

Discussion of Changes to Requirements and Application Material

This paper provides background information on the changes made by the ISQM 2¹ Task Force (the Task Force) to the requirements and application material in proposed ISQM 2, as reflected in the marked draft in **Agenda Item 5-D**, and the rationale for those changes. The changes to paragraph 41A(e) (previously paragraph 41A(c)) and related application material in proposed ISQM 1² are those made by the Task Force to the proposed drafting discussed with the IAASB in December 2019 (see **Agenda Item 8-A** for that meeting). This paper also includes cross-references for the proposed revisions that are discussed in more detail in the relevant sections of **Agenda Item 5**.

Reference	Changes and the Rationale for Those Changes
Engagements Subject to an Engagement Quality (EQ) Review	
Paragraph 41A(e) of proposed ISQM 1 and related application material	<ul style="list-style-type: none"> • See Section I of Agenda Item 5.
Introduction	
Paragraph 2A	<p><i>Requirement</i></p> <ul style="list-style-type: none"> • In response to Board comments, deleted the reference to an EQ review being ‘one response, among others’ in paragraph 2A and replaced it with an EQ review as a ‘<i>specified response</i>’ (emphasis added) that is designed and implemented by the firm in accordance with proposed ISQM 1. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • As a result of the change to paragraph 2A, consequential revisions also were made elsewhere in the proposed standard (i.e., paragraphs A7 and A36) that referred to an EQ review as a ‘response’ to assessed quality risks by

¹ Proposed International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*

² Proposed 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*

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	clarifying that it is a 'specified response' to assessed quality risks relating to the engagement performance quality objectives.
Paragraph 2B	<p><i>Application Material</i></p> <ul style="list-style-type: none"> The Task Force noted that paragraph 13A in proposed ISQM 1, which is the equivalent of paragraph 2B in proposed ISQM 2, did not have similar application material to paragraph A0 in proposed ISQM 2. While there were a few editorial suggestions from Board members relating to paragraph A0, the Task Force opted to delete this application material for consistency with paragraph 13A in proposed ISQM 1. The Task Force considers that paragraph 2B sufficiently describes the inherent scalability of the proposed standard.
Paragraph 7	<p><i>Requirement</i></p> <ul style="list-style-type: none"> Deleted the reference to 'managing and achieving quality on the engagement' in response to a Board member comment that proposed ISA 220 (Revised)³ applies only to audit engagements while proposed ISQM 2 applies to all types of engagements that require an EQ review in accordance with paragraph 41A(e) of proposed ISQM 1.
Requirements	
Appointment and Eligibility of EQ Reviewers	
Paragraph 15	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Clarified the wording of paragraph A2 in response to a Board member comment that different individuals may be responsible for the different processes referred to in the example, and stating that fact would better link to the first sentence of paragraph A2.
Paragraph 16	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Changes in paragraph A4 were made to align with the revision in proposed ISQM 1⁴ to address service providers within the resources component of the firm's system of quality management.

³ Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraphs 29 and 40

⁴ Proposed ISQM 1, paragraph 38

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<p>Paragraph 16(a)</p>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A6: Added a footnote reference to indicate that the description of ‘competence’ comes from paragraph A117 of proposed ISQM 1. • Paragraph A7: Given the revisions in the scope of engagements subject to an EQ review in paragraph 41A(e) and its related application material in proposed ISQM 1 (see Section I of Agenda Item 5), clarified that the factors in paragraph A153I of proposed ISQM 1 that the firm may have considered in determining that an EQ review is an appropriate response to assessed quality risks may be an important consideration in the firm’s determination of the competence and capabilities required to perform an EQ review.
<p>Paragraph 16(b)</p>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> • In consultation with IESBA Representatives and Staff, added ‘and independence’ in paragraph 16(b) to clarify that both objectivity and independence are distinct principles to be maintained by individuals appointed as EQ reviewers in complying with relevant ethical requirements. <p><i>Application Material</i></p> <ul style="list-style-type: none"> • Paragraph A14: In consultation with IESBA Representatives and Staff, moved paragraph A17C back to paragraph A14 as the application material provided therein is more closely linked to relevant ethical requirements relating to objectivity and independence in paragraph 16(b). In addition, further clarified that relevant ethical requirements may include provisions that address threats to independence created by the long association of personnel with an audit or assurance client, which is distinct from, but may need to be considered in, applying the mandatory cooling-off period in accordance with paragraph 16A. • Paragraph A15: Replaced ‘another key audit partner’ with ‘other engagement team member’ in paragraph A15 in response to a Board member comment that the term ‘key audit partner’ may have jurisdictional implications. Further, it is a term not commonly used in the IAASB standards (i.e., used only once in paragraph A14 of extant ISQC 1⁵). The Task Force notes that the proposed change to ‘other engagement partner’ is aligned with the proposed wording used in paragraph 120.14 A2.(b) of the International Ethics Standards Board for Accountants’

