

# Agenda Item 3-E

## Discussion of Changes to the Requirements and Related Application Material

This paper presents the rationale for changes to the requirements and related application material for engagements subject to an engagement quality (EQ) review in proposed ISQM 1<sup>1</sup> (as reflected in **Agenda Item 3-C**), and in proposed ISQM 2<sup>2</sup> (as reflected in **Agenda Item 3-D**).

Reference	Changes and the Rationale for Those Changes
<b>Engagements Subject to an EQ Review in Proposed ISQM 1</b>	
<b>Paragraph 34(f)</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:               <ul style="list-style-type: none"> <li>○ Replaced the words “addressing / requiring” to “address / require” in paragraph 34(f) to be consistent with the verb form used (i.e., present participle to present tense form) when referring to specified responses in proposed ISQM 1.</li> <li>○ Changed “assessed quality risks” to “address one or more quality risk(s)” in paragraph 34(f)(iii), the sub-heading above paragraph A134 and the lead-in to the boxed example under paragraph A134 to align with the definition of the term “response (in relation to a system of quality management)” in paragraph 16(u) of proposed ISQM 1.</li> </ul> </li> </ul>
	<p><i>Application Material - Paragraph A134</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:               <ul style="list-style-type: none"> <li>○ Replaced the term “factors” in paragraph A134 and the term “conditions and circumstances” in the lead-in of the boxed example under paragraph A134 with “conditions, events, circumstances, actions or inactions” to align with full term used in paragraph 25(a) of proposed ISQM 1 when referring to such conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality</li> </ul> </li> </ul>

<sup>1</sup> 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*

<sup>2</sup> Proposed ISQM 2, *Engagement Quality Reviews*

Reference	Changes and the Rationale for Those Changes
	<p>objectives.</p> <ul style="list-style-type: none"> <li>○ Clarified in paragraph A134 that in designing and implementing responses to one or more quality risk(s), the firm may determine that an EQ review is an appropriate response that is <i>based on, and responsive to, the reasons for the assessments given to the quality risks</i> (emphasis added) arising from certain <i>conditions, events, circumstances, actions or inactions</i> (emphasis added). This clarification is aligned with the wording used in: <ul style="list-style-type: none"> <li>- Paragraph 26 of proposed ISQM 1 (i.e., based on, and responsive to, the reasons for the assessments given to the quality risks); and</li> <li>- Paragraph 25(a) of proposed ISQM 1 (i.e., conditions, events, circumstances, actions or inactions).</li> </ul> </li> </ul>
	<p><i>Application Material – Boxed Example in Paragraph A134</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Deleted the term “conditions and circumstances” from the two lead-ins that describe the nature and circumstances of the engagements performed by the firm to align with the wording used in: <ul style="list-style-type: none"> <li>- Paragraph 25(a)(ii)a (i.e., the types of engagements performed by the firm and the reports to be issued); and</li> <li>- Paragraph 25(a)(ii)b (i.e., the types of entities for which such engagements are undertaken).</li> </ul> </li> </ul> </li> <li>• In response to a Board comment, removed the reference to “emerging technologies” from the boxed example in paragraph A134 of proposed ISQM 1 as an appropriate response for such engagements that involve emerging technologies may likely be the use of a subject matter expert than an EQ review. Removing these words also makes the reference to “emerging industries” in the boxed example consistent with the first bullet of paragraph A30 of proposed ISQM 2.</li> <li>• In response to a Board comment, added a new lead-in clarifying that the last three bullets in the boxed example are entities other than listed entities, which may have public interest considerations or public accountability characteristics.</li> </ul>
	<p><i>Application Material - Paragraph A135</i></p> <ul style="list-style-type: none"> <li>• To improve the flow of the application material, moved paragraph before paragraph A136. The Task Force determined that it is more logical to discuss responses other than an EQ review before discussing circumstances when the firm may determine that there are no audits or other engagements for which an EQ review or another</li> </ul>

