

Agenda Item 3

Proposed ISQM 2¹: Issues and Recommendations

Objectives of the IAASB Discussion

The objectives of this Agenda Item are to approve the scope of engagements subject to an engagement quality (EQ) review presented in **Agenda Item 3-A** and proposed ISQM 2 presented in **Agenda Item 3-B**.

Section I – Introduction and Approach to This Paper

1. Since the March and June 2020 IAASB meetings, the ISQM 2 Task Force (the Task Force) has focused on addressing the comments received during the April 1, 2020 IAASB videoconference, including the written comments received, and further coordination with other relevant task forces.²

Appendices and Other Agenda Papers Accompanying this Issues Paper

2. The following appendices and agenda items accompany this paper:

Appendix 1	Overview of the ISQM 2 Task Force's activities, including outreach and coordination with other task forces during the third quarter of 2020
Appendix 2	Extract from the IAASB minutes of meetings – approved for March 2020 and draft for June 2020
Agenda Item 3-A	Draft of the scope of engagements subject to an EQ review (Clean)
Agenda Item 3-B	Draft of proposed ISQM 2 (Clean)
Agenda Item 3-C	Draft of the scope of engagements subject to an EQ review (Tracked changes from April 1, 2020)
Agenda Item 3-D	Draft of proposed ISQM 2 (Tracked changes from April 1, 2020)
Agenda Item 3-E	Discussion of changes to the requirements and related application material
Agenda Item 3-F	Re-exposure paper
Agenda Item 3-G	Table of comparison between the requirements relating to engagements subject to an EQ review in ED-ISQM 1 ³ and the final draft of proposed ISQM 1
Agenda Item 3-H	Table of comparison between the requirements in ED-ISQM 2 ⁴ and the final draft of proposed ISQM 2

Discussions with IESBA Representatives and Staff and Other IAASB Task Forces

3. Discussions were held to update IESBA Representatives and Staff about the changes in the

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

² These include the IAASB's ISQM 1, ISA 220 and ISA 600 Task Forces and the International Ethics Standards Board for Accountants' (IESBA) Engagement Quality Reviewer (EQR) Objectivity Task Force.

³ Exposure Draft (ED), 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*

⁴ ED, Proposed ISQM 2, *Engagement Quality Reviews*

application material relating to the objectivity of EQ reviewers to align with the proposed revision to the IESBA Code⁵ addressing the objectivity of EQ reviewers, now broadened to cover “appropriate reviewers” as defined in the IESBA Code. The changes resulting from these discussions (as reflected in **Agenda Item 3-D**) are explained in **Agenda Item 3-E**.

4. Discussions were held with the ISQM 1 Task Force Chair and Staff about a suggested change to the boxed example under paragraph A134 of proposed ISQM 1 relating to the last three bullets under the types of entities for which engagements are undertaken. The consideration in making the suggested change was clarifying how those types of entities aligned with the fundamental concepts of the firm’s risk assessment process in proposed ISQM 1 (i.e., quality objectives and quality risks). The changes resulting from these discussions (as reflected in **Agenda Item 3-C**) are explained in **Agenda Item 3-E**.

Structure of the Board Discussion

5. At the virtual Board session on September 16, 2020, the Task Force Chair will present the agenda items in the following order:
 - (a) The revised draft of the requirements and related application material in proposed ISQM 1 on engagements subject to an EQ review. The Task Force has provided the clean and marked drafts of the scope of engagements subject to an EQ review in **Agenda Items 3-A** and **3-C**, respectively. The Task Force Chair will refer to the marked draft, **Agenda Item 3-C**, as the basis for discussion.
 - (b) The revised draft of proposed ISQM 2. The Task Force has provided the clean and marked drafts of proposed ISQM 2 in **Agenda Items 3-B** and **3-D**, respectively. The Task Force Chair will refer to the marked draft, **Agenda Item 3-D**, as the basis for discussion.
 - (c) The Task Force Chair will walk through the revised drafts in sections and will take comments on the requirements together with the related application material as noted in the table below. In walking through the revised drafts, the Task Force Chair will refer to the changes to requirements and related application material as described in **Agenda Item 3-E**.