⁵ 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*

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	<p>(IESBA) Exposure Draft (ED), <i>Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers</i>.</p> <ul style="list-style-type: none"> Paragraphs A15–A16: In consultation with IESBA Representatives and Staff, the Task Force discussed incorporating the content of paragraph A16 into paragraph A15 and deleting the examples of threats to objectivity in paragraph A15 to remove duplication with the examples provided in the IESBA’s ED (see the link above). The Task Force has opted to keep the examples in paragraph A15 as they may still be helpful to those jurisdictions that have not adopted the IESBA Code. Further, the Task Force clarified in paragraph A16 that, in addition to providing examples of threats to objectivity, the IESBA Code also provides example of factors that are relevant in evaluating the level of such threats, and safeguards or actions that might address such threats.
Paragraph 16A	<p><i>Requirement</i></p> <ul style="list-style-type: none"> Added the word ‘also’ (emphasis added) in paragraph 16A to clarify that the mandatory cooling-period required for an individual being appointed as EQ reviewer after previously serving as the engagement partner is in addition to the requirements addressing general threats to the EQ reviewer’s objectivity in paragraph 16(b). <p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A17B: Based on a Board member comment, revised the wording to align with the wording used in proposed ISA 600 (Revised).⁶ Paragraph A17C: Moved back to paragraph A14. See above for the changes to paragraph A14.
Paragraphs 18(a) and 18(b)	<p><i>Requirement</i></p> <ul style="list-style-type: none"> Changed the structure of paragraph 18 in response to a Board member comment. The Task Force notes that the change in structure aligns the EQ reviewer’s overall responsibility for the performance of an EQ review, including responsibilities for the direction, supervision and review (DSR) of the work of individuals assisting in the EQ review, with how the engagement partner’s overall responsibility for managing and achieving quality on the audit engagement is structured in proposed ISA 220 (Revised), including responsibilities over the DSR of the work of members of the engagement team.⁷

⁶ Proposed ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

⁷ Proposed ISA 220 (Revised), paragraphs 13 and 29

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	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Streamlined the wording in paragraph A19A to align with the revisions in paragraph 18(b). The Task Force concluded that the additional words in paragraph A19A were unnecessary as they simply repeated the wording of the revised requirement in paragraph 18(b).
Paragraph 20	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Some Board members and respondents to ED-ISQM 2 asked for clarification, or more guidance, as to when it may be necessary for a replacement EQ reviewer to reperform procedures, or use the work performed by the original EQ reviewer. In response to these comments, the Task Force clarified in paragraph A21 that firm policies or procedures may also address the responsibility of the individual appointed to replace the EQ reviewer to perform procedures sufficient to fulfill the requirements with respect to the performance of the EQ review. The Task Force considers that it is difficult to provide specific guidance in this area, given the different circumstances and timing of dealing with a replacement EQ reviewer. However, the Task Force also added wording in paragraph A21 that firm policies or procedures may further address the need for consultation in such circumstances.
Performance of the EQ Review	
<i>Responsibilities of the EQ Reviewer</i>	
Paragraph 22	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Revised the wording in paragraph A26 to help clarify that it may only be appropriate for the EQ reviewer to perform procedures near the end of the engagement when the engagement is not complex and is completed within a short period of time. This revision was in response to a Board member concern that the previous wording could suggest to some that it was appropriate to perform the EQ review near the end of any engagement, including larger, more complex engagements. <p>Group Audit Considerations</p> <ul style="list-style-type: none"> Clarified in paragraph A28A that, as indicated in the requirement in paragraph 18(a), the firm's policies or procedures require the EQ reviewer to take overall responsibility for the performance of the EQ review. The Task Force considers that this additional wording re-emphasizes the fact that the EQ reviewer for the group audit takes

