consideration of other risks the engagement team determined did not rise to the level of a significant risk and the proposed response to the significant risks.
- The engagement team's proposed group audit strategy with respect to the identification of significant components.
- The engagement team's decisions regarding the use of specialists or experts.
- The engagement team's consideration of, and disclosures of, related party transactions.
- Conclusions drawn, or results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions in respect of certain estimates, accounting policies, or going concern considerations.
- The engagement team's evaluation of the procedures performed by experts and conclusions drawn therefrom.
- In group audit situations, the engagement team's evaluation of work performed by component auditors and the conclusions drawn therefrom.
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- The engagement team's proposed audit opinion and matters to be communicated in the auditor's report, for example, key audit matters, or a "Material Uncertainty Related to Going Concern" paragraph.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

#### *Documentation of the EQC Review*

62. As part of the outreach to a selection of firms, the QCTF also asked the firms about their policies and procedures in relation to how the EQC review is documented. The QCTF noted varying practices, for example, EQC reviewers may sign off all working papers reviewed, or may have a separate section in the audit file which includes, among other matters, confirmation of the review of relevant documentation, satisfactory resolution of matters identified during the EQC review and concurrence with the issuance of the auditor's report.
63. The QCTF is still considering the most appropriate way to enhance the requirements addressing the documentation of the performance of the EQC review, and as suggested by the IAASB, will give consideration to the timing of when such documentation should take place.



### Matters for IAASB CAG Consideration

6. The Representatives are asked to share their views regarding the proposals in relation to EQC reviews, in particular:
  - (a) In relation to the scope of engagements subject to EQC review, do the Representatives have any views regarding the types of risks associated with engagements that are addressed through the performance of an EQC review?
  - (b) Do the proposals regarding how the timeliness of the EQC review would be addressed in ISQC 1 sufficiently emphasize the importance of the EQC review being undertaken at appropriate stages during the engagement?
  - (c) Do the Representatives support the proposed approach to clarifying what are considered significant judgments, and do the Representatives agree that how this would be explained in ISQC 1 should have the effect of discouraging a checklist approach?
  - (d) Do the Representatives have any recommendations regarding how the requirements addressing the documentation of the EQC review can be further enhanced, including the appropriate timing of such documentation?

### *Eligibility of the EQC Reviewer*

64. Both the CAG Representatives and the IAASB emphasized the importance of appointing an EQC reviewer that is sufficiently competent to fulfill the role and that has the appropriate authority. The IAASB was also supportive of enhancing the criteria for the eligibility of the EQC reviewer, although cautioned that the requirements should not be overly prescriptive resulting in firms having limited suitable resources who are able, or willing, to fulfill the role.
65. In considering the attributes necessary for the EQC reviewer to be suitably qualified to fulfill the role, the QCTF researched other standards or regulations that address the attributes of the EQC reviewer, as well as the attributes that apply to engagement partners and professional accountants which could apply to the EQC reviewer.<sup>9</sup>
66. The QCTF has identified the following attributes as necessary in order for an individual to be eligible to perform the EQC review:
  - (a) *Appropriate authority* – Paragraph 39 of ISQC 1 indicates that the EQC reviewer needs to have the necessary authority. Although appropriate authority is absolutely essential to the effectiveness of the EQC review, the QCTF is of the view that the term “appropriate authority” could be taken to mean that the EQC reviewer must have a particular title or position within the firm, for example, being at the same or higher level within the firm’s hierarchy. The QCTF noted that the purpose of appropriate authority is to establish the ability of the EQC reviewer to confidently challenge the significant judgments made by the engagement team, which would be achieved through the firm establishing the right culture that supports the EQC reviewer in undertaking their role. This in turn would lead to a situation where the engagement team,

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<sup>9</sup> These included International Education Standard 8 (IES 8) on Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised), the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants (Code), the EU Regulation and the PCAOB’s standard AS 7.

including the engagement partner, has professional respect for the EQC reviewer and considers the EQC reviewer as a person who can raise appropriate challenges. There are various ways that a firm can establish such a culture and support for the EQC reviewer, for example, the firm may identify a senior individual within the firm who oversees the EQC review process, or the firm's processes for addressing differences of opinion may be helpful. The firm's culture and the influence it has on the role of the EQC reviewer would be explained in the application material supporting the requirements related to the EQC review (the firm's culture will also be addressed in the other sections of ISQC 1 such as governance and leadership).

