

Coordination between the IAASB and IESBA—Objectivity of the Engagement Quality Control (EQC) Reviewer**Objective of the IAASB and IESBA Discussion**

The objective of the discussion is to obtain feedback from the IAASB and IESBA (the Boards) on the proposed way forward with respect to the coordination between the Boards regarding the objectivity of the EQC reviewer, in view of the IAASB's quality control project addressing matters in relation to EQC reviews. The proposals in this Agenda Item have been developed by the IAASB's Quality Control Task Force¹ (QCTF), in conjunction with the IAASB and IESBA members responsible for coordination matters in relation to the Boards,² and IAASB and IESBA Staff.

Introduction

1. In 2013, the IAASB published its findings on its post-implementation review of the clarified International Standards on Auditing (ISAs) which included key findings on aspects of quality control. Furthermore, inspection findings by audit oversight bodies have consistently highlighted issues with respect to firms' systems of quality control, including inspection findings related to EQC reviews on public interest entity audits. The IAASB has also continued to consider the issues and implementation needs of small-and-medium sized practices (SMPs), in particular how ISQC 1³ can be adapted appropriately based on the nature and size of the firm or engagements performed by the firm.
2. In order to further understand the issues in relation to quality control and other related topics, the IAASB published the Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*, in December 2015. In the ITC, the IAASB noted concerns arising from the ISA Implementation Monitoring project and audit oversight bodies regarding the selection of the EQC reviewer, including the qualifications, experience and objectivity of the individual selected to perform the EQC review. The ITC included possible actions to strengthen the selection of the EQC reviewer, that included:
 - (a) Elevating the application material in extant ISQC 1 in relation to the objectivity of the EQC reviewer to requirements; and
 - (b) Including a requirement for the firm to establish a policy that defines the period of time that an individual who had previously been involved in the audit, including in the role of the engagement partner, would not be eligible to fill the role of the EQC reviewer (referred to as a "cooling off period").⁴

¹ The project page is available at: [Quality Control Project - EQC review](#)

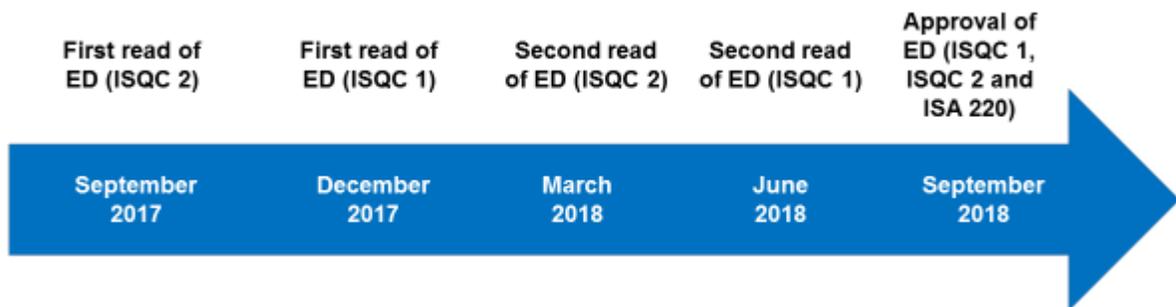
² Megan Zietsman (IAASB Deputy Chair) and Sylvie Soulier (IESBA member)

³ International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

⁴ This is a different cooling-off period from the cooling-off period established in the IESBA's Code of Ethics for Professional Accountants (IESBA Code) in relation to the long association provisions. The cooling-off period under the IESBA Code addresses

The ITC also acknowledged the Public Company Accounting and Oversight Board's (PCAOB) requirements in its standard, AS 1220,⁵ which includes a requirement for a “cooling off period” for an EQC reviewer.