Reference	Changes and the Rationale for Those Changes
	<p>form of engagement review is an appropriate response to address the quality risk(s).</p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Shortened paragraph A135 for clarity.</li> </ul> </li> </ul>
	<p><i>Application Material - Paragraph A136</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Clarified in paragraph A136 that in some cases, the firm may determine that there are no audits or other engagements for which an EQ review or another form of engagement review is an appropriate response to address the quality risk(s). Consequently, deleted the last part of the paragraph.</li> </ul> </li> </ul>
	<p><i>Application Material - Paragraph A137</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ To align with the firm’s risk assessment process in proposed ISQM 1: <ul style="list-style-type: none"> <li>- Clarified (in the first and second sentences of paragraph A137) that the firm may identify and assess quality risks specific to public sector entities, and therefore may determine that an EQ review is an appropriate response.</li> <li>- Added a fourth sentence in paragraph A137 clarifying that when a public sector entity has additional reporting requirements, the firm may also consider the importance to users of that reporting in identifying and assessing quality risks and determining whether an EQ review is an appropriate response.</li> </ul> </li> </ul> </li> <li>• In response to a Board comment, deleted the word “larger” before public sector (in the first sentence of paragraph A137) to avoid any implication that the guidance only applies to “larger” public sector entities.</li> <li>• Further clarified (in the first sentence of paragraph A137) that the firm may identify and assess quality risk(s) for public sector entities due to their size and complexity, the range of their stakeholders or the nature of the services they provide. Consequently, deleted the last part of the second sentence.</li> <li>• Simplified and streamlined the wording in the third sentence of paragraph A137 in response to editorial suggestions.</li> </ul>

Reference	Changes and the Rationale for Those Changes
<b>Proposed ISQM 2</b>	
<b>Introduction</b>	
<b>Scope of this ISQM</b>	
<b>Paragraph 2</b>	<ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:               <ul style="list-style-type: none"> <li>○ Added a new sentence at the end of paragraph 2 to align with the matters covered in the “scope” of the standard in paragraph 4 of proposed ISQM 1 and paragraph 1 of proposed ISA 220 (Revised).</li> </ul> </li> </ul>
<b>The Firm’s System of Quality Management and Role of Engagement Quality Reviews</b>	
<b>Paragraph 5</b>	<ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:               <ul style="list-style-type: none"> <li>○ Deleted the word “assessed” when referring to the term “quality risks” in paragraph 5 to align with the deletion in paragraph 26 of proposed ISQM 1.</li> </ul> </li> </ul>
<b>Paragraph 6</b>	<ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:               <ul style="list-style-type: none"> <li>○ Made changes to the lead-in of paragraph 6 to align with the wording in paragraph 2 of proposed ISA 220 (Revised).<sup>3</sup></li> </ul> </li> </ul>
<b>Paragraph 7</b>	<ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:               <ul style="list-style-type: none"> <li>○ Changed the wording in paragraph 7 to add a reference to proposed ISQM 1, and to align with the term used in the last sentence of paragraph 15 of proposed ISQM 1 (i.e., ...when applicable to the <i>type</i> (emphasis added) of engagement, exercising professional skepticism). The terminology change is also consistent with the requirement in paragraph 25(c)(i) of proposed ISQM 2.</li> </ul> </li> </ul>

<sup>3</sup> [Proposed] International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

Reference	Changes and the Rationale for Those Changes
<b>Authority of this ISQM</b>	
<b>Paragraph 10</b>	<ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:                             <ul style="list-style-type: none"> <li>○ Replaced the word “it” with “this ISQM” in the second sentence of paragraph 10 to align with the wording used in paragraph 12 of proposed ISQM 1 (i.e., Authority of this ISQM) .</li> </ul> </li> </ul>
<b>Effective Date</b>	
<b>Paragraph 11</b>	<ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:                             <ul style="list-style-type: none"> <li>○ Replaced the word “and” with “or” in paragraph 11(a) to align with the wording used in proposed ISQM 1.</li> <li>○ Added the proposed effective date (i.e., December 15, 2022).</li> </ul> </li> </ul>
<b>Definitions</b>	
<b>Paragraph 13</b>	<ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:                             <ul style="list-style-type: none"> <li>○ Replaced the words “in this ISQM” with “for purposes of this ISQM” in the lead-in of paragraph 13 to align with the wording used in paragraph 16 of proposed ISQM 1 and paragraph 12 of proposed ISA 220 (Revised).</li> <li>○ Replaced the term “<i>an</i> engagement quality review” with “<i>the</i> engagement quality review” in paragraph 13(c) to align with the wording used in paragraph 12(k) of proposed ISA 220 (Revised) (i.e., “<i>the</i> audit engagement”).</li> <li>○ Added a reference to paragraphs A12-A15 as relevant application material to the definition of “relevant ethical requirements” in paragraph 13(c). This approach is aligned with proposed ISQM 1 that includes application material (i.e., paragraphs A23–A25) to its definition of “relevant ethical requirements” (i.e., paragraph 16(t)). In the case of proposed ISQM 2, paragraphs A12-A15 also provide examples of relevant ethical requirements to individual professional accountants, such as an EQ reviewer.</li> </ul> </li> </ul>