Sections of the Standard	Requirements	Application Material
<i>Engagements Subject to an EQ Review in Proposed ISQM 1</i>	Paragraph 34(f)	Paragraphs A133–A137
<i>Proposed ISQM 2</i>		
Introduction, Objective, Definitions, Applying, and Complying with, Relevant Requirements	Paragraphs 1–16	–
Appointment and Eligibility of EQ Reviewers	Paragraphs 17–23	Paragraphs A1–A24
Performance of the EQ Review	Paragraphs 24–27	Paragraphs A25–A49
Documentation	Paragraphs 28–30	Paragraphs A50–A53

6. Following the virtual Board session on September 16, 2020, the Task Force will update the drafts

⁵ IESBA’s *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

to address Board members' comments and to align with the changes in proposed ISQM 1 and ISA 220 (Revised),⁶ as well as to align with the proposed revisions to the IESBA Code addressing the objectivity of appropriate reviewers arising from the IESBA's discussion at its September 2020 meeting. Thereafter, the final drafts will be presented for approval at the virtual Board sessions on:

- (a) September 21, 2020, with respect to proposed ISQM 2. The Task Force Chair will walk through the entire standard in sections (as described in paragraph 5(c) above). The Board will be asked to vote to approve the standard.
- (b) September 23, 2020, with respect to the scope of engagements subject to an EQ review in proposed ISQM 1, as part of the approval of that standard.

Section II – Changes to the Requirements and Related Application Material

7. The changes to the requirements and related application material for engagements subject to an EQ review in proposed ISQM 1 (as presented in **Agenda Item 3-C**), and in proposed ISQM 2 (as presented in **Agenda Item 3-D**), are explained in **Agenda Item 3-E**.

Matters for IAASB Consideration

1. The IAASB is asked for its views on the changes to the requirements and related application material with respect to the following:
 - (a) Engagements subject to an EQ review in proposed ISQM 1 (as presented in **Agenda Item 3-C**); and
 - (b) Proposed ISQM 2 (as presented in **Agenda Item 3-D**).

Section III – Due Process Considerations

8. In the Task Force's view, the significant matters it has identified as a result of its deliberations since the beginning of this project, and its conclusions and recommendations thereon, have been reflected in the agenda materials presented to the IAASB at its meetings. In the Task Force's view, there are no significant matters discussed in the course of this project that have not been brought to the IAASB's attention.
9. The Task Force considers, therefore, that the drafts of the scope of engagements subject to an EQ review in proposed ISQM 1 (as presented in **Agenda Item 3-A**), and proposed ISQM 2 (as presented in **Agenda Item 3-B**), reflect all significant matters raised in the course of the project. The only changes expected to be made in finalizing the drafts for approval at the September 2020 IAASB meeting will be those arising from the Board discussion at this meeting in relation to proposed ISQM 1 and ISA 220 (Revised), and the proposed revisions to the IESBA Code addressing the objectivity of appropriate reviewers arising from the IESBA's discussion at its September 2020 meeting.

Consideration of the Need for Re-Exposure

10. Based on the final drafts presented to the Board for the September 2020 meeting in **Agenda Items 3-A** and **3-B**, the Task Force does not recommend re-exposure. The rationale for the Task Force decision on this matter is set out in **Agenda Item 3-F**. See also the comparisons between the requirements relating to:
 - (a) Engagements subject to an EQ review in ED-ISQM 1 and the final draft of proposed ISQM 1 presented in **Agenda Item G**; and

⁶ Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

- (b) ED-ISQM 2 and the final draft of proposed ISQM 2 presented in **Agenda Item 3-H**.

Section IV – Next Steps

11. In coordination with the ISQM 1 and ISA 220 Task Forces, the Task Force will consider the need for specific implementation support materials related to proposed ISQM 2 and develop an implementation plan, which will leverage the experience obtained in developing the ISA 315 (Revised 2019)⁷ Implementation Plan.

⁷ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

Appendix 1

ISQM 2 Task Force Activities, Including Outreach and Coordination with Other IAASB Task Forces and Working Groups

1. The following sets out the activities of the Task Force, including outreach and coordination with other IAASB task forces and working groups, and the IESBA EQR Objectivity Task Force, relating to EQ reviews.

Task Force Activities in the Second and Third Quarters of 2020

2. In the second and third quarters of 2020, the Task Force held two videoconferences (on April 23 and August 21, 2020) to discuss the Task Force's consideration of the direction received at the March and June 2020 IAASB meetings and develop the changes to the requirements and related application material for the IAASB's consideration at this meeting. Thereafter, the Task Force Chair and Staff liaised with other Task Force Members and Staff via email to obtain input on further changes to the requirements and related application material.