3. Responses were received from a broad range of stakeholders with overall support for the IAASB to pursue possible revisions to ISQC 1, including enhancing the requirements and application material in relation to the selection of EQC reviewers. Respondents indicated that the independence, integrity and objectivity of the EQC reviewer should be addressed, as well as technical expertise, experience and authority. However, it was generally cautioned that the requirements should not be so onerous such that there is a limited availability of individuals to perform the EQC review, in particular in relation to SMPs.
4. The IAASB discussed matters related to EQC reviews at its September 2016, December 2016, March 2017 and June 2017 meetings, which included the approval of a project proposal to address quality control at both the firm (ISQC 1) and engagement level (ISA 220⁶). At its June 2017 meeting, the IAASB agreed that the topic of EQC reviews should be located in a proposed new standard (ISQC 2⁷), with only certain aspects remaining in ISQC 1⁸ and ISA 220.⁹ A first read of the proposed exposure draft of ISQC 2, including the requirements that will remain in ISQC 1,¹⁰ will be discussed by the IAASB at its September 2017 meeting (see [Agenda Item 3–B](#) and [Agenda Item 3–C](#)). A summary of the project timeline going forward is set out below.



5. In March 2017 the IAASB and the IAASB Consultative Advisory Group (CAG) discussed the QCTF's proposals in relation to the requirements addressing the eligibility of an individual to be appointed as the EQC reviewer. These proposals addressed the considerations in relation to the objectivity of the

a familiarity threat in relation to the client, the client's operations and senior management, or the subject matter or subject matter information. Appendix 1 clarifies why the long association provisions in the IESBA Code would not always result in a cooling-off being imposed on an engagement team member, for example, when it is not a public interest entity, or when the individual has served the client in the role of engagement partner for a period of 4 years and switches to the EQC reviewer for 3 years (i.e., the individual is permitted to serve a maximum of 7 years).

⁵ PCAOB Auditing Standard (AS) 1220, *Engagement Quality Review*

⁶ ISA 220, *Quality Control for an Audit of Financial Statements*

⁷ ISQC 2, *Engagement Quality Control Review*

⁸ The requirements addressing the scope of engagements subject to an EQC review would remain in ISQC 1.

⁹ The requirements addressing the responsibilities of the engagement partner with respect to the EQC review would remain in ISA 220.

¹⁰ Various other enhancements are being considered by the IAASB in relation to ISQC 1. A first read of the ISQC 1 ED will be discussed by the IAASB at its December 2017 meeting.

EQC reviewer and explored whether a cooling-off period for an individual who had previously been involved in the audit, including in the role of the engagement partner, should be pursued. The section below explains the current proposals of the QCTF in relation to how objectivity of the EQC reviewer will be addressed in ISQC 2, together with a description of how this interrelates with the IESBA Code. The section also explains the issues that require further consideration by the Boards.

Overview of How the IAASB Proposes Addressing the Objectivity of the EQC Reviewer in ISQC 2 and Issues that Require Further Consideration

6. The QCTF has extensively deliberated the attributes that would be necessary in order for an individual to be able to objectively evaluate the significant judgments of the engagement team in performing the EQC review. In previous meetings of the IAASB, although there was support for the attributes proposed by the QCTF, members suggested that the requirements should not be overly prescriptive resulting in firms having limited suitable resources who are able, or willing, to fulfill the role. Similar views were expressed by the CAG. Accordingly, the QCTF has focused on developing the attributes in a manner that facilitates scalable application, based on the circumstances of the engagement. The key attributes that the QCTF will propose to the IAASB in its September 2017 meeting include (see paragraph 9 of **Agenda Item 3–C**):
 - (a) Sufficient time to perform the EQC review;
 - (b) Objectivity in relation to the engagement subject to the EQC review and the engagement team;
 - (c) Compliance with the requirements relevant to EQC reviewers within law and regulation, if applicable; and
 - (d) Appropriate authority to evaluate the significant judgments made by the engagement team and the conclusions reached thereon. Appropriate authority is supported by:
 - (i) Technical competence and sufficient knowledge of the entity's industry; and
 - (ii) Sufficient and appropriate experience related to engagements of a similar nature and complexity.
7. Some of these attributes are included in paragraphs 39 and 40 of extant ISQC 1 (technical qualifications, necessary experience and authority, and objectivity), however they have been enhanced through further clarification and improvement of their interconnectivity.
8. In developing the proposed requirements, the QCTF considered how the IESBA Code addresses the objectivity of the EQC reviewer. **Appendix 1** of this Agenda Item provides an explanation of how the principles in the IESBA Code relate to the objectivity of the EQC reviewer, with a focus on self-review threats, self-interest threats and familiarity threats that may arise in the context of the EQC reviewer's role when performing the EQC review. Other relevant ethical requirements may also apply to the EQC reviewer, for example, ethical requirements established in the firm's jurisdiction.
9. The IESBA Code requires all professional accountants to apply the Conceptual Framework¹¹ to comply with the fundamental principles, including objectivity. The Conceptual Framework specifies in a principles-based manner, an approach for identifying, evaluating and addressing threats. This

