Proposed ISQM 2: Analysis of Due Process Related to Re-Exposure

Overview

1. If the Board votes to approve proposed ISQM 2, then a separate vote of the Board is required on whether the standard should be re-exposed. Based on the changes proposed in Agenda Item 3-D, and prior to any changes proposed at the September 2020 IAASB meeting, the ISQM 2 Task Force (the Task Force) believes that proposed ISQM 2 does not warrant re-exposure.

2. This paper sets out the Task Force’s analysis of the provisions of the due process related to whether an approved standard needs to be re-exposed.

What Does the Due Process Require?

3. Appendix A to this paper includes relevant extracts from the IAASB’s due process. The principal consideration in the due process is “whether there has been substantial change to the exposed document such that re-exposure is necessary.” The related working procedures, which support the due process, include three examples of situations that may constitute potential grounds for a decision to re-expose:

   - Substantial change to a proposal arising from matters not aired in the exposure draft (ED) such that commentators have not had an opportunity to make their views known to the IAASB before it reaches a final conclusion;
   - Substantial change arising from matters not previously deliberated by the IAASB; or
   - Substantial change to the substance of a proposed international pronouncement.

4. The Task Force notes that there will almost always be changes to standards between an ED and the final standard to be appropriately responsive to comments received on exposure, and this is true for proposed ISQM 2. In forming its view on re-exposure, the Task Force has considered the reasons for re-exposure set out above and focused on these in determining its views for the purpose of this paper.

Considerations Relevant to the Development of the Task Force’s View on Re-Exposure

Key Elements Addressed in ED-ISQM 2

5. The key elements addressed in the ED of proposed ISQM 2 (ED-ISQM 2) were highlighted in the Explanatory Memorandum to ED-ISQM 2. These included:

   (a) Extending the requirement for an engagement quality (EQ) review to engagements in addition to audits of financial statements.
   (b) Enhancing the eligibility criteria for an individual to be appointed as an EQ reviewer.

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1 Proposed International Standard on Quality Management (ISQM) 2, Engagement Quality Reviews
2 ED, Proposed ISQM 2, Engagement Quality Reviews
3 Explanatory Memorandum to ED-ISQM 2, paragraph 3
6. The requirements for EQ reviews currently reside in extant ISQC 1 and ISA 220. The basis for developing a separate standard for EQ reviews was included in paragraphs 11-13 of the explanatory memorandum to ED-ISQM 2. The IAASB agreed that since the EQ review is an appropriate response to address a quality risk(s), ED-ISQM 1 should address the circumstances in which an EQ review should be performed. ED-ISQM 2 addresses the specific requirements for the appointment and eligibility of the EQ reviewer and the performance and documentation of the review.

Respondent Comments to the Scope of Engagements Subject to an EQ Review in ED-ISQM 1

7. With respect to the requirements relating to the scope of engagements subject to an EQ review, respondents to ED-ISQM 1 generally supported the proposals. However, respondents raised concerns that principally related to the new requirement for the firm’s policies or procedures to require an EQ review for audits of financial statements of entities that the firm determines are of significant public interest (SPI). Respondents were of a view that the concept of SPI cannot be consistently interpreted, and therefore may be confusing or may result in inconsistent application of the requirements.

Respondent Comments to the Eligibility Criteria of the EQ Reviewer in ED-ISQM 2

8. With respect to the requirements relating to the eligibility criteria for an individual to be appointed as the EQ reviewer, respondents to ED-ISQM 2 generally agreed that objectivity of the EQ reviewer is critical to the effectiveness of the EQ review (i.e., to provide a basis for an objective evaluation of the significant judgments made by the engagement team). However, respondents raised concerns that principally related to:

(a) The need for guidance or a requirement on a cooling-off period, particularly for an individual being appointed as the EQ reviewer after previously serving as the engagement partner; and

(b) The location of the guidance or the requirement (i.e., whether it should be located in proposed ISQM 2, or the IESBA Code, or in both).

