

ISQM 2 – Question 4(b): Location of the Guidance (or Requirement) – Agree but with further comments

Question 4(b) in the EM to ED-ISQM 2 asked respondents:

If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?

1 Monitoring Group**04_ISQM 2_IOSCO**

References to the Ethics code (and/or an improved cooperation with IESBA) seem appropriate to clarify its' importance in delivering the desired engagement quality.

3 Regulators and Oversight Authorities**07_ISQM 2_FRC**

We acknowledge that the period of cooling-off might be best determined by IESBA and encourage the IAASB and IESBA to collaborate on the matter in finalising the standard. However, if IESBA are unable to undertake such revisions to the IESBA Code before finalisation of the standard, the IAASB would be expected to address the cooling-off period directly in ISQM2.

08_ISQM 2_IRBA

It is our view that requirements related to cooling-off should preferably be addressed in the IESBA Code. Users currently must reconcile local legislation with the IESBA Code requirements; so, including EQ reviewer independence requirements in the quality management standards will further complicate the matter. However, in the absence of such a requirement in the IESBA Code, it is necessary that it be addressed in ISQM 2.

Regarding an EQ reviewer, the IESBA Code deals with a cooling-off period that follows a 7 years “on” period, as well as a cooling-off period for an individual who performed different key audit partner roles for seven years. The IESBA Code does not deal specifically with the cooling-off period where the engagement partner transitions to be an EQ reviewer. While the conceptual framework of the IESBA Code will apply to considerations of threats to objectivity and independence, our view is that the conceptual framework would not be sufficiently robust in addressing the risks. Alternatively, the IESBA Code could be used to prescribe a cooling-off period (e.g. two or three years). This, however, would require a change to the IESBA Code and liaison between the IAASB and the IESBA.

09_ISQM 2_IAASA

We would also support the inclusion (in paragraph 16) of a cooling-off period for both the engagement partner and senior audit staff before they are permitted to assume the role of engagement quality reviewer for an engagement.

4 National Auditing Standard Setters**15_ISQM 2_CFC**

Yes, however we suggest that a reference to the applicable section/reference of the IESBA code be included.

16_ISQM 2_HKICPA

We agree that such guidance should be located in proposed ISQM 2 to make it more comprehensive as this is a standard on quality management of engagement quality review. In addition, we consider the proposed ISQM 2 should emphasise that more stringent requirement should be applied by firms where local ethical requirements go beyond the requirements of ISQM 2.

18_ISQM 2_JICPA

We agree that ED-ISQM 2 deals with a “cooling-off” period for individuals before being able to act as the engagement quality reviewer. We believe that IESBA Code requirements deal primarily with independence of the engagement team and engagement quality reviewer from the entity. Therefore, the “cooling-off” period for engagement partners and engagement quality reviewers should be dealt with in ED-ISQM 2 as a matter of the eligibility of engagement quality reviewers. However, we have the following comments:

- Paragraph 16 requires the firm to establish policies or procedures that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner, and paragraph A5 states that “accordingly, this ISQM requires the firm to establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer.” However, other than the establishment of a “cooling-off” period, we believe that there is no alternative for the policies or procedures for such limitations. In order to clarify what is required, we believe that the requirement should clearly state that the firm is required to establish a suitable cooling-off period.
- We believe that flexibility should be allowed for the firm in determining the suitable cooling-off period in light of the circumstances of the engagements, and we agree with the statement in paragraph 28 of the Explanatory Memorandum of ED-ISQM 2 (“the IAASB recognizes that circumstances may differ for engagements other than audits of listed entities and therefore the firm may determine that no cooling-off period is necessary for certain types of engagements, or the firm’s policies or procedures may specify a different cooling-off period”). In this regard, the engagements that fall under the category of “the firm determines that an engagement quality review is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks” as described in paragraph 37(e)(iii)b of ED-ISQM 1, are those for which the firm voluntarily requires an engagement quality review, and it should be permissible to establish no cooling-off period for such engagements. We believe this flexibility will encourage the performance of the engagement quality review in a small firm where a cooling-off period is difficult to set.

Based on the above, we suggest the following amendments to paragraphs 16 and A5:

"16. The firm shall establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer and that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner by establishing a suitable cooling-off period

A5. An individual who has served as the engagement partner is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual's objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level...Accordingly, this ISQM requires the firm to establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who

previously served as the engagement partner, for example, by establishing a suitable-specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends upon the facts and circumstances of the engagement, and applicable provisions of law or regulation or relevant ethical requirements. The firm's policies or procedures may specify a different cooling-off period depending on the facts and circumstances of the engagement. In the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the engagement quality reviewer until two subsequent audits have been conducted. In the case of the audit or other engagement for which the firm determines that an engagement quality review is an appropriate response to assessed risks based on the reasons for the assessments given to those risks (see paragraph 37(e)(iii)b of ISQM 1), the firm may determine that a cooling-off period is not necessary."

