

## Quality Management (Firm Level): Proposed Exposure Draft of International Standard on Quality Control (ISQC) 2 – Engagement Quality Control (EQC) Reviews

### Objective of the IAASB Discussion

The objective of this Agenda Item is to obtain the IAASB's input on the Quality Control Task Force's<sup>1</sup> (QCTF) proposals on the ISQC 2 Exposure Draft (ED) that includes the proposed requirements relating to the selection of the engagements subject to EQC review in ISQC 1.<sup>2</sup>

### Introduction

1. At its June 2017 meeting, the IAASB supported the QCTF's proposal to develop a new standard in relation to EQC reviews, although it was proposed that the requirements and application material in relation to the scope of engagements subject to EQC review would remain in revised ISQC 1 (**see section A of this Agenda Item**). Accordingly, ISQC 2 would include the following sections:
  - Objective and definitions (**see Section B**).
  - Eligibility of the EQC reviewer (**see Section C**).
  - Appointment of the EQC reviewer (**see Section D**).
  - Performance and documentation of the EQC review (**see Section E**).
  
2. The IAASB has discussed the various aspects of EQC reviews at a number of meetings, including September 2016, December 2016 and March 2017. The minutes from these discussions are included in the relevant sections of this Agenda Item, as a reminder of the direction proposed by the IAASB. This Agenda Item sets out the QCTF's proposals in response to the IAASB's feedback, as well as a result of further deliberations of the QCTF. Furthermore:
  - **Agenda Item 3–B** includes the proposed paragraphs of ISQC 1 (Revised) in relation to the scope of engagements subject to EQC review;
  - **Agenda Item 3–C** includes the proposed ISQC 2 Exposure Draft;
  - **Agenda Item 3–D** includes a comparison between the requirements and application material in the proposals presented to the IAASB in December 2016 and March 2017, and the proposals in **Agenda Item 3–B** and **Agenda Item 3–C**; and
  - **Agenda Item 3–E** includes a comparison between the requirements and application material in extant ISQC 1 and ISA 220 in relation to EQC reviews, and the proposals in **Agenda Item 3–B** and **Agenda Item 3–C**.

<sup>1</sup> The project page is available at: [Engagement Quality Control Review – ISQC 2](#). Please refer to the Appendix of **Agenda Item 7–A** for details of the QCTF activities.

<sup>2</sup> ISQC 1, *Quality Management for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*.

**A. Scope of Engagements Subject to an EQC Review (ISQC 1 (Revised)) (Paragraph 1-3 and A1–A5 of Agenda Item 3–B)**

**Extract of Minutes of the September 2016 IAASB meeting**

Ms. French noted that Consultative Advisory Group (CAG) Representatives were supportive of strengthening the requirements for engagements that should be subject to an EQC review, although had mixed views about how this should be operationalized.

The Board agreed that the requirement for an EQC review needs to be strengthened, with broad support for the firm to determine which engagements should be subject to an EQC review on the basis of a risk-based approach supported by robust criteria (i.e., in addition to listed entities or those required by law or regulation to be subject to an EQC review). The Board provided the following additional suggestions and matters for consideration:

- Any changes should address the fundamental reason why the EQC review requirement should be extended, i.e., to address the impact of a possible audit failure, specifically the public interest impact.
- Further consideration should be given to how the Quality Management Approach will also help signal engagements where an EQC review should be performed.
- The EQC review requirements should be addressed in a manner that does not undermine other responses implemented by the firm to address quality risks. Recognition of other forms of reviews that are not strictly EQC reviews may also be appropriate to facilitate more focused reviews on engagements, or areas of those engagements, where risk exists.
- The criteria should not be prescriptive and ought to focus on the public interest aspects (including entities that obtain funds from the public or government). The Board provided some suggestions of possible criteria.
- Appropriate emphasis to circumstances where jurisdictions prescribe entities that should be subject to an EQC review, which could encourage jurisdictions to make such a determination.

**Minutes of the December 2016 IAASB meeting**

Ms. French explained that the Small and Medium Practices (SMP) Committee was concerned with the proposed scope of engagements subject to an EQC review and were of the view that the proposals are going beyond what is needed to address the public interest.

The Board in general agreed with the direction of the Quality Control Working Group's (WG) proposals for EQC reviews and provided the following recommendations:

- In relation to the scope of the engagements that are subject to an EQC review:
  - Focus on the risks being addressed by the EQC review in developing the requirements, and that they appropriately capture engagements that have significant judgments, while ensuring that how the requirements are articulated will be understandable in practice.

- Consider the appropriateness of certain factors proposed, and other factors that may also be relevant in determining when an EQC review should be performed.
- Bring more prominence to the fact that the EQC review is one of a number of controls that may be implemented by a firm in addressing quality risk.

#### PIOB OBSERVER REMARKS

Prof. Van Hulle noted that an audit failure would not only impact the stakeholders of the audited entity, but could also impact the reputation of the firm and of the profession as a whole. Furthermore, he suggested that the category of entities for which EQC review is required be extended to include public interest entities. He explained that financial institutions are by definition in the public interest and, as such, should be subject to an EQC review. He expressed his support for the inclusion of a risk based assessment by firms to determine entities additional to those required by the standard, to be subject to an EQC review.

3. The IAASB feedback from the September 2016 and December 2016 meetings supported the proposals that the EQC review should be performed for audits of listed entities and when required by law or regulation. The IAASB further supported strengthening the requirement for the firm to identify other engagements that should be subject to an EQC review, on the basis of a risk-based approach.