- (b) *Technical competence* – Paragraph 39 of ISQC 1 includes technical qualifications as a necessary attribute to be eligible to perform the EQC review, however, the term “qualifications” is not defined in ISQC 1. “Technical competence” is defined in the International Accounting Education Standards Board *Glossary of Terms* as “the ability to apply professional knowledge<sup>10</sup> to perform a role to a defined standard”. The QCTF is of the view that the term “qualifications” appears limited to the education of the EQC reviewer, rather than all-encompassing of the person's knowledge and ability to apply such knowledge. Furthermore, throughout the ISAs, “competence” is used in relation to the knowledge, experience and skills of the engagement team. Accordingly, the QCTF is of the view that the phrase “technical qualifications” should be replaced with “technical competence”. The QCTF debated whether it would be appropriate to prescribe that the EQC reviewer needs to have the technical competence which is required to serve as the engagement partner on the audit, similar to the approach in AS 7. However the QCTF concluded that the necessary level of competence varies depending on the circumstances of the engagement and that such a requirement may be too restrictive as there could be circumstances where this would not be practicable. Instead, the application material would provide examples of what is meant by “technical competence”.
- (c) *Capacity* – As highlighted in paragraph 56–57 above, more emphasis would be brought to the timeliness of the EQC review. In order to echo the importance of performing the EQC review procedures at appropriate stages during the engagement, the QCTF is of the view that the requirement should include that the individual has sufficient capacity to perform the EQC review.
- (d) *Practical experience* – Paragraph 39 of extant ISQC 1 indicates that the individual needs to have the necessary experience to perform the role of the EQC reviewer. However, given the IAASB's views regarding the importance of having an appropriate level of experience in order to be able to perform the role of EQC reviewer, the QCTF recommends that the practical experience of the EQC reviewer should be separate from technical competence in order to give it additional prominence. In addition, the QCTF is of the view that a specific requirement that such experience should include experience related to the audit of financial statements of listed entities is appropriate in clarifying the minimum expectation for such engagements and ensuring that the EQC reviewer is suitable. Furthermore, in order to respond to the views of respondents to the ITC, the application material would explain the importance of the firm considering inspection results or other performance ratings related to engagement quality of the proposed EQC reviewer.

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<sup>10</sup> “Professional knowledge” is defined in the IAESB *Glossary of Terms* as “Those topics that make up the subject of accountancy as well as other business disciplines that, together, constitute the essential body of knowledge for professional accountants”.

- (e) *Objectivity* – Paragraph 20 of ISQC 1 requires the firm to establish policies and procedures addressing compliance with relevant ethical requirements by the firm and its personnel (including the EQC reviewer). This is supported by application material which references the fundamental principles of the IESBA Code, which includes the principle of objectivity. Furthermore, law, regulation or other relevant ethical requirements may also establish requirements in relation to the objectivity of the EQC reviewer. Paragraphs 71–80 below further discuss the objectivity of the EQC reviewer, including the time that an individual who had previously served as engagement partner would not be eligible to fulfill the role of the EQC reviewer (cooling-off period).
67. The IAASB highlighted at their September 2016 meeting that the function of the EQC reviewer needs to be reinforced, i.e., the EQC reviewer should critically evaluate and challenge the judgments, decisions and conclusions of the engagement team and the engagement team should evaluate how best to address the issues raised by the EQC reviewer. However, the engagement team should not rely on the EQC reviewer to make decisions and judgments. In circumstances when there are differences of opinion between the EQC reviewer and the engagement team, the firm would have established processes for addressing differences of opinion. This concept is addressed in paragraph A49 of the extant ISQC 1 (the EQC reviewer does not make decisions for the engagement team), however, further application material will be included to emphasize this.

