

EQR Objectivity—Issue and Proposals

Introduction

1. Some respondents to the IAASB's December 2015 [Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*](#) questioned whether the global auditing or ethics and independence standards should clarify issues relating to the engagement quality reviewer's (EQR)¹ objectivity. Specifically, it was pointed out that some jurisdictions require firms to establish mandatory "cooling-off periods" for individuals previously involved in the audit engagement, in particular engagement partners.
2. The IAASB noted that relevant ethical requirements, such as the IESBA's *International Code of Ethics for Professional Accountants (including International Independence Standards)*, may not specifically address threats to objectivity that may arise in these circumstances. For example, a self-review or self-interest threat may arise, particularly when judgments made by the individual in the previous engagement continue to influence subsequent periods, as is often the case in an audit of financial statements.
3. The IAASB issued the exposure draft (ED) [Proposed International Standard on Quality Management \(ISQM\) 2, *Engagement Quality Reviews*](#) in February 2019. The Explanatory Memorandum (EM) accompanying the ED of proposed ISQM 2 included a specific request to respondents for input on whether there is a need for guidance in the proposed ISQM 2 to address the matter of cooling off as an eligibility requirement for the EQR (e.g., where an individual has served previously as an engagement partner on the same engagement), and whether such guidance be located in proposed ISQM 2 or the Code.
4. IESBA representatives supported the inclusion of questions in the EM to ED-ISQM 2 in relation to this specific request for comments (see [Appendix 1](#)). They had also expressed the view that it would be helpful to:
 - State in an explicit manner that threats may be created when an individual who was previously involved in an audit engagement (whether as the engagement partner or as another member of the engagement team) is appointed as the EQR, and that those threats should be evaluated and addressed in accordance with the provisions in the Code.
 - Indicate that the IESBA believes that the nature of the role an individual served on the audit engagement (e.g., as an engagement partner versus another role on the engagement team) influences the level of the threat(s) to compliance with the fundamental principle of objectivity when the individual assumes the role of EQR on the engagement.

Responses to ED-ISQM 2

5. Paragraphs 23-28 of the EM to ED-ISQM 2 describe the IAASB discussion and views relating to the eligibility of an individual to be appointed as the EQR immediately after serving as the engagement

¹ A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review. An engagement quality review is an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached thereon. The EQR's evaluation of significant judgments is performed in the context of professional standards and applicable legal and regulatory requirements.

partner.

6. Overall, respondents agreed that the objectivity of the EQR is critical to the effectiveness of the EQ review (i.e., an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon). Refer to [Appendix 1](#) for further details on the responses received relating to questions 4(a) and 4(b) in the EM to ED-ISQM 2.
7. Considering the responses to ED-ISQM 2, the general consensus among respondents appears to be that threats to the objectivity of an engagement partner stepping into an EQR role is an important issue that needs to be addressed in proposed ISQM 2 or the Code. The ISQM 2 Task Force considered that a specific “cooling-off” after serving as an engagement partner is necessary so that the evaluation of significant judgments is objective (in fact and in appearance) and therefore an appropriate response to assessed quality risks.

Consideration of IESBA-Specific Matters

Feedback at the September 2019 Meetings

8. At the September 2019 meeting, the IESBA liaison member presented a high-level overview of respondents’ feedback on ED-ISQM 2.
9. On the matter of requiring a “cooling-off” period for individuals moving into the role of EQR, the IESBA was briefed on the options presented by the ISQM 2 Task Force and the strong support for a mandatory cooling-off requirement expressed by the respondents to the ED.
10. The IESBA agreed that the matter of EQR objectivity should be addressed in the Code. Some views were expressed that any discussion about a cooling-off period should be in the Code, although there were other views that there should be a proper articulation of the threats that are created and how they might be evaluated and addressed. The Board agreed to take up the issue in the Code as a matter of priority to try to align as much as possible with the IAASB’s timeline for approval of ISQM 2 in June 2020. Accordingly, the Board asked the IESBA coordination representatives to present the proposed changes to the Code (and the related project proposal) at the December 2019 IESBA meeting for consideration with a view to approval for exposure.