#### Listed Entities

4. The QCTF discussed the requirement in paragraph 31 of ISA 700 (Revised),<sup>3</sup> to communicate key audit matters for complete sets of general purpose financial statements of listed entities, and considered whether the requirement to perform an EQC review for an audit of financial statements of listed entities should also only apply to audits of general purpose financial statements of listed entities. The QCTF noted that as the objective of the EQC review is different from the objective of communicating key audit matters, the requirement should remain applicable to all audits of financial statements of listed entities (Paragraph 1(a) of **Agenda Item 3–B**).

#### Engagements For Which an EQC Review is Required by Law or Regulation

5. The QCTF noted that when an EQC review is required to be performed by law or regulation (Paragraph 1(b) of **Agenda Item 3–B**), entities that are public interest entities (PIEs)<sup>4</sup> in the jurisdiction are ordinarily captured by such requirements. However, not all jurisdictions have laws or regulations addressing the performance of EQC reviews. Accordingly, the application material supporting the firm's identification of engagements subject to an EQC review on the basis of risk (discussed further in paragraph 6 below) includes entities that "may be of significant public interest" as one of the characteristics for firms to consider. The QCTF is of the view that this sufficiently emphasizes

<sup>3</sup> International Standards on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

<sup>4</sup> A PIE, in this context, would typically include entities falling within the definition of PIE under the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). Accordingly, this would typically include listed entities and those defined by local legislation or regulation as PIEs. It is recognized that some jurisdictions have already defined what this means whereas others have not. Therefore in using PIE hereafter it is recognized that some jurisdictions would still need to define what they would consider a PIE if the IAASB were to use that terminology.

the consideration of PIEs in the selection of engagements subject to an EQC review, without imposing a 'bright-line' requirement.

#### *Risk-Based Approach to Identifying Other Engagements*

6. In the August 2017 teleconference, the IAASB discussed how the quality objectives, quality risks and responses would be established in ISQC 1 (Revised), as well as how the requirements in extant ISQC 1 would be incorporated in revised ISQC 1. The IAASB concurred that in addition to establishing quality objectives, the firm would be required:
  - (a) To identify quality risks in relation to the quality objectives—The quality risks identified by the firm would be based on the circumstances of the firm and the nature of engagements it performs, and would need to include the prescribed quality risks set out in revised ISQC 1 (the prescribed quality risks would be derived from the requirements in extant ISQC 1).
  - (b) Design and implement responses to the quality risks—Only minimal responses would be prescribed in ISQC 1 (Revised) that would include performing EQC reviews.
7. The QCTF agreed that the requirement for the firm to identify engagements subject to an EQC review should clearly link to the firm's risk identification and assessment, given the new approach in ISQC 1 (Revised) and the fact that the EQC review is a response to the quality risks. Furthermore, the QCTF is of the view that in the process of identifying and assessing quality risks, the firm would typically identify those engagements where an EQC review should be performed, as the nature of engagements performed by the firm is a considering factor in identifying and assessing quality risks. Accordingly, the proposed requirement has been established to signal that identifying other engagements for which an EQC review is an appropriate response is undertaken through the QMP based on the assessed likelihood and impact of the quality risks (paragraph 1(c) of **Agenda Item 3–B**).
8. In order to support consistent application of the requirement, the proposed application material includes characteristics of engagements for which an EQC review may be an appropriate response (Paragraph A3 of **Agenda Item 3–B**). The proposed application material has been based on the requirements in extant ISQC 1, as well as paragraph A40 and A41 of ISA 700 (Revised), and is responsive to the views previously expressed by the IAASB to emphasize the "impact to the public" (see also discussion in paragraph 5 above). The application material also includes other characteristics, for example, engagements with a high level of complexity or judgment and engagements where there is a risk related to the engagement team, for example, the long association of senior personnel, or the engagement partner is newly appointed.
9. The QCTF further notes that there may be situations when the engagement is not within the scope of the firm's policies or procedures, but the firm otherwise determines that an EQC review is needed. Such circumstances have been highlighted in the application material (paragraph A1 of **Agenda Item 3–B**) In such cases, in the view of the QCTF, the EQC review should still be performed in accordance with the requirements of ISQC 2, i.e., the selection of the EQC reviewer and the performance of the EQC review should be undertaken in the same manner, irrespective of whether or not the engagement is within the scope of the firm's policies or procedures. This is similar to how the communication of key audit matters has been addressed in ISA 700 (Revised), i.e., if the auditor

voluntarily communicates key audit matters, it is done so in accordance with ISA 701.<sup>5</sup> The requirement in paragraph 3 of **Agenda Item 3–B** that requires compliance with the requirements of ISQC 2 in relation to the selection of the EQC reviewer and performance and documentation of the EQC review applies to all engagements, irrespective of the circumstances in which the firm determines an engagement is to be subject to an EQC review (this is also noted in paragraph A1 of **Agenda Item 3–B**).

10. The QCTF also discussed situations when the engagement partner may request the performance of an EQC review, and noted that the EQC review is a firm-level response to quality risk. Accordingly, the QCTF is of the view that in such cases the firm would typically consider the engagement partner's request and determine whether an EQC review is an appropriate response to the quality risks in relation to the engagement, or whether other firm-level responses would be appropriate (e.g., a consultation, use of experts, etc.). In circumstances when there is a disagreement between the firm and the engagement partner about whether an EQC review needs to be performed, such disagreement may be subject to the firm's processes addressing differences of opinion. Nevertheless, the QCTF recognize that this topic requires further exploration in collaboration with the ISA 220 Task Force, and therefore at this stage, placeholders have been included in the application material (paragraph A1 of **Agenda Item 3–B**).