19_ISQM 2_KSW

We agree that such guidance is located in ISQM 2, as it is more efficient to have all guidance included in one standard. Nevertheless the concept of "cooling-off" period should also be addressed by the IESBA Code of Ethics above all in order to avoid any misinterpretations because of not clear alignment.

5 Accounting Firms

23_ISQM 2_BTI

Typically, such requirements would be included in the IESBA code, however we see no reason why this should not be included in ED-ISQM2 as it specifically relates to requirements for the EQR. It may be appropriate in due course to incorporate this requirement also in the IESBA Code, but it may be difficult to align updates to the Code with the timing of implementation of the requirements in ISQM2.

24_ISQM 2_BTVK

We agree with the inclusion of such guidance in ED-ISQM 2, but recommend that the IESBA Code be reviewed to verify that it is consistent with the proposed guidance in ED-ISQM 2.

25_ISQM 2_BDO

We support the rest of the guidance on the cooling-off period in paragraph A5, including the 2-year period for listed entities although we note that that there is a risk that the 2-year cooling-off period (which is similar to PCAOB AS 1220) within the application guidance will become a rule of thumb or may be seen as a presumptive requirement. Providing a cross-reference to applicable IESBA paragraphs in the application guidance (or acknowledgment of local requirements) would also be helpful for firms.

27_ISQM 2_CHI

Consistent guidance ought to be located in both ISQM 2 and the IESBA Code.

29_ISQM 2_DTL

Agreed that it should appear in ISQM2 (or ISQM1 if it is decided to just have the one standard).

34_ISQM 2_KPMG

We welcome the fact that the IAASB has worked with the IESBA in developing this material. We note that the considerations regarding threats to objectivity of an EQ Reviewer who was previously an Engagement Partner are not specifically addressed in the Code. Instead the Code, at section 540, addresses partner rotation and cooling-off periods in the context principally of long association with an audit client, in relation to

independence (not specifically objectivity) and related to this, the effects of service in a combination of key audit partner roles on respective cooling-off periods.

We also highlight that section 540 of the Code currently recognises that a partner may serve in a combination of Engagement Partner and Engagement Quality [Control] review roles, which therefore may no longer be aligned with the proposals in ED ISQM 2.

Accordingly, we suggest that amendments are made to the Code to better recognise the self-review threats in this scenario, especially if an Engagement Partner were to be appointed to the role of EQ Reviewer, and we recommend that this section be updated to give greater emphasis to the nature of the role(s) performed and the potential risks when moving from one role to another, in addition to the focus on overall length of service.

We consider that, in general, the Code would be the appropriate place to address these considerations. However, we also highlight that the Code is describing independence considerations, and ED ISQM 2 is describing objectivity. We therefore recommend that IAASB align these further, e.g. ED ISQM 2 could note that consideration of objectivity includes consideration of independence of the EQ Reviewer, both from the engagement team, and from the engagement itself, to supplement the material in the Code in relation to these circumstances.

35_ISQM 2_KI

The guidance could be located in both ISQM 2 and the IESBA Code providing it will be consistent.

36_ISQM 2_MZRS

Yes, this appears reasonable although it would be useful to have clear linkage or referencing between the two documents

37_ISQM 2_MZRSUS

We support having the guidance (same language) in both ISQM 2 and the IESBA Code.

38_ISQM 2_MNP

We agree that the guidance regarding a cooling off period should be located in proposed ISQM 2. We also support continued efforts to ensure consistency between the requirements of proposed ISQM 2 and the IESBA Code, including the incorporation of additional guidance in the IESBA Code relating to cooling off periods.

39_ISQM 2_MSI

We think that the requirement would probably be best stated in both standards, this would ensure that the scope for misunderstanding or misinterpretation was minimized.

40_ISQM 2_NI

No harm in having the requirement in ISQM2, in addition to the IESBA Code, as long as it is consistent

42_ISQM 2_PKFI

While we recognize the merits of both locations, our preference is that such guidance should be included in ISQM 2 as opposed to the IESBA Code. This is principally because we believe the guidance will more likely be written in terms which are consistent with the objective of scalability, if located in ISQM 2.