¹¹ See proposed restructured IESBA Code Part 1 – Complying with the Code, Fundamental Principles and Conceptual Framework, Section 120, *The Conceptual Framework* in Agenda Item 2-C of the IESBA's [September 2017 meeting](#) materials.

includes the types of threats that may arise in relation to the objectivity of an individual performing the role of EQC reviewer. Examples of threats to the objectivity of the EQC reviewer include:

- (a) A self-review or self-interest threat as a result of having been a previous member of the engagement team, in particular the engagement partner.
- (b) A familiarity or self-interest threat when the EQC reviewer is a close or immediate family member of the engagement partner, or another member of the engagement team who makes key decisions or judgments on significant matters,.
- (c) An intimidation threat in circumstances when the EQC reviewer is in the chain of command of the engagement partner.

Questions have been raised about whether these threats could be made explicit or better illustrated through appropriate guidance.

Cooling-off Period

10. The IAASB has been deliberating whether there should be a specific provision addressing the cooling-off period in relation to an individual who was previously involved in the engagement, in order to address the self-review threat or self-interest threat that may arise in circumstances when this occurs.¹² In the December 2015 ITC, the IAASB had requested respondents' views on this proposal. Overall, there were mixed views from respondents to the ITC on whether or not a prescriptive cooling-off period should be established and if so by whom, i.e., the IAASB or the IESBA. There were other varying suggestions raised by the respondents including:

- A requirement for the firm to establish policies or procedures for a cooling-off period; and
- Encouragement for further collaboration between the IAASB and IESBA.

11. The IAASB considered the QCTF's proposals in relation to the cooling-off period at its March 2017 meeting. This discussion included whether a cooling-off period should be prescribed and if so, whether it would be appropriate to locate such a requirement in the IAASB's Standards.¹³ [Agenda Item 6–A](#) of the March 2017 meeting indicated the agreement of the QCTF that the requirement for a cooling-off period would be best placed in the IESBA Code, however:

- Some members of the QCTF were 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.
- One member of the QCTF was 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.

¹² This is a different cooling-off period from the cooling-off period established in the IESBA Code in relation to the [long association](#) provisions. The use of cooling off period in this context is related to a self-review or self-interest threat that may arise as a result of having been a previous member of the engagement team, in particular the engagement partner. The cooling-off period under the IESBA Code addresses a familiarity threat in relation to the client, the client's operations and senior management, or the subject matter or subject matter information.

¹³ As it is described in paragraph 4, in its June 2017 meeting, the IAASB agreed that the topic of EQC reviews will be located in ISQC 2, with only certain aspects remaining in ISQC 1 and ISA 220.

The IAASB agreed that further coordination with the IESBA should be undertaken, taking into consideration the respective remits of the two Boards, that was also supported by the IAASB CAG, IFAC Small and Medium Practices Committee, as well as the Public Interest Oversight Board (PIOB) observer at the March 2017 IAASB meeting. The IAASB in general did not support undertaking revisions to ISQC 1 in the absence of the IESBA taking further steps to address the issue. The IAASB further noted that since some jurisdictions do not apply the IESBA Code, how this matter is addressed in ISQC 1 should be carefully considered.