Consideration of Nature and Extent of Changes Post-ED

9. The Task Force thoroughly considered these concerns in developing and arriving at the drafts of the scope of engagements subject to an EQ review in proposed ISQM 1, and proposed ISQM 2, as presented in Agenda Items 3-A and 3-B, respectively. In doing so, the Task Force made changes to address the concerns, while at the same time retaining the key elements highlighted in paragraph 5.

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4 International Standard on Quality Control (ISQC) 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements and Related Services Engagements

5 International Standard on Auditing (ISA) 220, Quality Control for an Audit of Financial Statements

6 ED, Proposed ISQM 1 (Previously ISQC 1), Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements

7 For more details, see Agenda Item 7 of the September 2019 IAASB meeting, paragraphs 11-18.

8 For more details, see Agenda Item 7 of the September 2019 IAASB meeting, paragraphs 30-46.

9 International Ethics Standards Board for Accountants (IESBA), International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code)
above, with modifications to these elements to address respondents’ specific comments on these areas. To facilitate an understanding of the changes post-ED:

(a) Paragraphs 10-13 of this paper provide an explanation of the post-ED changes to the requirements in proposed ISQM 1 relating to the scope of engagements subject to an EQ review.

(b) Paragraphs 14-17 of this paper provide an explanation of the post-ED changes to the requirements in proposed ISQM 2 relating to the eligibility criteria for an individual appointed as EQ reviewer after previously serving as the engagement partner.

(c) Agenda Item 3-E provides an explanation of the relevant changes made to the proposed ISQMs since the EDs.

(d) Agenda Item 3-G compares, in a tabular form, the requirements relating to engagements subject to an EQ review in ED-ISQM 1 and in the final draft of proposed ISQM 1, as presented in Agenda Item 3-A.

(e) Agenda Item 3-H compares, in a tabular form, the requirements in ED-ISQM 2 and in the final draft of proposed ISQM 2, as presented in Agenda Item 3-B.

Post-ED Changes to Requirements Relating to the Scope of Engagements Subject to an EQ Review in Proposed ISQM 1"10

10. Post-ED, the Board further considered whether it would be possible to define SPI and determined that the global jurisdictional implications or barriers would be difficult to overcome because of the disparity of the factors or characteristics ascribed to SPIs in different jurisdictions or regions.

11. The Board also further considered requiring EQ reviews to be performed on certain engagements based on various criteria relating to the nature and circumstances of the engagement or the entity, which may be for reasons other than addressing one or more quality risk(s). However, the Board is generally of a view that requiring an EQ review in response to reasons that are not risk-based is inconsistent with, and may be viewed as undermining, the principle of a risk-based approach in proposed ISQM 1.

12. As part of a firm’s risk assessment process in identifying and assessing quality risks to provide a basis for the design and implementation of responses, the firm is required to obtain an understanding of the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality objectives, including with respect to the nature and circumstances of the engagements performed by the firm. Therefore, it becomes more challenging to explain how a category of "due to the nature and circumstances of the engagement or the entity" would differ from

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10 See the following agenda materials for more details of the issues and recommendations put forth by the Task Force, and the corresponding minutes of meetings for the summary of the Board decisions made at those meetings:

(a) Agenda Item 7 of the September 2019 IAASB meeting, and the approved minutes of the September 2019 IAASB meeting;
(b) Agenda Item 8 of the December 2019 IAASB meeting, and the approved minutes of the December 2019 IAASB meeting;
(c) Agenda Item 5 of the March 2020 IAASB meeting, and the approved minutes of the March and April 2020 IAASB meetings; and
(d) Agenda Item 8-A of the June 2020 IAASB meeting and the draft minutes of the June 2020 IAASB meeting.
the category of engagements for which an EQ review is an appropriate response to address one or more quality risk(s).

13. Accordingly, the separate category of entities subject to an EQ review based on the firm's determination of the entity being of SPI, or due to the nature and circumstances of the engagement or the entity, was absorbed into the broader category of engagements for which the firm determines an EQ review is an appropriate response to address one or more quality risk(s).

