Paragraph 41A(c) of ISQM 1 and Related Application Material — Draft (Marked)
(Previously Paragraph 37(e) in the Exposure Draft of ISQM 1 (ED-ISQM 1))

This paper is a draft of the requirements in paragraph 41A(c) of proposed ISQM 1 (previously paragraph 37(e) of ED-ISQM 1) and related application material, marked from the indicative drafting presented at the September 2019 IAASB meeting (see Agenda Item 7 for that meeting).

Paragraph 37A1A(ec) Requirement

37. 41A. In designing and implementing responses, to address the quality risks identified and assessed by the firm relating to the engagement performance quality objectives, the firm shall, at a minimum, include the following specific responses:

... [Moved from 37(e)] The firm establishes policies or procedures addressing engagement quality reviews in accordance with proposed ISQM 2, and that require an engagement quality review for:

(i) Audits of financial statements of listed entities;

(ii) Audits or other engagements for which an engagement quality review is required by law or regulation; and (Ref: Para. A103)

(iii) Audits or other engagements for which the firm determines that an engagement quality review is [appropriate]:

(a) An appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks; or (Ref: Para. A104-A105x)

(b) Appropriate due to the nature and circumstances of the engagement or the entity. (Ref: Para. A105-A106)

Application and Other Explanatory Material

Engagements Subject to an Engagement Quality Review (Ref: Para. 37A1A(ec))

A101. [Deleted]

A102. [Deleted]

Engagement Quality Review Required by Law or Regulation (Ref: Para. 41A(c)(ii))

A103. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that:

- Are characterized as public interest entities as defined in a particular jurisdiction;

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1  Proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control 1), Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

Prepared by: Dan Montgomery and Hanken Talatala (November 2019)
Paragraph 41A(c) of Proposed ISQM 1 and Related AM — Draft (Marked)

(Previously Paragraph 37(e) of ED-ISQM 1)

IAASB Main Agenda (December 2019)

- Operate in the public sector or which are recipients of government funding, or entities with public accountability;
- Operate in certain industries (e.g., financial institutions such as banks, insurance companies and pension funds);
- Meet a specified asset threshold; or
- Are under the management of a court or judicial process (e.g., liquidation).

**Engagement Quality Review as a Response to Assessed Quality Risks (Ref: Para. 41A(c)(iii)(a))**

A104. Audits or other engagements for which the firm may determine that an engagement quality review is an appropriate as a response to assessed quality risks may include, for example, engagements:

- That involve a high level of complexity or judgment, such as:
  - An audit of financial statements for an entity operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g., certain large financial institutions or mining entities), or for which uncertainties exist related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.
  - An assurance engagement that requires specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (e.g., a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein).
- Where issues have been encountered on the engagement, such as audit engagements with recurring internal or external inspection findings, unremediated deficiencies in internal control, or a material restatement of comparative information in the financial statements.
- For entities in emerging industries or that involve emerging technologies, or for which the firm has no previous experience.
- For which unusual circumstances are identified during the firm’s acceptance and continuance of client relationships and specific engagements (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).
- That involve reporting on financial or non-financial information that is expected to be included in a regulatory filing, or that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus.
- For entities for which concerns were expressed in communications from securities or prudential regulators.

A105. In some cases, the firm may determine that there may be no audits or other engagements for which an engagement quality review is required to be performed as a response to assessed quality risks (e.g., when a firm does not perform audits of listed entities and other responses to assessed quality risks are determined by the firm to be appropriate).

**Public sector considerations**

A105x. [Moved from A107] The firm may determine that an engagement quality review is an appropriate as a response to assessed quality risks for public sector engagements in the public sector for which law or regulation establishes additional reporting requirements (e.g., a separate report on instances...
Paragraph 41A(c) of Proposed ISQM 1 and Related AM — Draft (Marked)

(Previously Paragraph 37(e) of ED-ISQM 1)

IAASB Main Agenda (December 2019)

of non-compliance with law or regulation to the legislature or other governing body or communicating such instances in the auditor's report on the financial statements).

Other Entities for Which the Firm Determines an Engagement Quality Review is Appropriate Based on the Nature and Circumstances of the Engagement or the Entity (Ref: Para. 41A(c)(iii)(b))

A105A. The firm may develop establish criteria for determining the types of identifying audits or other engagements for which an engagement quality review is determined to be appropriate due to the nature and circumstances of the engagement or the entity. Factors that the firm may consider in developing such criteria include, for example:

- Entities that are characterized as a The public interest or public accountability characteristics of the entity in a particular jurisdiction, and for which an engagement quality review is not otherwise required by law or regulation.
- Whether relevant ethical requirements for the engagement provide related guidance. For example, the IESBA Code provides a definition of “public interest entity” for purposes of requirements and guidance that relate specifically to such entities, but indicates that firms are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number, and a wide range, of stakeholders. Paragraph 400.8 of the IESBA Code further indicates that the factors to be considered include:
  - The nature of the business, such as the holding of a significant amount of assets in a fiduciary capacity for a large number of stakeholders. Examples include financial institutions, such as certain banks and insurance companies, and pension funds.
  - Size.
  - Number of employees.
  - The high public profile of the entity or its management or owners.
  - The number and diversity of shareholders.
  - Expectations about how the engagement report or other engagement deliverables may be used by stakeholders.

A105B. Although the firm may take into account public interest or public accountability characteristics of the entity in establishing such criteria, this ISQM does not require the performance of an engagement quality review for public interest entities, as defined in a particular jurisdiction, unless otherwise required by law or regulation.

Public sector Considerations Specific to Public Sector Audit Organizations

A106. Public sector entities may be of significant public interest due to their size and complexity, the range of their stakeholders and the nature of the services they provide. Factors to consider in determining whether an engagement quality review may be appropriate for a public sector entity due to the nature and circumstances of the engagement or the entity, the firm may consider factors similar to those in paragraph A105A.

- A public sector entity is of significant public interest may include whether the entity is a national, regional, or local government, or whether an opinion is being expressed on the entire entity or only certain units. Another factors to that may be considered may include whether the entity is a corporation that is state owned or in which the state has a controlling stake or a stake with significant influence. For Larger larger public sector entities may be determined to be of significant
public interest due to their social or economic influence on the community or region in which the entity operates.

A107. [Moved to A105x]