#### *Robustness of the Proposed Requirements*

11. The Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits* recognized the concerns regarding the appropriateness of the criteria established by firms under extant ISQC 1 for engagements subject to an EQC review, including that insufficient focus is being placed on entities of particular public interest that are not listed entities. Respondents to the ITC generally supported further consideration of strengthening the requirements for entities that should be subject to an EQC review, however had varying views about how this could be achieved.
12. The QCTF evaluated whether the proposals in **Agenda Item 3–B** would result in the appropriate selection of engagements for an EQC review, in particular entities that are not listed entities but which are of particular public interest. The proposals include a new requirement for an EQC review to be performed when required by law or regulation (this was application material in extant ISQC 1) which, as explained in paragraph 5, would typically include PIEs. Furthermore, as part of the firms' risk identification and assessment, which is a new requirement introduced to ISQC 1 (Revised), the firm identifies the additional engagements where quality risks are most likely to exist (under extant ISQC 1, the firm is only required to establish criteria for such engagements, without a basis for how such criteria should be established). The application material supporting the firm's identification of engagements on a risk-based approach includes more characteristics than paragraph A41 of extant ISQC 1, for example, the size of the entity, complexity or judgment associated with the engagements and risks arising from the engagement team. Furthermore, these characteristics are explained with examples. As a result, with the exception of one member (see paragraph 13 below), the QCTF is of

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<sup>5</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

the view that the proposals in **Agenda Item 3–B** would result in the appropriate selection of engagements for an EQC review, in particular entities of public interest.

13. One member of the QCTF is of the view that a more prescriptive requirement should be introduced in the scope of engagements subject to an EQC review.<sup>6</sup> This member is concerned that the proposals in paragraph 1 of **Agenda Item 3–B** are not more robust when compared to paragraph 35 of extant ISQC 1, and that they do not address the issues explored in the ITC. This member noted that firms may not apply the requirement consistently or appropriately, and that in applying extant ISQC 1, firms avoid the selection of engagements for an EQC review on the basis of risk.

#### *Interconnectedness Between ISQC 1 (Revised) and ISQC 2*

14. Given the IAASB's decision to develop a new standard addressing EQC reviews, the QCTF considered how the requirements in ISQC 1 (Revised) related to the scope of engagements subject to an EQC review would be connected to the requirements in ISQC 2. The QCTF noted that the link for the communication of key audit matters between ISA 700 (Revised) and ISA 701 is created through the requirements in paragraphs 30 and 31 of ISA 700 (Revised). Accordingly, a requirement has been introduced in ISQC 1 (Revised) that the firm is required to establish policies or procedures related to EQC reviews in accordance with ISQC 2 (Paragraph 3 of **Agenda Item 3–B**).
15. ISQC 2 includes requirements addressing the documentation of the EQC review. This is discussed further in paragraph 40-44 below. However, since the requirements relating to the scope of engagements subject to an EQC review are located in ISQC 1 (Revised), the QCTF is of the view that a specific documentation requirement is also needed in ISQC 1 (Revised). The proposed documentation requirement in paragraph 2 of **Agenda Item 3–B** replicates the requirements relating to documentation in ISQC 2, i.e., documentation of the firm's policies or procedures and documentation by the firm of the individual engagements selected for an EQC review. When the requirements are incorporated in the draft of ISQC 1 (Revised), the QCTF will consider the appropriate placement of the documentation requirement (i.e., it may be more appropriately placed under the documentation section in ISQC 1 (Revised)).

#### *Other Matters*

16. The QCTF noted the IAASB's suggestion to bring more prominence to the fact that the EQC review is one of a number of responses that may be implemented by a firm in addressing quality risks. The nature of the QMP is such that the firm designs responses to address the quality risks based on the circumstances of the firm, including the nature of engagements performed by the firm. Accordingly, the concept that the response to the quality risk should be appropriate to the risk would be explained in the QMP. However, in order to more explicitly signal that the EQC review may be one of a number of responses, the application material supporting the proposed requirements in revised ISQC 1 in relation to the EQC review highlights this (Paragraph A1 of **Agenda Item 3–B**).

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<sup>6</sup> This member proposes that an additional criteria should be added to paragraph 1 of **Agenda Item 3–B** that requires an EQC review to be performed for "Engagements performed by the firm for entities that have significant public interest because of the nature and size of the business or because they have a large number and wide range of stakeholders."

17. The QCTF noted that there are various considerations specific to public sector audit organizations. However, the QCTF is of the view that these considerations need to be further explored and plans to arrange outreach activities with public sector organizations, in conjunction with other aspects related to quality control, in the first quarter of 2018.

#### **Matter for IAASB Consideration**

1. The IAASB is asked to share their views regarding the proposed requirements and application material addressing the scope of engagements subject to an EQC review in ISQC 1 (Revised), including:
  - (a) Whether the IAASB agrees with the proposal to retain the requirement for an EQC review for *all* audits of financial statements of listed entities, i.e., not only for general purpose financial statements?
  - (b) Whether the IAASB supports the proposals in relation to other engagements for which the firm determines that an EQC review is required, i.e., paragraph 1(c) of **Agenda Item 3–B**?
  - (c) Whether the IAASB is of the view that the proposals will result in the appropriate selection of engagements for an EQC review, in particular entities that are not listed entities but which are of particular public interest?

#### **B. Objective and Definition**

##### **Minutes of the September 2016 IAASB Meeting**

CAG Representatives agreed that an objective should be established, however had diverse views regarding the depth of the EQC review and whether it should remain focused on significant judgments.