However, of greater importance than location of the guidance, is its clarity. In its current form we believe that the guidance is ambiguous and contains inherent inconsistencies. For example, Para 28 of the Explanatory Memo to ISQM 2 states:

“The IAASB recognizes that circumstances may differ for engagements other than audits of listed entities and therefore the firm may determine that no cooling-off period is necessary for certain types of engagements, or the firm’s policies or procedures may specify a different cooling-off period. The IAASB is of the view that ED-ISQM 2 provides appropriate flexibility because it places the onus on the firm to establish policies or procedures that are appropriate to address the issue.”

The wording above from para 28 is helpful, particularly to SMPs, in optimizing the scalability of the proposed standard. However, Para 26 of the Explanatory Memo to ISQM 2 appears to provide contradictory guidance to para 28:

“The IAASB is of the view that when an individual is appointed as the engagement quality reviewer immediately after serving as the engagement partner, there are no safeguards or other actions that would eliminate the threats to the individual’s objectivity or reduce them to an acceptable level.”

Comparing the two, para 26 suggests that there are no acceptable circumstances in which an EQR could be appointed immediately after serving as the engagement partner, whereas para 28 indicates that a firm may determine that no cooling-off period is necessary for certain types of engagements.

Para 28 also appears to be inconsistent with para A5 of the Application Guidance, which states:

“An individual who has served as the engagement partner is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual’s objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level.”

From these three excerpts, it is unclear whether or not the IAASB does recognize that a firm may establish a policy for no cooling-off period on engagements other than audits of listed entities, in certain circumstances. This is unfortunate, not simply because of the risk of varying interpretations but, by contradicting para 28, the wording of para 26 and AG 5 appears to erode an important aspect of scalability which para 28 appeared to offer.

Our comments on this matter, including our response to 4 a) above, collectively demonstrate that the proposed standard would benefit from clearer wording in context of the EQR cooling-off period, to help reduce ambiguity and to better promote scalability.

6 Public Sector Organizations

51_ISQM 2_OAGA

Yes, we support the guidance in paragraphs 16-17 and agree that it should be included within ISQM 2. Including the guidance with ISQM 2 keeps the guidance centrally located and eliminates the need to exposure draft ISQM 2 if the IESBA Code changes.

52_ISQM 2_OAGC

We do not feel there is a need for additional guidance in the standard concerning cooling off periods beyond that already provided.

7 Member Bodies and Other Professional Organizations

59_ISQM 2_BICA

IESBA Code provides general ethical requirements guidance to professional accountants in all circumstances. It falls upon the accountant to apply the code appropriately as circumstances change. Standards established wishing to make reference to ethical compliance should do so but establish specific criteria and guidance on their own accord. Guidance for “cooling off” period is therefore best placed in ED-ISQM 2.

61_ISQM 2_CaICPA

Yes. If there is to be an ISQM 2 it should be comprehensive.

62_ISQM 2_CAQ

We support that such guidance should be updated and located in ED-ISQM 2 and to the extent possible, the IESBA Code also should be updated and align with ED-ISQM 2. Most importantly, guidance in ED-ISQM 2 and the IESBA Code should not be contradictory.

64_ISQM 2_CICC-AIC

It should be included in both.

65_ISQM 2_CCC-ICPARD

It should be included in both

73_ISQM 2_IEC-IAB

Yes, the guidance shouldn't be separated from the standard.

74_ISQM 2_ICAEW

If it is not to be included as a requirement, as a public interest issue, it should be included in the IESBA Code. IAASB should address directly the position for unlisted entities. It is easier to argue the need for more flexibility in such cases.

78_ISQM 2_IBRACON

Yes. However, a reference to applicable IESBA Code paragraphs' would be appreciated.

81_ISQM 2_IMCP

Keep it in the ISQM2 but aligned with the Ethics Code.

87_ISQM 2_SRO-AAS

Yes, however we see no harm that it was emphasized in both pronouncements.

88_ISQM 2_SAICA

As indicated above, there are areas of additional guidance that we suggest be included in ED-ISQM 2.

It is SAICA's preference for any additional requirements in relation to a cooling off period for the engagement quality reviewer to be included in the International Code of Ethics for Professional Accountants.

8 Individuals and Others

90_ISQM 2_TAS-CAA

Granted, the guidance relates to Objectivity which is a principle within the Code. However, it relates, specifically to Engagement Quality Reviews and as such would be better placed in ISQM 2 which is specifically for Engagement Quality Reviews. There should however be consistency between the Code and ED-ISQM 2 in prescribing the cooling off period as noted above.