Proposed Way Forward

12. Since the March 2017 IAASB meeting, two teleconferences have been held between the Chair of the QCTF, the IAASB and IESBA members responsible for coordination, as well as IAASB and IESBA Staff, to consider how the coordination may be undertaken between the two Boards.¹⁴
13. Recognizing the nature and complexity of the issue, the degree of overlap between the two Boards in relation to this topic and the proposed timeline of the IAASB's project (i.e., the matter is relatively urgent), the QCTF, the IAASB and IESBA members responsible for coordination matters in relation to the Boards, and IAASB and IESBA Staff, propose that a joint working group be formed comprising four members, with two representatives from each Board. The joint working group would be chaired by the Chair of the QCTF. The purpose of the joint working group would be to consider and develop recommendations on how the issues may be addressed, including:
 - (a) How the principles in the IESBA Code could be made more explicit or be better illustrated in relation to the objectivity of the EQC reviewer, for example, clarification in the IESBA Code, application material in ISQC 2 or other guidance that may accompany ISQC 2;¹⁵ and
 - (b) Whether there should be a specific provision addressing the cooling-off period in relation to an individual who was previously involved in the engagement, or other actions that could be taken to address this matter, for example, a requirement for the firm to establish policies or procedures for a cooling-off period. Further deliberations in this regard may include where the requirement should be located (i.e., ISQC 2 or the IESBA Code), which engagements this should apply to, who within the engagement team should be subject to the cooling-off period and the length of the cooling-off period.
14. Given the IAASB's project timeline (see paragraph 4 above), the proposals of the joint working group would need to be presented to the Boards, tentatively via teleconference, in February 2018, with the aim of obtaining the Boards' views on:
 - (a) How the principles in the IESBA Code could be more explicit or better illustrate the objectivity of the EQC reviewer; and
 - (b) The proposals of the joint working group in relation to how the issue of the cooling-off period should be addressed, in particular whether there should be a cooling-off period and if so, which Board should address it.

¹⁴ During the June 2017 meeting of the IAASB Steering Committee and IESBA Planning Committee, this issue was noted as a matter for which coordination may be required, but has not yet been initiated.

¹⁵ If it is determined that a guide is appropriate, the recommendations would include matters relating to the content of the guide and its nature, for example, whether it should be a publication of the IAASB, IESBA or a joint publication, and the status of its authority.

This would allow for a discussion with the respective CAGs in March 2018, ahead of the IAASB's planned approval of the ISQC 1 and ISQC 2 ED's in September 2018. This timeline would also allow sufficient time for the IAASB to address any changes to ISQC 2 that are necessary as a result of the Boards' input. If it is suggested that changes to the IESBA Code should be considered, these could be addressed by the IESBA in a timeframe as determined appropriate by the IESBA, i.e., these would not necessarily need to be effected within the same timeframe as the IAASB's project set out in paragraph 4.

15. The QCTF, the IAASB and IESBA members responsible for coordination matters in relation to the Boards, and IAASB and IESBA Staff are of the view that:
 - (a) The above proposal will result in proactive coordination between the Boards, and will provide a mechanism that will enable transparent communication to the Boards and allow both Boards to provide appropriate input within the scope of their remits.
 - (b) Limiting the size of the proposed joint working group to a few members will facilitate coordination in an effective and efficient manner, thereby ensuring that the matter is considered within an appropriate timeframe in relation to the IAASB's project.
 - (c) This approach will respect the independence of each Board to set standards pursuant to its remit, i.e., although the Boards will discuss how the matters should be addressed and which Board should address the matter, once it is determined which Board is responsible for pursuing the matter, it will be the responsibility of that Board to address the matter as they see fit.

Matters for the Boards' Consideration

1. Do the IAASB and IESBA agree with the proposed process of coordination described above, including the establishment of the joint working group, and are there any other actions that the IAASB and the IESBA recommend in relation to how coordination should be undertaken?

Appendix 1

Consideration of How the Principles in the IESBA Code relate to the Objectivity of the EQC Reviewer

[Please note: The references to the IESBA Code are to the January 2017 staff-prepared draft *Compilation of the Restructured IESBA Code*. References in grey text are references to the extant IESBA Code. An updated staff-prepared draft *Compilation of the Restructured IESBA Code as of August 2017, inclusive of Task Forces' revisions to address the January 2017 IESBA EDs* will be considered at the IESBA [September 2017 meeting](#) (see Agenda Item 2-C).]

