

ISQM 2 – Question 4(a): Need for a Cooling-Off Period and Related Guidance Thereon – Disagree

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

What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?

4 National Auditing Standard Setters

10_ISQM 2_AICPA

We believe that the requirement should address the objectivity of the engagement quality reviewer and guidance should address the need for safeguards such as cooling-off periods and assessing competency.

We are not convinced that the engagement quality review would be less effective because the reviewer previously served on the engagement. We do believe this is a scalability issue; however, not one that is necessarily limited to small firms. Requiring a cooling-off period could result in firms that rotate engagement partner and engagement quality reviewer roles within a group of partners needing to use an external provider. This might have the unintended consequence of such firms choosing not to rotate engagement leadership (if not otherwise required to do so), which would not be an improvement in quality. We are also concerned about the availability of qualified resources with specific and relevant skill sets, such as a particular industry or topic-specific expertise. Given limited resources, for an engagement risk in which an engagement quality review is the appropriate response, an experienced person who recently served as the engagement partner could be a more effective engagement quality reviewer than someone else with less experience or competency related to that engagement risk.

We are concerned that paragraph A5 will be interpreted as creating a de facto requirement to have a 2-year cooling-off period for all engagements, not just listed entities, and certainly for entities of “significant public interest. If the reason for selecting a two-year period is related to an entity presenting comparative financial statements, that should be made clear, as many entities, such as local governments, often do not present comparative financial statements. Firms could then include whether the entity presents comparative financial statements as a consideration in determining the eligibility of an engagement quality reviewer.

We believe that the requirement for a cooling-off period is prescriptive and not principles-based. We note that such a requirement may result in a lessening in audit quality as some firms may follow the letter of the requirement but not the principle upon which the requirement is based. Accordingly, we urge the IAASB to revise this requirement to be more principles-based. Further, we would prefer that the example in paragraph A5 be revised to refer to a regulator who requires a 2-year cooling off period.

Accordingly, we recommend the following revisions 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 **policies and procedures designed to maintain the objectivity** ~~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. Those policies or procedures shall require that the engagement quality reviewer not be a member of the engagement team, and: ...

A5. **Policies and procedures designed to maintain the objectivity of an engagement quality reviewer** ~~An individual who has served as the engagement partner~~ **on the previous year’s**

~~engagement may address the following areas~~ 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.:

- ~~The extent of changes in~~ In recurring engagements, the matters on which significant judgments are made and the facts and circumstances around those significant judgments **compared to the period(s) in which the individual was the engagement partner** are not likely to vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the immediate previous period.
- ~~The procedures and incentives placed by the firm's system of quality management on objective reviews (for example, the engagement quality reviewer would not be penalized for identifying a misstatement related to a year in which the reviewer was the engagement partner)~~

Accordingly, this ISQM requires the ~~A~~ firm **may** 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. 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. ~~In the case of~~ **For example, the IESBA Code and certain regulators require that for** an audit of financial statements of a listed entity, it is unlikely that an engagement partner ~~would~~ **is not** be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

11_ISQM 2_AUASB

The AUASB notes that IESBA has changed the IESBA code to include more detailed and specific requirements for auditor rotation for Public Interest Entities (PIEs) with detailed rotational rules and limits for combined roles of Audit Partner, Key Audit Partner, and EQR roles, as well as specified clean periods depending on the combination of the roles held by the partner.

The AUASB considers that any reference to the "cooling-off" period, including the guidance currently included in paragraph A5 of ED-ISQM 2 "that firms establish the cooling-off period and that the determination of a suitable cooling-off period depends upon the facts and circumstances of the engagements (and applicable provisions of law or regulation or relevant ethical requirements)" should reside in the IESBA code. If these principles reside within the IESBA code they will apply to all professional accountants (or their firms, as applicable) and address the fundamental principles, including independence, and apply the conceptual framework. This would then support consistency across jurisdictions. The test of partner rotation and suitable cooling-off periods is linked to independence and as such should therefore be addressed within the IESBA code.

Accordingly, the AUASB is of the view that the application material in paragraph A5 relating to any "cooling-off" period should be removed from ISQM 2 and a reference to the IESBA code instead be considered if this application guidance is to be retained.

17_ISQM 2_IDW

Paragraph 16 of the draft requires the firm to set policies and procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer 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 (i.e., a “cooling-off period”). Paragraph A5 further explains why such limitations are required and steers firms to require at least a two-year cooling-off period. These paragraphs in connection with paragraph A4 would then effectively require a firm to seek an engagement quality reviewer external to the firm if these limitations on eligibility of engagement partners were not fulfilled.

We would like to point out that EU legislation for both public interest entities (PIEs) and non-PIEs does not require a rotation period for the engagement quality control reviewer or a cooling-off period for former engagement partners. Furthermore, although the IESBA Code of Ethics requires an engagement quality control reviewer for PIEs to rotate every seven years, the Code does not require such a cooling-off period for individuals that were previously the engagement partner on the engagement. This implies that, for example, under current EU legislation and the IESBA Code, an individual could serve for one year as an engagement partner and then another six years as the engagement quality reviewer. Under the proposal in the draft, the engagement partner would need to cool-off for two years prior to serving as the engagement quality reviewer.