The Board agreed that the EQC review is a firm level control performed at the engagement level, given the purpose of the EQC review in responding to risks at the firm level and the determination being made by the firm of which engagements are subject to EQC reviews. Furthermore, the Board was of the view that the responsibility for audit quality at the engagement level rests with the engagement partner, and setting the objective as an engagement level control could dilute this responsibility. In establishing the objective, the Board requested that the WG further consider:

- Clearly articulating the level at which the control is established in order to make clear where accountability is, while also explaining the nature, timing and extent of the EQC review operates at the engagement level.
- As it relates to the depth of the review, retaining the focus on significant judgments made by the engagement team, although providing clarity about what this means. Ms. Healy recommended that paragraphs A8 to A11 of ISA 230<sup>7</sup> could also be helpful in considering the meaning of “significant judgments.”

<sup>7</sup> ISA 230, *Audit Documentation*

- Emphasizing that the EQC review is an activity that should take place throughout the engagement, and not merely be performed at the end of the engagement.
- How to link quality management at the engagement level and the EQC review (i.e., the quality management at the engagement level would facilitate improved information for the engagement partner to engage throughout the audit with the EQC reviewer).

#### **Minutes of the December 2016 IAASB meeting**

Ms. French explained that the SMP Committee was supportive of the proposed changes to the timing of the EQC review, however provided various suggestions and comments on the proposed objective and definition, mostly relating to the clarity and appropriateness of certain aspects of the objective and definition.

The Board in general agreed with the direction of the WG proposals for EQC reviews and provided the following recommendations:

- In relation to the objective and the definition of the EQC review, reinstate the concept that the EQC review should be completed on or before the date of the report while retaining the proposal that the EQC review should be performed at appropriate stages during the engagement and modify the language to encapsulate all circumstances when an EQC review is performed.

#### **Objective (Paragraph 6–7 of Agenda Item 3–C)**

18. Given the IAASB's decision at its June 2017 meeting to develop a separate standard for EQC reviews, the QCTF has focused their discussions on developing an objective for the new standard, taking into account previous proposals of the QCTF and IAASB discussions in relation to the objective of an EQC review.
19. The QCTF discussed various aspects of the objective, including:
  - (a) Who the objective should relate to, i.e., the firm or the EQC reviewer; and
  - (b) What the objective should aim to achieve.
20. The EQC review is a firm-level response to quality risks, however the EQC reviewer performs the review on behalf of the firm. Extant ISA 220<sup>8</sup> contains the provisions addressing the responsibilities of the EQC reviewer, however the EQC reviewer is not considered a member of the engagement team. The QCTF therefore concluded that it is more appropriate for the responsibilities of the EQC reviewer to be located in ISQC 2. This also allows these requirements to be applicable to EQC reviewers performing reviews in relation to engagements other than audits of financial statements, for example, an EQC review of an engagement performed under ISAE 3000 (Revised).<sup>9</sup>

<sup>8</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

<sup>9</sup> International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information*

21. Given that ISQC 2 applies to the firm as well as the EQC reviewer, the QCTF agreed that the objective of ISQC 2 should relate to:
  - (a) The firm establishing policies or procedures in relation to the EQC review; and
  - (b) The EQC reviewer performing the review in accordance with such policies or procedures.
22. The QCTF also agreed that the objective should reflect the outcome of the EQC review, i.e., that it results in an objective evaluation of the significant judgments made by an engagement team and the conclusions reached thereon. Furthermore, given that ISQC 2 does not include the scope of engagements subject to an EQC review, the QCTF agreed that the objective should clearly indicate the aspects of the EQC review addressed by the standard, i.e.:
  - (a) The selection of appropriate individuals as EQC reviewers; and
  - (b) The performance and documentation of the EQC review.
23. The QCTF further noted that the description of an EQC review as a firm response to a quality risk(s) i.e., the firm's action(s) to address a quality risk(s), including policies or procedures, is set out in the definition of the EQC review, and therefore it is unnecessary to explain this in detail in the objective.

*Definition of the EQC Review* (Paragraph 8(a) of **Agenda Item 3–C**)

24. The QCTF has further developed the proposed definition of an EQC review in response to the IAASB's feedback from its December 2016 meeting. This includes removing the description of the entities that are subject to an EQC review and reinstating the reference to the review being completed on or before the date of the report, which is encompassed in the extant definition.
25. Furthermore, consistent with the QCTF's conclusions explained above, the QCTF is of the view that the definition should link the performance of the EQC review to the quality risks within the QMP, in order to reinforce the concept that an EQC review is a response to a quality risk. The QCTF debated whether this description should also refer to those engagements for which an EQC review is required by law or regulation. However, the QCTF noted that the EQC review is always a response to a firm's quality risk, irrespective of how the engagement is selected, i.e., engagements that are listed entities are subject to an EQC review because of their public interest and the risk associated with such engagements. Similarly, when law or regulation requires the performance of an EQC review, this is typically to address a firm's quality risk associated with such engagements. Furthermore, the IAASB had suggested in December 2016 to remove the references in the definition to the types of engagements subject to an EQC review.
26. In previous discussions with the IAASB in relation to the objective of an EQC review, the QCTF had proposed using the phrase "in a timely manner at appropriate stages during the engagement." However, discrete stages of the engagement might not exist in all circumstances and feedback from the CAG indicated that some may interpret performing the review at the end of the engagement as being an appropriate stage. The QCTF is of the view that the definition should articulate the timing of the review (instead of the objective as previously proposed) and the phrase "in a timely manner" should be used. The requirements and application material addressing the performance of the EQC review also elaborate on the appropriate timing of the EQC review (paragraph A23–A24 of **Agenda Item 3–C**).