1. Paragraph R110.2¹⁶ of the proposed restructured IESBA Code¹⁷ (paragraph 100.5 of the extant IESBA Code) requires a professional accountant to comply with the fundamental principles set out in the IESBA Code, which includes objectivity.¹⁸ Section 120¹⁹ of the restructured IESBA Code specifies in a principles-based manner, an approach for identifying, evaluating and addressing threats to compliance with the fundamental principles and includes more explicit requirements and application material for doing so. For example, paragraph R120.6 (new explicit requirements derived from paragraphs 100.6 and 290.1 of the extant IESBA Code) requires professional accountants to identify threats to compliance with the fundamental principles, which may include self-review threats, self-interest threats, familiarity threats, advocacy threats and intimidation threats. **For the purposes of this discussion, the focus is on self-review threats, self-interest threats and familiarity threats that may arise in the context of the EQC reviewer's role when performing the EQC review.** The EQC reviewer has a responsibility to apply all of the requirements and application material in the IESBA Code, and there may be other threats that may arise in relation to the EQC reviewer that are not explained below.

Familiarity threats

2. A familiarity threat is described in paragraph 120.6 A3 (d) of the IESBA Code (paragraph 110.12 (d) of the extant IESBA Code) as “the threat that due to a long or close relationship with a client, or

¹⁶ Proposed restructured IESBA Code Part 1 – Complying with the Code, Fundamental Principles and Conceptual Framework, Section 110, *The Fundamental Principles*

¹⁷ In January 2017, the IESBA released the following three exposure drafts (EDs) with proposals to enhance and the restructure the provisions in the extant IESBA Code:

[Structure ED-2, Improving the Structure of the Code of Ethics for Professional Accountants—Phase 2;](#)

[Safeguards ED-2, Proposed Revision Pertaining to Safeguards in the Code—Phase 2 and Related Conforming Amendments;](#)
and

the [Applicability ED, Proposed Revisions to Clarify the Applicability of Provisions in Part C of the Extant Code to Professional Accountants in Public Practice](#)

The IESBA has now received comments from respondents to those EDs and plans to consider Task Forces' proposed revisions in response during its September 2017 meeting.

¹⁸ Paragraph 110.1 of the proposed restructured IESBA Code defines objectivity as “not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others”.

¹⁹ Proposed restructured IESBA Code Part 1, Section 120, *The Conceptual Framework*

employer, a professional accountant will be too sympathetic to their interests or too accepting of their work”. Sections 540²⁰ (paragraphs 290.148-290.168 of the extant IESBA Code) and 940²¹ (partially new requirement, partially restructured from section 291.137 of the extant IESBA Code) of the IESBA Code, which contain the provisions relating to the long association of personnel, address familiarity threats for professional accountants in public practice (PAPPs) performing audits and reviews of financial statements or other assurance engagements in relation to:

- The client;
 - In the case of an audit, the client’s operations and senior management; or
 - The subject matter (financial statements) or subject matter information (financial information which forms the basis of the financial statements), i.e., the engagement.
3. For audits of public interest entities, Section 540 of the IESBA Code (paragraphs 290.148-290.168 of the extant IESBA Code) contains requirements and application material that prescribe the maximum period that an individual may serve on the engagement, including as EQC reviewer, as well as minimum cooling-off periods, that are intended to address such familiarity and self-interest threats. During the cooling-off period, an individual is prohibited from being involved in the client relationships, including performing the role of EQC reviewer. However, Section 540 (paragraphs 290.148-290.168 of the extant IESBA Code) does not address the circumstances when the individual switches between various roles during the time-on period, for example, an individual is permitted to serve a maximum of 7 years and therefore may fulfill the role of engagement partner for 4 years and switch to the EQC reviewer for 3 years. In respect of audits of entities that are not public interest entities, the conceptual framework set out in Section 120 of the IESBA Code would apply with respect to identifying, evaluating and addressing threats created from long association (see introduction paragraphs in Sections 540). Accordingly, although the long association provisions may preclude the engagement partner from fulfilling the role of EQC reviewer in certain circumstances in order to address a familiarity or self-interest threat, there are circumstances that may arise when this is not explicitly prohibited.
 4. Furthermore, the long association provisions address familiarity threats in relation to the client, its management and the engagement. However, Sections 540 (paragraph 290.148-290.168 of the extant IESBA Code) and 940 (partially new requirement, partially restructured from section 291.137 of the extant IESBA Code) do not include provisions to deal with familiarity threats that may be created from situations that exist within the firm (e.g., the EQC reviewer is a close family member of the engagement partner).
 5. As highlighted above, paragraph 120.6 A3 (d) of the IESBA Code (100.12 (d) of the extant IESBA Code) describes familiarity threats in the context of the “relationship with a ... employer”. The