Proposed Application Material on EQR Objectivity

11. The IAASB is of the view that when an individual is appointed as the EQR immediately after serving as the engagement partner, there are no safeguards or other actions that would eliminate the threats to the individual’s objectivity or reduce them to an acceptable level. This view recognizes that the EQR is responsible for objectively evaluating the significant judgments made by the engagement team and the conclusions reached thereon. In the case of an audit of financial statements, significant judgments made in prior periods often affect judgments made in subsequent periods, albeit facts and circumstances may change over time. The ability of the EQR to objectively evaluate the significant judgments is affected by previous involvement with those judgments.
12. Currently, the Code does not have a dedicated EQR section. The IESBA representatives propose adding application material at the end of Section 120² (within the subsection dealing with considerations for audits, reviews and other assurance engagements) to describe the different types of threat that may be created when an individual is appointed EQR immediately after having served

² Section 120, *The Conceptual Framework*

on the audit engagement team, the factors that are relevant in evaluating the level of such threats, and actions that might be safeguards to address the threats. This would be entirely consistent with the conceptual framework.

13. The IESBA representatives considered different locations in the Code for the proposed guidance. As discussed at the September 2019 IESBA meeting, the IESBA representatives did not believe that it would be appropriate to place the guidance in the International Independence Standards as the central issue is about the objectivity of the EQR. After considering possible other locations in the Code, including in a new standalone section, the IESBA representatives believe that Section 120 would work best. Section 120 already deals with separate topics pertinent to audits, reviews and other assurance engagements, i.e., the linkage between independence and the fundamental principles, and professional skepticism. Adding the topic of EQR objectivity in that context would fit well with the present structure of Section 120. In addition, the proposed guidance on EQR objectivity is fairly self-contained as not to disturb the rest of Section 120. (See [Appendix 2](#) to this paper.)

Matters for IESBA Consideration

1. Does the IESBA agree with the proposed application material to address the issue of EQR objectivity?
2. Does the IESBA agree with the proposed placement of the new application material in Section 120?

Explicit “Cooling-Off” Period

14. At its September 2019 meeting, the IAASB considered the diversity of views among respondents to ED-ISQM 2 on the matter of cooling-off:
 - Whether or not to have a requirement for a specified cooling-off period for an individual stepping into the EQR role after serving as the engagement partner, and whether such a requirement or guidance should be in the Code or ISQM 2; and
 - Whether the scope should include listed entities, public interest entities (PIEs), all audited entities, or even more broadly all entities subject to an assurance engagement, for which an EQ review is required or for which the firm determines an EQ review is an appropriate response to assessed quality risks.
15. IESBA representatives recognize the importance of reinforcing the objectivity of the EQR given the importance of the role. They are also mindful that any limitations should result from the application of the conceptual framework to the specific facts and circumstances of the engagement, and that the Code should remain principles-based.
16. After having given the matter due consideration, the IESBA representatives believe that it would be best to leave it to the IAASB to establish in ISQM 2 whether a cooling-off requirement should be introduced, following the proposed guidance set out in Section 120, and if so, what the minimum cooling-off period and the scope of the requirement should be, and to whom it should apply. The IESBA representatives propose this approach for three main reasons:
 - An EQ review undertaken in accordance with proposed ISQM 2 may be performed for a variety of engagements (i.e., not only audits of financial statements, and not only for audits of listed entities), depending on whether the firm determines that an EQ review is an appropriate

response to a quality risk. It would be more appropriate for the scope of any cooling-off requirement to be specified in the standard that establishes the requirement for an EQ review, i.e., proposed ISQM 2.

- If the Code were to establish a cooling-off requirement, a breach of such a requirement would trigger a breach of the Code, which may call into question the firm's compliance with relevant ethical requirements. The IESBA representatives believe that it would be more appropriate for a breach of such a requirement to be remediated as a quality issue through the firm's system of quality management.
- If a cooling-off requirement is to be established, it would be better located together with other eligibility criteria for the EQR in proposed ISQM 2 so that all the relevant material can be found in one place.