**Definition of the EQC Reviewer** (paragraph 8(b) of **Agenda Item 3–C**)

27. The QCTF has not previously presented a proposed amended definition of the EQC reviewer to the IAASB. The proposed definition in the exposure draft of ISQC 2 is largely similar to the definition in extant ISQC 1 but does not specify the eligibility criteria for the EQC reviewer. The QCTF is of the view that summarizing the eligibility criteria in the definition could result in misconstruing such criteria and therefore recommend simplifying the definition by referring to the eligibility criteria more generally.
28. The definition of the EQC reviewer in extant ISQC 1 includes a reference to “a team made up of such individuals.” The QCTF agreed that in some circumstances the EQC reviewer could be assisted by individuals in performing the role, however there would still be a need for an individual to be assigned ultimate responsibility for the EQC review.<sup>10</sup>
29. The QCTF acknowledged the IAASB’s recommendation to specifically address circumstances when an EQC reviewer may use assistants in performing the EQC review. The QCTF is of the view that the reference to a team in the definition blurs the responsibility for the EQC review that cannot be easily clarified in the definition. Furthermore, by including the team in the definition, each member of the team would be required to comply with all of the provisions in ISQC 2, including in relation to the eligibility of the EQC reviewer. In the view of the QCTF, there are some circumstances when a member of the EQC review team may not need to meet all such criteria. Therefore, the QCTF recommends that the reference to a team in the definition of an EQC reviewer should be removed, and the application material supporting the appointment of the EQC reviewer should explain that the EQC reviewer may be supported by other individuals, provided that such individuals are objective (paragraph A18 of **Agenda Item 3–C**).

**Matter for IAASB Consideration**

2. The IAASB is asked to share their views regarding the proposals in relation to the objective of ISQC 2, including whether it is appropriate to locate the responsibilities of the EQC reviewer in ISQC 2, instead of ISA 220.
3. The IAASB is asked to share their views regarding the proposals in relation to the revised definitions, including whether the IAASB supports the proposal to remove the reference to “team” from the definition of an EQC reviewer, and instead explain the use of a team in the application material supporting the appointment of the EQC reviewer.

**C. Eligibility of the EQC Reviewer** (Paragraph 9–10 of **Agenda Item 3–C**)**Minutes of the September 2016 IAASB Meeting**

CAG Representatives also emphasized the importance of the timeliness of the EQC review, and the selection of an EQC reviewer with the appropriate competencies, authority and independence, noting the importance of the firm’s tone and culture towards the EQC review.

<sup>10</sup> The QCTF noted that Auditing Standard (AS) 1220, *Engagement Quality Review of the Public Company Accounting Oversight Board (PCAOB)* permits the use of others to assist the reviewer.

The Board supported the recommendations of the WG as they relate to improving the robustness of the selection of the EQC reviewer, although cautioned that these should not be overly prescriptive resulting in firms having limited suitable resources who are able, or willing, to fulfil the role. The Board 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. The Board provided the following additional matters for consideration:

- Emphasizing that the EQC reviewer should have the appropriate authority and status within the firm to enable them to confidently challenge the significant judgments.
- Addressing the appropriateness of the EQC reviewer's practical experience, for example, circumstances when the EQC review is delegated to a technical resource with limited practical experience.
- Reinforcing that the function of the EQC reviewer is not to override the judgments of the engagement team, but rather for the EQC reviewer to challenge those judgments and for the engagement team to evaluate how best to address the issues raised by the EQC reviewer.
- Addressing the capacity of the EQC reviewer to perform the review, i.e., their time available.
- Carefully addressing the appropriate skills of the EQC reviewer.

The Board was supportive of further liaison with the International Ethics Standards Board for Accountants (IESBA) on the issue relating to the 'cooling-off' period between serving as the engagement partner and the EQC reviewer, although mixed views were expressed regarding whether a prescriptive period should be established. Those in support of a fixed period suggested 3 years or 5 years and indicated that it would prevent inconsistent application by firms, whereas those not supportive of a fixed period were of the view that there is no proper basis for establishing a fixed period.

#### **Minutes of the March 2017 IAASB meeting**

Ms. French provided an overview of the Quality Control Task Force's (QCTF) proposals in relation to the eligibility of the EQC reviewer, which included 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). Ms. French also highlighted the feedback from the CAG Representatives at their recent March 2017 meeting, as well as the views of the SMP Committee.

The Board was supportive of the overall direction proposed by the QCTF and encouraged a principles-based approach. The Board requested the QCTF to further consider:

- Circumstances when the EQC review is performed by a group of reviewers and encouraged the QCTF to acknowledge such circumstances.

- The Board's view that the EQC reviewer's authority is created through the processes established by the firm's system of quality management. The Board indicated that the proposals regarding the relationship between the firm's culture and the EQC reviewer's authority were confusing and therefore encouraged clarity regarding how the firm's culture influences the EQC reviewer's authority. The Board also noted that the chain of command in relation to the EQC reviewer could impact the EQC reviewer's authority and objectivity, and recommended that this be specifically discussed in the standard.
- Clarifying the distinction between technical competence and practical experience, and emphasized the importance of attaining an appropriate balance between the attributes. The Board also noted that in some jurisdictions the EQC reviewer is required to be licensed, which could further limit the number of individuals that are eligible to perform the EQC review. The Board also recommended that the criteria for the eligibility of the EQC reviewer should be linked to the basis for which the engagement is subject to an EQC review, however did not consider that it is always necessary for the EQC reviewer to have experience in relation to listed entities.
- The provisions regarding the degree to which the EQC reviewer may be consulted should be retained, as these had been diluted in the proposed revisions.
- How the proposals would relate to engagements that are non-audit engagements.