²⁰ Proposed restructured IESBA Code Part 4A – Independence for Audits and Reviews, Section 540, *Long Association of Personnel (Including Partner Rotation) with an Audit Client*

²¹ Proposed restructured IESBA Code Part 4B – Independence for Other Assurance Engagements, Section 940, *Long Association of Personnel with an Assurance Client*

Applicability ED contains proposals²² to clarify that the provisions in Part C of the extant IESBA Code (i.e., those applicable to professional accountants in business (PAIB)) might be applicable to PAPPs in ethical situations not involving clients. Paragraph 200.6 A1 of the IESBA Code (paragraph 300.11 of the extant IESBA Code) provides examples of facts and circumstances that might create familiarity threats for a PAIB, in the context of the relationship with an employer (e.g., a professional accountant being responsible for the financial reporting of the employing organization when an immediate or close family member employed by the organization makes decisions that affect the financial reporting of the organization). Similarly paragraph 200.6 A1 (paragraph 300.11 of the extant IESBA Code) also contains examples of facts or circumstances that might create intimidation threats that may be relevant to an EQC reviewer. These examples may help provide guidance for EQC reviewers in dealing with familiarity threats that may be created within the engagement team (e.g., the EQC reviewer is a close family member of the engagement partner).

6. In essence, a familiarity threat in relation to the client, its management, the engagement or the engagement team is addressed in the IESBA Code. While certain sections of the IESBA Code provide explicit requirements and application material for addressing familiarity threats (e.g., the long association provisions for audits of public interest entities), the application of the conceptual framework is relevant for other circumstances (specifically paragraphs R120.10–120.10 A2 (paragraph 100.9 of the extant IESBA Code)). However, the IESBA Code is not explicit in terms of explaining how a familiarity threat in relation to the engagement team may arise in the circumstance of an EQC reviewer and how such a threat could be adequately safeguarded.

Self-review or Self-interest Threats

7. A self-review threat is described in paragraph 120.6 A3 (b) of the IESBA Code (paragraph 100.12 (b) of the extant IESBA Code) as “the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made, or an activity performed by the accountant, or by another individual within the accountant’s firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity”. A self-interest threat is described in paragraph 120.6 A3 (a) of the IESBA Code (paragraph 100.12 (a) of the extant IESBA Code) as “the threat that a financial or other interest will inappropriately influence the professional accountant’s judgment or behavior”.
8. In the case of an EQC reviewer, a self-review or self-interest threat may arise as a result of the EQC reviewer being previously involved in the engagement. For example, after serving as the engagement partner on an audit of financial statements, the objectivity of the individual may be impaired in subsequent financial periods in relation to areas of the engagement where the individual exercised significant judgment, due to the fact that the judgments made in one financial period may have relevance in succeeding financial periods. Although this situation is covered by the IESBA Code through the application of the requirements and application material in the conceptual framework, the IESBA Code is not explicit in explaining how a self-review or self-interest threat may arise in the circumstance of an EQC reviewer and how such a threat could be adequately safeguarded.

²² Paragraph R300.5 of the January 2017 Applicability ED indicates that “Where a PAPP is performing professional activities pursuant to the accountant’s employment or ownership relationship with the firm, there might be requirements and application material in Part 2 [Proposed restructured IESBA Code, Part 2, Professional Accountants in Business] that are also applicable to those circumstances. If so, the PAPP shall comply with the relevant provisions”. The IESBA is considering revisions to the proposals in its Applicability ED in light of the feedback from respondents during its September 2017 meeting.