17. To complement this approach, the ISQM 2 Task Force is proposing the following requirement in ISQM 2³:

The firm's policies or procedures established in accordance with paragraph 16(b) shall address threats to objectivity created by an individual being appointed as an engagement quality reviewer after previously serving as the engagement partner. Such policies and procedures shall 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 engagement quality reviewer

Matter for IESBA Consideration

1. Does the IESBA agree with the above proposal regarding addressing the need for a specific cooling-off period?

³ Refer to IAASB December 2019 issues paper Agenda Item 8 (<https://www.iaasb.org/meetings/iaasb-board-meeting-new-york-usa-1>)

APPENDIX 1

Overview of Responses to ED-ISQM 2 – Questions 4(a) and 4(b)

[Extract from IAASB September 2019 Board Papers]

1. Questions 4(a) and 4(b) in the EM to ED-ISQM 2 asked respondents:
 - (a) What are your views on the need for the guidance in proposed ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?
 - (b) If you support such guidance, do you agree that it should be located in proposed ISQM 2 as opposed to the IESBA Code?
2. Overall, respondents agreed that the objectivity of the EQR is critical to the effectiveness of the EQ review (i.e., for an objective assessment of the significant judgments made by the engagement team).
3. Responses to question 4(a) by category were as follows:
 - (a) 16 (18%) – agreed on the need for guidance on a cooling-off period;
 - (b) 54 (59%) – agree but had further comments (e.g., cooling-off period as a requirement; flexibility of cooling-off period depending on nature and circumstances of the engagement, among others);
 - (c) 12 (13%) – disagreed with the guidance or did not support a cooling-off period; and
 - (d) 9 (10%) – responses were unclear or did not include specific comments.
4. Responses to question 4(b) by category were as follows:
 - (a) 16 (18%) – agreed that the guidance should be located in ISQM 2;
 - (b) 35 (38%) – agreed but had further comments that the guidance (or requirement) should be located in ISQM 2, in both ISQM 2 and the IESBA Code, or align with or include reference to the IESBA Code;
 - (c) 26 (29%) – disagreed with the proposal to include the guidance in ISQM 2; and
 - (d) 14 (15%) – responses were unclear or did not include specific comments.

What IAASB Heard in Responses to ED-ISQM 2

Need for a Cooling-Off Period and Related Guidance Thereon

5. Of the 16 respondents who supported the need for guidance, there were no specific comments to note other than their acknowledgment of the need for such guidance.
6. The 54 respondents who agreed with the need for guidance on a cooling-off period but with concerns or comments had varying views about the requirement in paragraph 16 of ED-ISQM 2,⁴ and in

⁴ 16. The firm shall establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer and that include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. Those policies or procedures shall require that the engagement quality reviewer not be a member of the engagement team, and: (Ref: Para. A4–A5)

(a) Have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review; (Ref: Para. A6–A12)

particular about the lack of clarity and potential for inconsistent application of the related application material in paragraph A5⁵ of ED-ISQM 2.

7. About 17% (16 of 91) of respondents (including two Monitoring Group members) commented that:
 - (a) There should be a requirement for a specific cooling-off period for an individual stepping into the role of EQR after serving as engagement partner, with views varying as to whether such a requirement should be in ISQM 2 or in the IESBA Code; or
 - (b) ISQM 2 should be more specific in requiring the firm to establish policies or procedures that include a cooling-off period (as opposed to only being an example of the required ‘limitations’ in paragraph A5 of ED-ISQM 2).
8. 4 of the 16 respondents noted immediately above indicated a preference for a requirement to be included in the IESBA Code, but that the cooling-off should be addressed in ISQM 2 in the absence of such a requirement in the IESBA Code. One of these respondents indicated that while the Conceptual Framework in the IESBA Code applies to considerations of threats to objectivity and independence, it is not sufficiently robust in addressing the risks in circumstances when an engagement partner transitions to an EQR role.
9. Other comments on the requirement in paragraph 16 of ED-ISQM 2 included the following:
 - Regarding the firm establishing a cooling-off period, the standard should provide flexibility in determining an appropriate period based on the nature and circumstances of the engagement. In particular, respondents noted that a cooling-off period is appropriate for listed entities (and perhaps also for PIEs), but may not be necessary or appropriate for non-listed entities. In this regard, an inconsistency was noted between paragraph A5 of ED-ISQM 2, which implied through the example that a cooling-off period may be appropriate for all engagements subject to an EQ review, while paragraph 28 of the EM to ED-ISQM 2 indicates that the firm may determine that no cooling-off period is necessary for certain types of engagements. The flexibility implied in paragraph 28 of the EM to ED-ISQM 2 was noted as an important aspect of scalability for ISQM 2.