Coordination Activities with Other IAASB Task Forces and Working Groups and Other Standard Setting Boards

IAASB Task Forces – ISQM 1, ISA 220 and ISA 600⁸ Task Forces

3. In the third quarter of 2020, representatives of each Task Force were identified to cross-review the drafts of the quality management standards, with a focus on the alignment of the three standards. Thereafter, these representatives, together with the Task Force Chairs and Staff, discussed any significant matters through videoconference.
4. In the third quarter of 2020, the quality management Staff also discussed coordination matters through videoconference. A final cross-review of the standards was also performed prior to the final posting of the standards for the September 2020 meeting to ensure the drafts are appropriately aligned.
5. In the third quarter of 2020, the Task Force Chair and Staff liaised with the ISQM 1 Task Force Chair and Staff to obtain input on the suggested change to the boxed example under paragraph A134 of proposed ISQM 1 relating to the last three bullets under the types of entities for which engagements are undertaken, as noted in paragraph 4 of the Issues Paper.

IESBA EQR Objectivity Task Force

6. In the second and third quarters of 2020, the Task Force Chair and Staff held two videoconferences (on April 21 and August 6, 2020) with the IESBA EQR Objectivity Task Force Chair and Staff to discuss the changes in the application material relating to the objectivity of EQ reviewers in proposed ISQM 2 to align it with the proposed revisions to the IESBA Code addressing the objectivity of EQ reviewers, now broadened to cover "appropriate reviewers" as defined in the IESBA Code. A full draft of proposed ISQM 2 was also provided to the IESBA EQR Objectivity Task Force Chair and Staff for purposes of any further comments on the consistency between proposed ISQM 2 and the IESBA Code.

⁸ ED, Proposed ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Appendix 2

Extract from the IAASB Minutes of Meeting – Draft for June 2020⁹

9. Engagement Quality Reviews – ISQM 2

On behalf of Mr. Vanker, Mr. Botha updated the Board on the IESBA's Engagement Quality Reviewer (EQR) Task Force's proposed revision to the IESBA Code.¹⁰

PROPOSED REVISION TO THE IESBA CODE ADDRESSING THE OBJECTIVITY OF EQRs

The Board agreed that the proposed revisions to the IESBA Code addressing the objectivity of "appropriate reviewers" align with the provisions relating to the objectivity of EQRs in proposed ISQM 2.

With respect to broadening the scope of the guidance in the IESBA's exposure draft¹¹ to appropriate reviewers, matters raised by Board members for further consideration included:

- Whether engagement team members who review work of less experienced team members would be considered appropriate reviewers under the IESBA Code.
- Whether individuals performing inspections of engagements as part of a firm's monitoring activities would also be considered appropriate reviewers, and whether the eligibility requirements for such individuals are appropriately and sufficiently addressed in proposed ISQM 1.

A Board member asked whether the long association provision in the IESBA Code has been considered in relation to the required cooling-off period in proposed ISQM 2. Mr. Botha noted that the distinction of the threats addressed by the long association provision in the IESBA Code and the mandatory cooling-off period in proposed ISQM 2 have been clarified in prior coordination with IESBA representatives (i.e., the long association provision in the IESBA Code addresses threats to independence arising from the long association with the client, while the mandatory cooling-off period in proposed ISQM 2 addresses threats to objectivity created by an individual being appointed as an EQR after previously serving as the engagement partner).

In closing, Mr. Vanker acknowledged the coordination efforts by IESBA's EQR Task Force.

IAASB CAG CHAIR'S REMARKS

Mr. Dalkin did not raise any concern with respect to the alignment of the proposed revisions to the IESBA Code with proposed ISQM 2. Mr. Dalkin also noted that the IAASB CAG perspectives were reflected in the Board discussions.

PIOB OBSERVER REMARKS

Ms. Stothers highlighted that the long association provisions in the IESBA Code should have been considered in relation to the required cooling-off period in proposed ISQM 2.

⁹ Draft minutes are still subject to IAASB review and may therefore still change.

¹⁰ IESBA's *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

¹¹ IESBA's Exposure Draft (ED), [*Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers*](#)

WAY FORWARD

The ISQM 2 Task Force will prepare a revised draft of proposed ISQM 2 for discussion and approval at the September 2020 IAASB meeting. The ISQM 2 Task Force will continue its coordination activities with the ISQM 1, ISA 220 and ISA 600 Task Forces and relevant IESBA Task Forces.