#### OBJECTIVITY OF THE EQC REVIEWER

The Board agreed that further coordination with the IESBA should be undertaken, taking into consideration the respective remits of the two Boards. The Board did not support the IAASB undertaking revisions to the IAASB's Standards in the absence of the IESBA taking further steps to address the issue. The Board variously:

- Raised concern that the proposed requirements in relation to the objectivity of the EQC reviewer appear more onerous than the provisions in relation to an engagement partner.
- Noted that not all jurisdictions apply the IESBA Code of Ethics for Professional Accountants (Code) and therefore cautioned against proposals that would be specific to the IESBA Code.
- That a further understanding is needed regarding the basis for IESBA's cooling-off period of three years in relation to an EQC reviewer. The Board encouraged the QCTF to consider a two year cooling-off period (similar to the period prescribed by the United States Public Company Accounting Oversight Board) and to further understand the effect of the proposed cooling-off period on SMPs.

#### IAASB CAG CHAIR'S REMARKS

Ms. Lang highlighted that the CAG Representatives emphasized the importance of achieving an appropriate balance with respect to the criteria for the eligibility of the EQC reviewer and questioned how the proposals would be implemented and enforced. Furthermore, Ms. Lang noted that many IAASB CAG Representatives are also IESBA CAG Representatives, and accordingly were supportive of the cooperation with the IESBA on this topic.

## PIOB OBSERVER REMARKS

Mr. Holm encouraged the IAASB to further coordinate with the IESBA with respect to the cooling-off period.

30. In order to address the IAASB's concerns regarding the clarity, appropriate balance and interrelationship of the attributes of the EQC reviewer, the QCTF has made the following amendments:
- (a) The QCTF has reorganized the requirements and application material in relation to the eligibility of the EQC reviewer in order to better articulate and align the attributes that are interrelated. In particular, in order to have appropriate authority to evaluate and challenge the significant judgments made by the engagement team, the EQC reviewer needs to have the technical competence, including sufficient industry knowledge, and experience with engagements of a similar nature and complexity (paragraph A9 of **Agenda Item 3–C**).
  - (b) The QCTF has added the adjective “sufficient” in relation to the certain attributes. This provides flexibility that is customizable to the engagement circumstances. For example, sufficient knowledge of the entity’s industry is necessary in some circumstances but may not be a necessary attribute in other circumstances (paragraph A12 of **Agenda Item 3–C**). However, certain attributes need to exist irrespective of the engagement circumstances, for example, the EQC reviewer always needs to be objective and comply with law or regulation.
  - (c) The QCTF has amended the term “sufficient capacity” to “sufficient time”, as this term is considered clearer. The application material also notes that sufficient time means being available at appropriate points in time throughout the engagement
  - (d) The QCTF has included application material that explains additional considerations when establishing whether the EQC reviewer has appropriate authority. Paragraph A10 of **Agenda Item 3–C** explains scenarios where there is a need for the individual to be at a higher level in the hierarchy of the firm than the engagement partner whose engagement is being reviewed by that EQC reviewer. The culture of the firm created by firm leadership also contributes to the authority of the EQC reviewer, as explained in paragraph A1 of **Agenda Item 3–C**. This application material has been refined in response to the IAASB’s suggestion to clarify how the culture of the firm relates to the EQC review.
  - (e) The QCTF has enhanced the application material supporting technical competence and experience, in order to address the IAASB’s comments requesting more clarity. In doing so, the QCTF considered paragraph A11 of ISA 220<sup>11</sup> and paragraph A8 of ISA 610 (Revised 2013)<sup>12</sup> in revising the application material (paragraph A11 of **Agenda Item 3–C**).
31. The QCTF considered the IAASB’s suggestion that the criteria should be linked to the basis for which the engagement is subject to an EQC review. However, the QCTF is of the view that it could undermine other important criteria, for example, objectivity, and may imply that experience related to

<sup>11</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

<sup>12</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

listed entities is always required (this is contrary to other views expressed by the IAASB). The QCTF further noted that the requirement addressing the appointment of the EQC reviewer (paragraph 11 of **Agenda Item 3-C**) requires the firm to determine an individual who can objectively evaluate candidates against the eligibility criteria and has an understanding of the engagements. This appointment process is intended for the firm to determine the “best person for the job” given the available candidates and their circumstances.

32. As suggested by the IAASB, the QCTF has also reinstated the requirement similar to paragraph 39(b) of extant ISQC 1 that addresses the degree to which an EQC reviewer can be consulted on the engagement without compromising the reviewer’s objectivity. However, the QCTF noted that the application material in paragraph A48 of extant ISQC 1 indicates that the purpose of the consultation is “to establish that the judgment made by the engagement partner will be acceptable to the EQC reviewer.” The QCTF is of the view that this could be misinterpreted to suggest that the EQC reviewer approves the judgment, and is therefore involved in the decision making process. Accordingly, this application material has been revised to reflect a more appropriate basis for consultation with the EQC reviewer, i.e., that the consultation takes place in order that the EQC reviewer can assess the judgments on a timely basis (paragraph A15 of **Agenda Item 3-C**).

*Objectivity* (paragraph 9(b) of **Agenda Item 3-C**)

33. The QCTF debated the extent to which the criteria should reference relevant ethical requirements and law or regulation. The QCTF noted that ISQC 1 will contain provisions addressing compliance with relevant ethical requirements that apply to all firm personnel and therefore it is not necessary to include such requirements in the criteria. However, the QCTF agreed that the principle of objectivity has particular importance in relation to the EQC review and there are considerations that are unique to the EQC reviewer, i.e., objectivity from the engagement and the engagement team. As a result, the QCTF is of the view that it remains appropriate to include objectivity as one of the criteria in relation to the eligibility of the EQC reviewer, supported by application material that explains the types of threats that may arise, including in relation to the engagement and the engagement team. The QCTF agrees with the views of the IAASB that such application material needs to remain framework-neutral.
34. Since the March 2017 discussion, IAASB Staff have engaged further with IESBA Staff to determine a way forward in resolving the question of whether or not there should be a period after which an engagement partner may not be able to serve as the EQC reviewer, and to discuss the broader issue of the objectivity of the EQC reviewer. In order to progress this discussion and appropriately address the topic of objectivity, a discussion will take place with the IAASB and IESBA during the joint Board session in September 2017. This discussion will focus on how further coordination should be undertaken in relation to the objectivity of the EQC reviewer (please refer to **Agenda Item J-3**).