Post-ED Changes to the Requirements Relating to the Eligibility Criteria of an EQ Reviewer in Proposed ISQM 2

14. Post-ED, the Board considered the need for guidance or a requirement on a cooling-off period, particularly for an individual being appointed as the EQ reviewer after previously serving as the engagement partner. Consistent with respondent comments to ED-ISQM 2, the Board was generally of the view that the objectivity of the EQ reviewer is an important aspect of the requirements regarding the eligibility of that individual to be appointed to that role by the firm. It is the separation from the previous involvement in making significant judgments as the engagement partner that is necessary for the EQ reviewer to objectively evaluate the significant judgments made by the engagement team and the conclusions reached thereon.

15. The Board also further considered whether the mandatory cooling-off requirement should apply to all engagements for which an EQ review is performed. The Board was generally of a view that threats to the objectivity of an engagement partner stepping into the role of EQ reviewer are not unique to audits of listed entities only, or to the type of engagement. In reaching this conclusion, the Board noted that other than for audits of listed entities, or when required by law or regulation, EQ reviews are not mandated for other engagements, and the firm may select responses other than an EQ review to address one or more quality risk(s), if appropriate. However, when an EQ review is required or has been determined by the firm to be the appropriate response, then the same requirements should apply in all cases. The Board was generally of a view that a conditional requirement would create a perception of different levels of EQ review for different types of engagements, which could lead to inconsistent application in practice and potential confusion in the minds of stakeholders, and therefore would not be in the public interest.

16. Accordingly, proposed ISQM 2 includes a requirement for the firm's policies or procedures to specify a cooling-off period of two years, or a longer period if required by relevant ethical requirements, before an engagement partner can assume the role of EQ reviewer, which applies to all engagements subject to an EQ review in proposed ISQM 1.

17. Throughout the course of the project, the Board has extensively deliberated this matter in close coordination with IESBA Representatives and Staff. After giving the matter due consideration, the IESBA considers that it would be more appropriate for the IAASB to determine whether a cooling-off

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(a) Agenda Item 7 of the September 2019 IAASB meeting, and the approved minutes of the September 2019 IAASB meeting;
(b) Agenda Item 8 of the December 2019 IAASB meeting, and the approved minutes of the December 2019 IAASB meeting;
(c) Agenda Item 5 of the March 2020 IAASB meeting, and the approved minutes of the March and April 2020 IAASB meetings; and
(d) Agenda Item 8-A of the June 2020 IAASB meeting and the draft minutes of the June 2020 IAASB meeting.
requirement should be included in proposed ISQM 2, taking into account the guidance set out in the proposed revisions to the IESBA Code and, if so, the circumstances in which the requirement should apply, to whom it should apply, and what the minimum cooling-off period should be.\textsuperscript{12} This position was reconfirmed at the June 2020 IESBA meeting, and at a coordination meeting on August 6, 2020 involving the respective IAASB and IESBA Task Force Chairs and Staff.

**Task Force Views on Whether the Changes Necessitate Re-Exposure**

18. The Task Force considered the major changes in the relevant requirements since ED (as shown in the tabular comparisons in **Agenda Items 3-G and 3-H**) and made the following observations:

   (a) There are no substantial changes to the key elements of the project. All the key elements of, the scope of engagements subject to an EQ review in ED-ISQM 1, and ED-ISQM 2 have been retained. Some of these elements have been modified and clarified in response to comments received on exposure, but have not altered the key elements of the proposed ISQMs, nor have they resulted in a departure from the project objectives.

   (b) No new concepts have been introduced.

   (c) The changes to the text post-exposure are in response to feedback from respondents to the ED and do not fundamentally or substantively change the proposals in the ED.

19. Furthermore, the Task Force is of the view that re-exposing proposed ISQM 2 will not result in new information or concerns that have not been aired already through the comment letters on ED-ISQM 2 or the subsequent outreach and consultation activities as presented in **Appendix B** to this paper.

20. On the basis of the above, the Task Force believes that re-exposure is not necessary. All of the members of the Task Force are in agreement with this conclusion.

\textsuperscript{12} Explanatory Memorandum to the ED, *Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers*, paragraph 17. The ED comment period closed on March 16, 2020.
Relevant Extracts from the IAASB’s Due Process

The matter of re-exposure is addressed in the IAASB’s Due Process and Working Procedures, paragraphs 23 and A40-A42.