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	<p>the lead in performing the required procedures in proposed ISQM 2, but may need to have discussions with other key members of the engagement team, including component auditors.</p> <ul style="list-style-type: none"> Added new paragraph A28Ax to clarify that an EQ reviewer may be appointed for a component of a group. The paragraph was added in response to Board member comments that the previous reference to a component EQ reviewer in paragraph A28A was confusing because it appeared to be linked to the use of assistants. The revisions to paragraphs A28A and A28Ax were discussed and agreed with the ISA 600 Task Force, which reaffirmed its previous view that the guidance in proposed ISQM 2 should be kept at a high level because the principles of performing an EQ review for a group audit are the same as for any other engagement. The Task Force notes that additional guidance could be provided as part of the implementation support materials for proposed ISQM 2.
Paragraph 22(b)	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Revised paragraph A31A in response to Board member comments asking for greater clarity about what may be expected of the engagement team when an EQ reviewer becomes aware of other areas where significant judgments would have been expected to be made by the engagement team. The change to the second sentence of paragraph A31A is in response to a Board comment that the use of the word ‘may’ implies that significant judgments would have been expected to be made, but that the EQ reviewer may choose <i>not</i> (emphasis added) to discuss such matters with the engagement team.
Paragraph 22(c)	<p><i>Requirement</i></p> <ul style="list-style-type: none"> Deleted the word ‘appropriate’ in paragraph 22(c)(i) in response to a Board member comment that the meaning or intent of exercising ‘<i>appropriate</i>’ professional skepticism is unclear. <p><i>Application Material</i></p> <ul style="list-style-type: none"> Paragraph A31Ax: In the discussions at the December 2019 IAASB meeting, Board members were supportive of providing examples of expected behaviors of an EQ reviewer in evaluating the engagement team’s basis for making significant judgments, including, when applicable to the type of engagement, the exercise of professional skepticism by the engagement team. Therefore, the Task Force has added paragraph A31Ax, which includes several points offered by respondents to ED-ISQM 2 and which were noted in the agenda materials for the December 2019 meeting (see Section II-C of Agenda Item 8 for that meeting).

Reference	Changes and the Rationale for Those Changes
	<ul style="list-style-type: none"> Paragraphs A31C and A31Ca: In response to Board member concerns that the wording in paragraph A31C may subtly suggest that the EQ reviewer is part of the engagement team, clarified that discussions about significant judgments and the relevant engagement team's documentation may 'assist the EQ reviewer in evaluating' the exercise of professional skepticism by the engagement team in relation to those significant judgments. The second and third sentences of paragraph A31C were moved to new paragraph A31Ca. Paragraph A31Cb: In response to Board member comments that relevant application material in proposed ISA 220 (Revised) may provide useful guidance in evaluating the exercise of professional skepticism by the engagement team, added paragraph A31Cb indicating that proposed ISA 220 (Revised)⁸ provides examples of the impediments to the exercise of professional skepticism at the engagement level, unconscious auditor biases that may impede the exercise of professional skepticism, and possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level.
Paragraph 22(d)	<p><i>Requirement</i></p> <ul style="list-style-type: none"> Clarified that for audits of financial statements, the EQ reviewer shall evaluate the 'basis for' the engagement partner's determination that relevant ethical requirements relating to independence have been fulfilled. This proposed change is in response to Board member comments that the requirement in paragraph 22(d) should contemplate the engagement partner relying on the firm's system of quality management, or assigning to other members of the engagement team the design or performance of procedures, tasks or actions, to assist the engagement partner in complying with the requirements of proposed ISA 220 (Revised). <p><i>Application Material</i></p> <ul style="list-style-type: none"> Changes in paragraph A31D were made to align with the wording in proposed ISA 220 (Revised).⁹
Paragraph 22(e)	<p><i>Application Material</i></p> <ul style="list-style-type: none"> Given that the required responses in paragraphs 37(c) and 37(d) of ED-ISQM 1 relating to consultation on difficult or contentious matters and differences of opinion have now been converted to quality objectives in paragraphs 36(d) and 36(e) of proposed ISQM 1, the application material in paragraph A32 was simplified by indicating that

⁸ Proposed ISA 220 (Revised), paragraphs A35-A37

⁹ Proposed ISA 220 (Revised), paragraph 21

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	the firm may establish policies or procedures that address consultation on difficult or contentious matters and differences of opinion within the engagement team, or between the engagement team and the EQ reviewer.
Paragraph 22(f)	<p><i>Application Material</i></p> <ul style="list-style-type: none"> • Simplified and streamlined the wording in paragraph A33 in response to Board member comments and editorial suggestions.
Paragraph 22(g)	<p><i>Application Material</i></p> <ul style="list-style-type: none"> • Consistent with revisions to the first sentence of paragraph A31A, clarified in paragraph A33B that the EQ reviewer may also become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team's procedures or conclusions. In view of these changes, deleted the last sentence in paragraph A33B.
Paragraph 23	<p><i>Application Material</i></p> <ul style="list-style-type: none"> • In response to Board member comments that the application material did not provide further guidance on what to do with respect to unresolved concerns, clarified in paragraph A35 that the firm's policies or procedures may, with respect to such unresolved concerns, also require consultation within or outside the firm (e.g., a professional or regulatory body).
Documentation	
Paragraph 27	<p><i>Application Material</i></p> <ul style="list-style-type: none"> • Clarified in paragraph A39 that the documentation of the EQ review may be '<i>finalized</i>' (emphasis added) after the date of the engagement report, but before the assembly of the final engagement file. However, in response to comments from some Board members that the documentation of the EQ review should be completed by the date of the engagement report, the Task Force added a sentence indicating that firm policies or procedures may specify that the documentation of the EQ review needs to be finalized on or before the date of the engagement report. The Task Force considers that this provides sufficient flexibility for firms in establishing policies or procedures.