#### The Process for the Selection of the EQC Reviewer

68. The IAASB was of the view that the selection of the EQC reviewer should be at firm level, rather than the engagement level, given that the EQC review is a firm level control. Furthermore, those selecting the EQC reviewer should not be involved in the engagement. However, this is not always possible, for example, in smaller firms where there are very few engagement partners. Under paragraph A49 of extant ISQC 1, the selection of the EQC reviewer is undertaken by the firm, *where practicable*. The QCTF proposes enhancing this by including a requirement that the EQC reviewer shall be selected by someone other than the engagement partner or other members of the engagement team, with application material explaining that in circumstances when there is no one other than the engagement partner or a member of the engagement team to select the EQC reviewer, other mechanisms are established to safeguard the objectivity of the EQC reviewer.
69. In addition, the QCTF is of the view that those responsible for selecting the EQC reviewer need to have sufficient knowledge to be able to assess whether individuals are eligible to perform the EQC review, which includes knowledge of the individuals as well as knowledge about the engagement that is being subject to an EQC review. These qualities are essential in ensuring that the objective of the EQC review is met because the right person is performing the review. Accordingly, the QCTF proposes introducing a new requirement that sets out the qualities of the person assigned the function of selecting the EQC reviewer.
70. The QCTF further recommends that application material be introduced addressing the circumstances when the firm selects an EQC reviewer outside from the firm, and how the requirements relating to the eligibility of the EQC reviewer would apply.

#### Objectivity

71. In considering the objectivity of the EQC reviewer, the QCTF considered how objectivity and threats to objectivity are defined and addressed in the IESBA Code. In doing so, the IAASB Staff, IESBA

Staff, Chair of the QCTF and certain members of the IESBA Board discussed the application of the IESBA Code, particularly in light of IESBA's various projects that have been recently completed, or are underway. The IESBA is particularly interested in the discussions of the IAASB in this regard, and intend to discuss the issues related to the objectivity of the EQC reviewer at their meeting in June 2017.

72. Paragraph 20 of ISQC 1 requires the firm to establish policies and procedures in relation to compliance by the firm and its personnel with relevant ethical requirements, and paragraph 25 requires the firm to establish policies and procedures addressing familiarity threats arising from long association of personnel that take into consideration relevant ethical requirements. Nevertheless, the QCTF is of the view that in order to enhance the firm's consideration of the objectivity of the EQC reviewer, that ISQC 1 needs to direct the firm to consider the requirements of law, regulation or relevant ethical requirements. In considering law, regulation or relevant ethical requirements, the firm may identify specific provisions that need to be applied in relation to long association with the client or a cooling-off period for an engagement partner that prohibits them from fulfilling the role of EQC reviewer for a certain period.
73. Although relevant ethical requirements address the principle of objectivity and the threats that may arise through the application of the fundamental principles, the QCTF is of the view that there are certain threats to objectivity that are unique to the EQC reviewer in the context of their role (i.e., in addition to the 'usual' threats that would be faced by a professional accountant in public practice which are explained in the IESBA Code). These include:
  - (a) A self-review or self-interest threat may arise from being a previous member of the engagement team, in particular the engagement partner, or being recently consulted on matters related to the engagement where areas of significant judgment exist.
  - (b) A familiarity or self-interest threat may arise when the EQC reviewer is a close or immediate family member of the engagement partner, or another key member of the engagement team, as well as in circumstances when close personal relationships are developed through long association with such personnel.
  - (c) An intimidation threat may arise in circumstances when a member of the engagement team, including the engagement partner is an aggressive or dominant individual, or the EQC reviewer is in the chain of command of a member of the engagement team, including the engagement partner.
74. The IESBA Code does not specifically discuss the above threats in the context of the EQC reviewer although, in the view of the IESBA, they are covered by the fundamental principles. The QCTF is of the view that there is insufficient granularity in the IESBA Code in terms of specifically explaining how these threats may arise in the case of an EQC reviewer and how such a threat could be adequately safeguarded. As a result, absent such threats being explicitly addressed in the IESBA code, the QCTF is of the view that the application material supporting the requirements that address the objectivity of the EQC reviewer would need to explain these threats in order that firms consider whether, or how these apply, in evaluating the objectivity of the EQC reviewer.

#### Cooling-off Period

75. The QCTF considered the circumstances when law, regulation or relevant ethical requirements do not explicitly prohibit a former engagement partner from fulfilling the role of an EQC reviewer. In

particular, the QCTF identified that a self-review or self-interest threat may exist in such circumstances, and that without a requirement in place which prescribes a cooling-off period (i.e., the time that an individual who had previously served as engagement partner would not be eligible to fill the role of the EQC reviewer), EQC reviewers may not be sufficiently objective. Accordingly, the QCTF is of the view that a requirement needs to be established for a cooling-off period in respect of audits of financial statements in order to address the proper performance of the EQC review in the public interest. In relation to engagements other than audits of financial statements, the QCTF is of the view that the risk of a self-review or self-interest threat may vary depending on the circumstances of the engagement and establishing a fixed cooling-off period in relation to these other types of engagements may be inappropriate.