*Law or Regulation* (paragraph 9(c) of **Agenda Item 3-C**)

35. The QCTF noted that law or regulation may contain requirements that are specific to an EQC reviewer (e.g., qualifications of the EQC reviewer) and therefore agreed that compliance with requirements of law or regulation should be included in the criteria regarding the eligibility of the EQC reviewer.

**Matter for IAASB Consideration**

3. The IAASB is asked to share their views regarding the proposed requirements and application material in relation to the eligibility of the EQC reviewer.

**D. Appointment of the EQC Reviewer (Paragraph 11 of Agenda Item 3–C)**

**Minutes of the March 2017 IAASB meeting**

THE PROCESS FOR THE SELECTION OF THE EQC REVIEWER

The Board was supportive of the QCTF’s proposals in relation to the firm’s selection of the EQC reviewer, however suggested that the exemption, “unless, in exceptional circumstances, it is not practicable”, be reconsidered as it is unlikely to be an exceptional circumstance in the case of SMPs.

36. The QCTF considered various options on how to address circumstances when the EQC reviewer may need to be selected by the engagement team. The QCTF considered expanding the restriction (i.e., beyond “exceptional circumstances”), but was concerned that this could result in the EQC reviewer being selected by the engagement team in situations where it is clearly not appropriate. Accordingly, the QCTF proposes that the requirement indicate that the person responsible for appointing the EQC reviewer has sufficient knowledge to be able to *objectively* assess whether the EQC reviewer meets the eligibility criteria. This is supported by application material that explains that there may be a threat to the person’s objectivity when they are part of the engagement team. This is reinforced by the requirement for the EQC reviewer to be objective, which would be threatened if they were selected by the engagement team. If the objectivity of the EQC reviewer or the person selecting the EQC reviewer were threatened, it would be up to the firm to implement appropriate safeguards.
37. The QCTF has also proposed various enhancements to the application material supporting this requirement, including guidance on the knowledge that may be required to objectively assess the eligibility of the EQC reviewer.

**Matter for IAASB Consideration**

4. Does the IAASB agree with the proposed requirement and application material relating to the appointment of the EQC reviewer and how the QCTF has proposed addressing circumstances when the EQC reviewer is selected by someone within the engagement team?

## E. Performance and Documentation of the EQC Review

### Minutes of the December 2016 IAASB meeting

Ms. French noted the SMP Committee's views on the execution of the EQC review, in particular that the public interest is a necessary driver of the required review procedures and that the determination of whether further review procedures should be performed should not rest solely with the EQC reviewer. Ms. French also noted the SMP Committee's recommendation to bring more emphasis to the roles and responsibilities of the EQC reviewer.

The Board in general agreed with the direction of the WG proposals for EQC reviews and provided the following recommendations:

- In relation to the execution of the EQC review:
  - Modify the requirements to address circumstances where there are no distinct "stages" in performing the engagement and reinstate the extant requirements related to the consideration of the financial statements, or other relevant subject matter.
  - Link the extent of the EQC review to the areas of quality risk that have been identified at the engagement level in accordance with ISA 220, and also take into consideration issues raised by regulators and audit committees.
  - Exercise caution in including examples of significant judgments in the application material to avoid creating a "checklist mentality."
  - Clarify the requirements relating to which documentation should be inspected by the EQC reviewer including that judgment may be applied in selecting that documentation.
  - Enhance the requirements addressing the documentation of the performance of the EQC review.

### *Performance of the EQC Review* (Paragraph 10–13 of **Agenda Item 3–C**)

38. As explained in paragraph 20 of this paper, the QCTF agreed that the responsibilities of the EQC reviewer should be located in ISQC 2 rather than ISA 220. Accordingly, a new requirement has been introduced that requires the EQC reviewer to perform the EQC review in accordance with the firm's policies or procedures (Paragraph 15 of **Agenda Item 3–C**). In addition, although the firm establishes policies or procedures regarding the performance of the EQC review, the EQC reviewer needs to exercise professional judgment in determining the nature, timing and extent of the procedures, as well as whether the procedures are sufficient to enable the EQC reviewer to evaluate the significant judgments made by the engagement team and the conclusions reached thereon. As a result, the requirement includes a responsibility for the EQC reviewer to stand back and evaluate the sufficiency of the procedures.
39. The QCTF has also made several amendments to the proposed requirements addressing the firm's responsibility to establish policies or procedures relating to the performance of the EQC review, in order to address the IAASB's comments and further clarify the work effort that should be undertaken by the EQC reviewer. These amendments include:

