

This paper is a marked draft of the requirements and related application material on engagements subject to an engagement quality (EQ) review in proposed ISQM 1,¹ which incorporates the proposed changes made by the ISQM 2 Task Force in response to the comments received during the April 1, 2020 IAASB videoconference, including the written comments received, and further coordination with the ISQM 1 Task Force.

REQUIREMENTS AND RELATED APPLICATION MATERIAL ON ENGAGEMENTS SUBJECT TO AN EQ REVIEW IN PROPOSED ISQM 1

(MARKED FROM APRIL 1, 2020)

Requirements

~~41A34~~. In designing and implementing responses, ~~the firm shall include the following responses~~ in accordance with paragraph ~~22F26~~ and in order to achieve the quality objectives, ~~the firm shall include the following responses~~: (Ref: Para. ~~A153AA116~~)

...

- (~~ef~~) The firm establishes policies or procedures ~~that~~ addressing engagement quality reviews in accordance with ~~[proposed]~~ ISQM 2, and ~~requiring-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. ~~A153HA133~~)
 - (iii) Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to ~~address one or more assessed~~ quality risk(s). (Ref: Para. ~~A153IA134-A153KA137~~)

Application and Other Explanatory Material

Engagements Subject to an Engagement Quality Review (~~Ref: Para. 41A(e)~~)

Engagement Quality Review Required by Law or Regulation (Ref: Para. ~~41A34~~(~~ef~~)(ii))

~~A153HA133~~. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that:

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

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*

- 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~~ Address One or More Quality Risk(s) (Ref: Para. ~~41A34~~(ef)(iii))

~~A153~~A134. ~~When identifying and assessing quality risks, The conditions, events, circumstances, actions or inactions understood by the firm in accordance with paragraph 22E25(a)(ii) requires the firm to understand factors relating relate~~ to the nature and circumstances of ~~the firm and the~~ engagements performed by the firm ~~that may adversely affect the achievement of its quality objectives~~. In designing and implementing responses ~~to address assessed quality risks, the firm may determine that an engagement quality review is an appropriate response that is based on, and responsive to, the reasons for the assessments given to the quality risks arising from certain conditions, events, and circumstances, actions or inactions may lead the firm to determine that an engagement quality review (i.e., an objective evaluation of significant judgments made by the engagement team and the conclusions reached thereon) is the appropriate response.~~

Examples of ~~such conditions, events, and circumstances, actions or inactions giving rise to one or more quality risk(s) for which an engagement quality review may be an appropriate response~~ include:

Conditions and circumstances ~~Those~~ relating to the types ~~and characteristics~~ of engagements performed by the firm and reports to be issued:

- Engagements that involve a high level of complexity or judgment, such as:
 - Audits of financial statements for entities 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 entities for which uncertainties exist related to events or conditions that may cast significant doubt on their ability to continue as a going concern.
 - Assurance engagements that require 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).
- Engagements on which issues have been encountered, 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.
- Engagements for which unusual circumstances have been identified during the firm's acceptance and continuance process (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).
- Engagements 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.

Conditions and circumstances ~~Those~~ relating to the types of entities for which engagements are undertaken:

- Entities in emerging industries ~~or that involve emerging technologies~~, or for which the firm has no previous experience.
- ~~Entities for which concerns were expressed in communications from securities or prudential regulators.~~
- Entities other than listed entities, which may have public interest considerations or public accountability characteristics, for example:
 - ~~Entities with public interest or public accountability characteristics, such as e~~Entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders including financial institutions, such as certain banks, insurance companies, and pension funds for which an engagement quality review is not otherwise required by law or regulation.
 - Entities with a high public profile, or whose management or owners have a high public profile.
 - Entities with a large number or diverse range of shareholders.

~~A153JA135. [Moved before paragraph A153J] The firm also may determine that responses other than an engagement quality review are appropriate to respond to assessed quality risks. In these circumstances, the firm may design and implement other types of responses, including The firm's responses to address quality risks may include other forms of engagement reviews that are not an engagement quality reviews. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures relating to significant risks, or reviews of certain significant judgments, by individuals within the firm who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.~~

~~A153JA136. In some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review or another form of engagement review is an appropriate response to address the quality risk(s) appropriate as a response to assessed quality risks (e.g., when other responses to assessed quality risks are determined by the firm to be appropriate).~~

Public sector considerations

~~A153KA137. The firm may identify and assess determine that an engagement quality review is appropriate as a response to assessed quality risks for specific to larger public sector entities due to their size and complexity, the range of their stakeholders, or the nature of the services they provide. In these circumstances, the firm may determine that an engagement quality review is an appropriate response to address such quality risk(s) (for example, utilities, hospitals or universities) based on the social or economic influence on the community or region in which the entity operates. Another consideration for public sector engagements is whether law or regulation may establishes additional reporting requirements for a public sector entity (e.g., a separate report on instances 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). In such cases, the firm may also consider the importance to users of that reporting in identifying and assessing quality risks and determining whether an engagement quality review is an appropriate response.~~