23. After approving the final revised content of an exposed international pronouncement, the PIAC\textsuperscript{13} votes on whether there has been substantial change to the exposed document such that re-exposure is necessary. An affirmative vote in accordance with the PIAC’s terms of reference that re-exposure is necessary is required to issue a re-exposure draft. The basis of the PIAC’s decisions with respect to re-exposure is recorded in the minutes of the PIAC meeting at which the related project is discussed. (Ref: Para. A40-A42)

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Re-Exposure (Ref: Para. 23)

A40. When an exposure draft has been subject to many changes, a summary comparative analysis is presented to the PIAC. This analysis shows, to the extent practicable, the differences between the exposure draft and the proposed final international pronouncement.

A41. The senior staff member of the PIAC, in consultation with the Chair of the PIAC and chair of the Project Task Force, advises the PIAC on whether a draft international pronouncement, or part thereof, needs to be re-exposed.

A42. Situations that constitute potential grounds for a decision to re-expose may include, for example: substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the PIAC before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the PIAC; or substantial change to the substance of a proposed international pronouncement.

\textsuperscript{13} Public Interest Activity Committee, i.e. the IAASB.
Appendix B

Outreach and Consultation Activities
After Closure of Comment Period on ED-ISQM 2

In addition to regular updates to the IAASB’s Consultative Advisory Group (September 2019, March 2020 and September 2020), the following outreach was undertaken after the closure of the comment period on ED-ISQM 2 (i.e., since July 2019):

Q3 of 2019:

- Presentation at the DFK International and Asia Pacific Annual Conference
- Presentation at the South African Institute of Professional Accountants'
- Presentation to the Basel Committee on Banking Supervision’s Audit Subgroup Members
- Meeting with U.S. Public Company Accounting Oversight Board Representatives
- Meeting with Center for Audit Quality Representatives
- Meeting with U.S. Securities and Exchange Commission Representatives
- Meeting with the International Organization of Securities Commissions’ Committee on Issuer Accounting, Audit and Disclosure
- Presentation at Crowe’s Americas Regional Conference
- Presentation at the Quarterly Accountancy Europe Audit and Assurance Policy Group Meeting

Q4 of 2019

- Meeting with the U.S. Auditing Standards Coordinating Forum at the Government Accountability Office
- Presentation at the Small and Medium Practices Committee Meeting
- Presentation at the Russell Bedford International Annual Global Conference
- Participation at the Hong Kong Institute of Certified Public Accountants’ Annual Auditing Update Conference
- Presentation at the PFK Conference: Elevating the Client Experience: “Taking the PKF Way to the Next Level”
- Presentation at the Committee of European Auditing Oversight Bodies’ SSG ISG Meeting
- Meeting with Shanghai Securities Regulatory Bureau and Shanghai Stock Exchange Representatives
- Meeting with China Securities Regulatory Commission Representatives
- Observer at the China Securities Regulatory Commission Meeting
- Panel Participation at the U.S. Public Company Accounting Oversight Board Annual International Institute on Audit Regulation Conference
• Meeting with Chinese Institute of Certified Public Accountants Representatives

Q1 of 2020
• Meeting with Chinese Institute of Certified Public Accountants Representatives
• Presentation to Members of CPA Australia
• Meeting with Chinese Ministry of Finance Representatives
• Presentation at the International Organization of Securities Commissions’ Committee on Issuer Accounting, Audit and Disclosure Meeting
• Meeting with the Committee In-charge of Responding to the IAASB’s Exposure Drafts at the Compagnie Nationale des Commissaires Aux Comptes
• Presentation to Small and Medium Practices Committee Representatives
• Presentation for Forum of Firms and Global Public Policy Committee Representatives

Q2 of 2020
• Meeting with National Auditing Standards Setters
• Meeting with Global Public Policy Committee Representatives
• Meeting with Representatives from Crowe Global - Americas Region
• Meeting with International Forum of Independent Audit Regulators’ Standards Coordination Working Group and Global Audit Quality Working Group Representatives