76. The QCTF considered whether such a requirement should be incorporated into ISQC 1, or whether it would be best addressed by IESBA. The QCTF observed that respondents to the ITC overall supported actions to address the cooling-off period, however there were mixed views as to whether it should be addressed by the IAASB, IESBA or both.
77. In relation to addressing familiarity threats to the EQC reviewer's independence, respondents to the IESBA's Exposure Draft, [\*Limited Re-Exposure of Proposed changes to the Code Addressing the Long Association of Personnel with an Audit Client\*](#) (Limited Re-ED), suggested locating the provisions relating to the long association of EQC reviewers for an audit client in ISQC 1. However, the IESBA concluded that this would be inappropriate given that independence is within the remit of IESBA (see [\*Basis for Conclusions: Changes to the Code Addressing Long Association\*](#) (BFC)). Although a familiarity threat is different from a self-review or self-interest threat, the principles in relation to where provisions are located in the IESBA Code versus ISQC 1 are analogous and should be applied consistently.<sup>11</sup> The QCTF further noted in the IESBA's BFC that they are committed to future coordination with the IAASB in respect of EQC reviewers on matters arising in relation to the revision of ISQC 1.
78. The QCTF agreed that the requirement for a cooling-off period (i.e., that prohibits a person who served as an engagement partner on an audit of financial statements from filling the role of the EQC reviewer on that engagement) would be best placed in the IESBA Code. Given the planned discussion by the IESBA at their June 2017 meeting, the QCTF is of the view that further coordination with IESBA is needed before finalizing the requirements in relation to the cooling-off period. Nevertheless, members of the QCTF are of the view that the IAASB may need to pursue addressing the cooling-off period in ISQC 1, in light of the time it may take IESBA to undertake the changes to the IESBA Code if IESBA determines this to be the appropriate course of action. However, one member of the QCTF is of the view that ISQC 1 should not be used as a mechanism to address matters that are within the ambit of the IESBA Code, and that it should be left to IESBA to address, irrespective of the time it would take to do so.
79. In light of the QCTF's views that a cooling-off period should be established (either in ISQC 1 or the IESBA Code), the QCTF debated an appropriate period for the cooling-off period. The QCTF noted

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<sup>11</sup> In the Limited Re-ED, the IESBA noted the following in relation to a possible cooling-off period from being an engagement partner to an EQC reviewer: "The IESBA determined that if a cooling-off period is to be served before a key audit partner could become an EQC reviewer, this matter would be best addressed under ISQC 1. The IESBA noted that ISQC 1 already establishes requirements for the independence and objectivity of the EQCR". The QCTF noted that this conclusion was prior to the IESBA's conclusion on the appropriate location of the long association provisions addressing familiarity threats, which is a similar issue, and therefore it is evident that the IESBA's thinking on this has evolved since the Limited Re-ED.

the requirement in the PCAOB's standard AS 7 that prescribes a 2 year cooling-off period. The QCTF is of the view that it is highly unlikely that a cooling-off period shorter than 2 years would be appropriate, because decisions that the engagement partner makes in an audit of financial statements usually has an effect for at least two years following that financial period. The QCTF also noted in IESBA's BFC that a period of 3 years was considered appropriate in relation to the cooling-off period for an EQC reviewer under the long association provisions (addressing a familiarity threat in relation to a client or engagement) because this would better ensure that the individual would be away from the audit engagement for a full 2 financials years, given the "hand-over" process that can occur at the end and beginning of an audit, thereby better supporting the "fresh look" principle.

**Matters for IAASB CAG Consideration**

7. The Representatives are asked to share their views regarding the proposals in relation to the eligibility of the EQC reviewer, in relation to the authority, technical competence, capacity and appropriate experience of the EQC reviewer.
8. Do the Representatives agree with the approach regarding how the EQC reviewer should be selected?
9. The Representatives are asked to share their views regarding how the objectivity of the EQC reviewer would be addressed in ISQC 1, in particular:
  - (a) Do the Representatives agree that a cooling-off period (the time that an individual who had previously served as engagement partner would not be eligible to fill the role of the EQC reviewer) needs to be established in respect of audits of financial statements?
  - (b) Do the Representatives have any views regarding where this requirement should be located, i.e., the IESBA Code or ISQC 1?
  - (c) Do the Representatives have any views regarding the period for the cooling-off period?