In our view, the results of this requirement and its application material are disproportionate. It is precisely the competence obtained in the previous role as engagement partner that may uniquely qualify an individual to engage in quality review on an engagement. Furthermore, the views of the reviewer would be balanced by the views of a new engagement partner. Consequently, we believe that the IAASB is overemphasizing objectivity compared to competence for reviewers. We also note that the requirement in paragraph 16 and its application material will further limit the pool of competent individuals that would be eligible to act as engagement quality reviewers – especially for smaller practices.

20_ISQM 2_MAASB

We see no need for the specific guidance in ISQM 2 on a “cooling-off” period for that individual before being able to act as the engagement quality reviewer as it is dealt with in the IESBA’s Code.

21_ISQM 2_NZAASB

Furthermore, the NZAuASB is strongly opposed to the guidance in paragraph A5 which provides, as an example of a limitation on the eligibility, establishing a cooling off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer.

The NZAuASB is of the view that the current drafting of the requirement, along with the related application material creates a de facto requirement that is not consistent with the IESBA’s *International Code of Ethics for Professional Accountants (including International Independence Standards) (the IESBA Code)*.

22_ISQM 2_NBA

To us this seems a bit of a precedent. The cooling-off period is a matter of independence and therefore we feel that the primary role for setting a cooling-off period lies with IESBA. In reality IESBA has set cooling-off periods for engagement partners and other key audit partners of PIEs during which they cannot act as an engagement quality reviewer. We wonder whether it is necessary for the IAASB to mention as an example that policies and procedures could be established to set an cooling-off period for other engagements.

5 Accounting Firms

32_ISQM 2_GTIL

We are of the view that the ED-ISQM 2 should not include a requirement for firms to develop a 'cooling off' period between an individual acting as an engagement partner and subsequently an engagement quality reviewer on the same engagement. We are of the view that this is in the purview of the International Ethics Standards Board for Accountants (IESBA) not the IAASB and accordingly should be addressed by IESBA.

See our response in (b) below.

We are supportive of preserving the objectivity of the EQ reviewer and of a requirement for firms to establish policies or procedures that put in place threats to safeguard the objectivity of the EQ reviewer. However, we do not support the guidance included in paragraph A5 of ED-ISQM 2 in relation to the establishment of a cooling off period. In our view such matters should be dealt with by the IESBA not by the IAASB.

7 Member Bodies and Other Professional Organizations

57_ISQM 2_APESB

APESB is concerned that the IAASB propose a cooling-off period for a previous Engagement Partner (EP) before they become an Engagement Quality Reviewer and the application material suggests a minimum period of two years for listed entities.

We believe this is inconsistent with the requirements of the IESBA Code which takes into account the possibility of multiple Key Audit Partner (KAP) roles (EP, Engagement Quality Control Reviewer (EQCR) or other KAP) and has rules in place where a combination of roles occur. APESB does not consider it best practice in standard setting to have an aspect of rotation rules outside of the IESBA Code. We are strongly of the view this matter should be considered by the IESBA and addressed in the IESBA Code as:

- i. KAP rotation is comprehensively dealt with in the IESBA Code;
- ii. There is no current prohibition in respect of movement between EP and EQCR, as long as, collectively the practitioner adheres to the applicable time on and time off periods when they perform a combination of KAP Roles. Further, if there is an independence threat for an EP moving to EQCR role, then it is dealt with by the conceptual framework of the IESBA Code; and
- iii. Audit partner rotation relates to ethical obligations, and it is advisable for all such ethical obligations to be dealt with in one place (the IESBA Code).

APESB recommends the proposed cooling-off period for a previous EP before they become an Engagement Quality Reviewer be considered by the IESBA and if applicable be included in the IESBA Code. We are supportive of the existing audit partner rotation roles in the IESBA Code which take into consideration the performance of a combination of roles.

66_ISQM 2_CPA

We do not support inclusion of a cooling off period as this is addressed in the Code of Ethics issued by IESBA.

75_ISQM 2_ICAP

The IESBA's Restructured Code of Ethics provides requirement for cooling off period. The proposed ISQM 2 also contains cooling-off period requirement which is inconsistent with the IESBA's Restructured Code of

Ethics. We believe that the IESBA Code of Ethics should contain all relevant provisions of the cooling-off period.

86_ISQM 2_NRF

As a general point, we believe that having a strict cooling-off period, without any exemptions, will lead to practical issues and extra costs that most likely will be challenging for SMPs.

Bearing in mind the collaboration between the IAASB and the IESBA and the frequent references in the ISQM standards to the IESBA Code of Ethics, we do not support having stricter rules for cooling off-periods in the ISQM 2 compared to the IESBA Code of Ethics.

We refer to the above.

89_ISQM 2_WPK

Provisions or guidance regarding the cooling off **should only be allocated in the IESBA Code of Ethics corresponding to the mandate of IESBA**. A repetition of provisions or guidance would not have positive impact on audit quality. If the guidance regarding the cooling off would be in line with the IESBA Code of Ethics no additional guidance is deemed necessary. Otherwise it would confuse the individual, the oversight and the public interest.