- (a) Incorporating the concept of “sufficiency” that provides flexibility in relation to the nature, timing and extent of the procedures performed, based on the nature of the engagement (paragraph 12 of **Agenda Item 3–C**). This has also been clarified in the supporting application material (paragraph A22 of **Agenda Item 3–C**).
  - (b) Clarifying the timing of the review, in order to emphasize that the EQC review should be performed at times throughout the engagement that are appropriate to the engagement circumstances. This is supported by application material that clarifies that the timing of the EQC review depends on the circumstances of the engagement. For example, there may be circumstances when it is appropriate to perform the EQC review at the end of the engagement (e.g., when the engagement is not complex and is completed within a short period of time) (paragraph A23 of **Agenda Item 3–C**).
  - (c) Introducing a requirement for the EQC reviewer to consider other matters that may be relevant to the engagement, including the results of monitoring and remediation. This may include information from other sources, for example, the results of inspections undertaken by an external oversight authority (paragraph 12(c) of **Agenda Item 3–C**).
  - (d) Introducing a requirement for the EQC reviewer to discuss areas of significant judgment with the engagement partner, in order to improve the two-way communication and linkage of ISQC 2 with ISA 220.<sup>13</sup> (Paragraph 13(a) of **Agenda Item 3–C**)
40. The QCTF considered whether the application material should explain typical areas of significant judgment in order to assist firms and EQC reviewers in identifying areas of significant judgment. The QCTF recognizes the concerns of the Board that such a list could drive a checklist-based approach. As presented to the IAASB in December 2016, the QCTF performed an evaluation of the ISAs to identify references to areas of significant matters or judgment, and noted several matters not included in paragraph A45 of extant ISQC 1. In the view of the QCTF, application material setting out areas of significant judgment is helpful, however such application material needs to include all relevant areas in the ISAs in order that it is not misleading. Paragraph A27 of **Agenda Item 3–C** includes a compilation of references in the ISAs to significant matters or significant judgments.
41. Paragraph 14 of **Agenda Item 3–C** includes a requirement derived from paragraph 38 of extant ISQC 1 (addressing independence and consultation). The QCTF debated whether this requirement is applicable to all EQC reviews, or only EQC reviews in relation to audits of financial statements. The QCTF further debated whether the EQC reviewer should consider all matters in relation to compliance with relevant ethical requirements, i.e., instead of only independence requirements (e.g., matters related to non-compliance with laws and regulations). The QCTF concluded that the proposals in relation to the quality risks in ISQC 1 (Revised) are still in development and include these topics. Accordingly, further work is needed in determining how those quality risks and the EQC review are related.

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<sup>13</sup> The engagement partner’s responsibilities in relation to the EQC review will remain in ISA 220. As changes to that standard are progressed, the QCTF will further consider any corresponding changes in ISQC 2.

**Documentation of the EQC Review (Paragraph 16–18 of Agenda Item 3–C)**

42. In the ITC, it was suggested that the documentation requirements in relation to the EQC review could be strengthened to include the timing and the substance of the EQC review procedures performed, and significant or substantive discussions between the engagement partner and the EQC reviewer. Respondents,<sup>14</sup> including Monitoring Group (MG) members, generally supported these proposals. Two respondents<sup>15</sup> did not support this proposal, as it was indicated that the requirements in extant ISQC 1 are sufficient in addressing the EQC reviewer's responsibilities and related documentation requirements.
43. In developing the documentation requirements, the QCTF considered the requirements in extant ISQC 1 and ISA 220 in relation to the documentation of the EQC review. The QCTF also considered the proposals on documentation in relation to ISQC 1 (Revised) (please refer to **Agenda Item 7–A**) and how these proposals would relate to the firm's documentation of matters related to the EQC review.
44. The QCTF is of the view that the documentation requirements should be established as follows:
- (a) A requirement for the firm to document its policies or procedures in relation to the EQC review (similar to the requirement in paragraph 17 of extant ISQC 1). In order to support consistent application, the QCTF is of the view that the proposed requirement should clarify the objective of such documentation, i.e., that the documentation needs to be sufficient to enable a consistent understanding and application of the firm's policies or procedures. This echoes the principles in the proposed documentation requirements in **Agenda Item 7–A**.
  - (b) A requirement for the firm to establish policies and procedures on documentation:
    - (i) At the firm level, i.e., documentation in relation to the selection of the EQC reviewer.
    - (ii) At the EQC reviewer level, i.e., establishing the expectations for the EQC reviewer in relation to the documentation. As indicated in the proposals to the ITC that were largely supported, these proposed requirements should address the nature, timing and extent of the EQC review procedures performed. The QCTF also recommends that such documentation should include significant matters arising during the review, which may include significant discussions between the engagement partner and EQC reviewer.
  - (c) A requirement for the EQC reviewer to comply with the firm's documentation policies or procedures.
2. The QCTF further considered how to explain the scalability of the documentation requirements and has therefore included application material that highlights that the form, content and extent of the documentation of the EQC review may depend on a variety of factors, and further notes that the documentation may be in different forms. In the application material (paragraph A24 of **Agenda Item**

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<sup>14</sup> MG: BCBS, IAIS; *Other Regulators and Audit Oversight Authorities*: EBA, ESMA, IRBA; *National Standard Setters*: CAASB, IDW, JICPA, NZAuASB; *Accounting Firms*: CHI, EYG, KPMG; *Public Sector Organizations*: AGSA; *Member Bodies and Other Professional Organizations*: AICPA, CPAA, FEE, ICAZ, WPK

<sup>15</sup> *Other Regulators and Audit Oversight Authorities*: MAOB; *Member Bodies and Other Professional Organizations*: IBR-IRE

**3–C)** it is highlighted that the documentation of the EQC review may be completed after the date of the report in accordance with ISA 230.

**Matter for IAASB Consideration**

5. The IAASB is asked to share their views regarding the proposed requirements and application material in relation to the performance of the EQC review, including whether the IAASB supports the proposed application material in paragraph A27 of **Agenda Item 3–C** regarding areas of significant judgment?
6. The IAASB is asked to share their views regarding the proposed requirements and application material in relation to documentation, including, whether the IAASB agrees with the level of specificity of the requirements in relation to documentation?