Reference	Changes and the Rationale for Those Changes
<b>Requirements</b>	
<b>Appointment and Eligibility of EQ Reviewers</b>	
<b>Paragraph 17</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• In response to Board comments, changed the first sentence of paragraph A3 because a firm may have more than one individual responsible for appointing EQ reviewers for similar types of engagements (i.e., not necessarily for different types of engagements).</li> </ul>
<b>Paragraph 18</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Replaced the words “external individual(s)” with “individual(s) external to the firm” in paragraph A4 to align with wording used in paragraph A22 of proposed ISQM 1 (i.e., individuals external to the firm).</li> <li>○ Clarified in paragraph A4 that an external EQ reviewer may be a partner or an employee of another firm, structure or organization within the firm’s network or a service provider to align with the wording used in paragraph A19 of proposed ISQM 1 that describes how networks and the firms within the network may be structured.</li> <li>○ Further clarified in paragraph A4 that when using such an individual external to the firm, provisions in proposed ISQM 1 addressing network requirements or network services or service providers apply.</li> </ul> </li> </ul>
<b>Paragraph 18(a)</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• In response to a Board comment, deleted the words “related to the nature and circumstances of the engagement or the entity” in the second sentence of paragraph A5 as the matters outlined in the bullets that follow do not necessarily relate to the nature and circumstances of the engagement or the entity.</li> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Replaced the term “factors” in paragraph A6 with “conditions, events, circumstances, actions or inactions” to align with the full term used in paragraph 25(a) of proposed ISQM 1 when referring to such conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality objectives.</li> <li>○ Changed “assessed quality risks” to “address one or more quality risk(s)” in paragraph A6 to align with the changes in paragraph 34(f)(iii) of proposed ISQM 1 as noted above.</li> </ul> </li> </ul>

Reference	Changes and the Rationale for Those Changes
	<ul style="list-style-type: none"> <li>○ Added “engagement-level” when referring to “findings,” and deleted “in-process or completed” when referring to “inspection of engagements” in paragraph A7 to align with the wording used in paragraph A17 of proposed ISQM 1.</li> </ul>
<b>Paragraph 18(b)</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• In response to editorial suggestions, changes were made to paragraph A12.</li> <li>• In consultation with IESBA Representatives and Staff, made changes in paragraph A15 to align with the proposed revisions to the IESBA Code relating to the objectivity of EQ reviewers, now broadened to cover “appropriate reviewers” as defined in the IESBA Code.</li> </ul>
<b>Paragraph 20(a)</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Deleted the words “either internal or external” when referring to the term “individual” or “individuals” in paragraph A19. This aligns with the broader reference in proposed ISQM 1 to “individual” or “individuals” as being internal or external to the firm.</li> </ul> </li> </ul>
<b>Paragraph 20(b)</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Replaced the words “external individual” with “individual external to the firm” in paragraph A21 to align with wording used in paragraph A22 of proposed ISQM 1 (i.e., individuals external to the firm).</li> </ul> </li> </ul>
<b>Paragraph 21(b)</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Deleted the words “work of” in paragraph 21(b) of proposed ISQM 2 to align with the wording used in paragraph 31(b) of proposed ISQM 1 and the construct used in paragraph 29 of proposed ISA 220 (Revised).</li> </ul> </li> </ul>
<b>Performance of the EQ Review</b>	
<b>Paragraph 25</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Added a footnote to paragraph A49 of proposed ISQM 1 in the first bullet in paragraph A30 to clarify that</li> </ul> </li> </ul>

Reference	Changes and the Rationale for Those Changes
	<p>the reasons for the assessments given to quality risks may affect the nature and extent of the EQ reviewer's procedures.</p> <ul style="list-style-type: none"> <li>○ Replaced "findings arising from the firm's monitoring activities" with "identified deficiencies and the remedial actions to address the identified deficiencies related to the firm's monitoring and remediation process" in the second bullet in paragraph A30 to align with the matters to be communicated by the firm in accordance with paragraph 47 of proposed ISQM 1.</li> <li>○ Replaced "other information relevant to the engagement" with "findings relevant to the engagement" in the fifth bullet in paragraph A30 to align with the definition of the term "findings (in relation to a system of quality management)" in paragraph 16(h) of proposed ISQM 1.</li> <li>○ Clarified in the sixth bullet in paragraph A30 that it is the information obtained from the firm's acceptance and continuance of client relationships and specific engagements that influences the nature and extent of the EQ reviewer's procedures. In addition, deleted the words "which may indicate new risks to achieving quality for an engagement" as it may be construed as identifying and assessing quality risks at the engagement level.</li> <li>○ Replaced "consideration of, and responses to, risks of material misstatement in the engagement" with "identification and assessment of, and responses to, risks of material misstatement in the engagement" in the seventh bullet in paragraph A30 to align with the wording used in ISA 315 (Revised 2019).<sup>4</sup></li> </ul>
<b>Paragraph 25(a)(ii)</b>	<p><i>Requirement</i></p> <ul style="list-style-type: none"> <li>● Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Clarified in paragraph 25(a)(ii) that the EQ reviewer shall read, and obtain an understanding of, information communicated by the firm related to the firm's monitoring and remediation process, in particular identified deficiencies that may relate to, or affect, the areas involving significant judgments made by the engagement team. This is aligned with the wording used in paragraph 39(a) of proposed ISA 220 (Revised) (i.e., firm's monitoring and remediation process).</li> </ul> </li> </ul> <p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>● Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Clarified in the third sentence of paragraph A34 that a deficiency identified by the firm may relate to</li> </ul> </li> </ul>

<sup>4</sup> ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

Reference	Changes and the Rationale for Those Changes
	<p>significant judgments made by engagement teams.</p> <ul style="list-style-type: none"> <li>• In response to Board comments, clarified in the last sentence of paragraph A34 that when such information (i.e., deficiency) is expected to be relevant to the significant judgments made on the engagement, it may provide the EQ reviewer with a basis for discussions with the engagement team in accordance with paragraph 25(b).</li> </ul>
<b>Paragraph 25(b)</b>	<p><i>Requirement and Application Material</i></p> <ul style="list-style-type: none"> <li>• In response to a Board comment, deleted the word “concluding” in paragraph 25(b) and in the relevant application material in paragraphs A29 and A34 as it could be read as concluding or ending the engagement. It was noted that drawing conclusions is part of the planning, performing and reporting stages of the engagement.</li> </ul>
<b>Paragraph 25(c)</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• In response to a Board comment, deleted the words “based on information obtained in paragraphs 25(a) and 25(b)” in the first bullet of paragraph A39 as it is viewed as duplicative of the requirement in paragraph 25(c). It was noted that “remaining alert” in this case may not necessarily be limited to the information obtained in paragraphs 25(a) and 25(b).</li> <li>• To be consistent with the order of a similar application material in ED-600,<sup>5</sup> moved paragraph A31Cb (now renumbered as paragraph A42) before paragraph A31Ca (now renumbered as paragraph A43).</li> </ul>
<b>Paragraph 25(e)</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards: <ul style="list-style-type: none"> <li>○ Clarified in paragraph A45 that proposed ISQM 1 addresses consultation on difficult or contentious matters and differences of opinion within the engagement team, or between the engagement team and the EQ reviewer or individuals performing activities within the firm’s system of quality management (e.g., assistant EQ reviewers or personnel responding to a consultation). This is aligned with paragraphs 31(d) and 31(e) of proposed ISQM 1.</li> </ul> </li> </ul>
<b>Paragraph 25(f)</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• In response to a Board comment, aligned the last sentence of paragraph A46 with the requirement in paragraph 25(f) by clarifying that the discussion with the engagement team, and review of such engagement documentation, may assist the EQ reviewer’s evaluation of the <i>basis for the engagement partner’s determination that the</i></li> </ul>

<sup>5</sup> ED, Proposed ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Reference	Changes and the Rationale for Those Changes
	<i>engagement partner's involvement has been sufficient and appropriate</i> (emphasis added).
<b>Documentation</b>	
<b>Paragraph 28</b>	<p><i>Application Material</i></p> <ul style="list-style-type: none"> <li>• Changes arising from the cross-review of drafts of the three quality management standards:                             <ul style="list-style-type: none"> <li>○ Clarified in paragraph A50 that paragraphs 57 to 60 of proposed ISQM 1 address the firm's documentation of its system of quality management. Hence, an EQ review is subject to the documentation requirements in proposed ISQM 1.</li> </ul> </li> </ul>