(b) Comply with relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer related to the engagement or the engagement team are eliminated or reduced to an acceptable level; and (Ref: Para. A13–A16)

(c) Comply with requirements of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer. (Ref: Para. A17)

⁵ A5. An individual who has served as the engagement partner is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual's objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level. In recurring engagements, the matters on which significant judgments are made and the facts and circumstances around those significant judgments are not likely to vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the immediate previous period. Accordingly, this ISQM requires the firm to establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends upon the facts and circumstances of the engagement, and applicable provisions of law or regulation or relevant ethical requirements. In the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

10. With respect to the guidance in paragraph A5 of ED-ISQM 2, respondents noted the following:
- The reference to “is not likely to be able to perform the role ... immediately after ceasing to be the engagement partner” sounds like a requirement. That, coupled with the fairly strongly worded example of a two-year cooling-off period, led respondents to believe that this would become a de facto requirement (or that regulators would interpret it as such).
 - That it was difficult to envision a situation where threats to objectivity of an EQR could be reduced to an acceptable level when an individual stepped into the EQR role immediately after serving as the engagement partner.
 - More guidance is needed to drive consistent implementation, given that firms will be determining the appropriate cooling-off period.
 - Whatever guidance is provided needs to be consistent with the provisions of the IESBA Code. Respondents noted that the long association provisions of the IESBA Code address cooling-off periods, but only in the context of independence and for PIEs, and do not specifically address a cooling-off period for an individual stepping into the EQR role after serving as engagement partner.
 - Suggestions that the guidance (or a requirement) should also address other key audit partners or other individuals stepping into the EQR role.
 - That the length of a cooling-off period should be a matter of firm policy, or that supported a minimum two-year or three-year cooling-off period.
11. Of the 12 respondents who did not agree with the need for a cooling-off period, or related guidance thereon, comments included the following:
- One respondent, although agreeing that the requirement should address the objectivity of the EQR and guidance should address the need for safeguards such as cooling-off periods and assessing competency of EQRs, was not convinced that the EQ review would be less effective because the EQR previously served on the engagement. It was noted that this is a potential issue for smaller firms with limited resources, and therefore is an important scalability point for ISQM 2.
 - Other respondent had similar comments about the need for continuity of knowledge, noting that this can contribute to the quality of the engagement; conversely, requiring a cooling-off period in all cases may be detrimental to audit quality for certain types of engagements. One respondent mentioned that competence gained as an engagement partner may uniquely qualify an individual to serve as an EQR, and that the IAASB appears to be overemphasizing objectivity over competence.
 - Respondents referred to the long association and partner rotation provisions in the IESBA Code, noting that:
 - The provisions in the IESBA Code already sufficiently deal with cooling-off periods. Respondents pointed out that the IESBA Code does not require a specific cooling-off period for individuals moving into an EQR role after serving as the engagement partner, while others seemed to believe that the IESBA Code provisions did specifically address this situation or were sufficient to provide the necessary safeguards.

- The ED-ISQM 2 requirement in paragraph 16 and guidance in paragraph A5 are inconsistent with, or go beyond, the provisions in the IESBA Code, or will result in confusion or inconsistent application when firms are establishing the related policies or procedures. One respondent noted that the provisions in the IESBA Code apply to PIEs while the guidance in paragraph A5 relates to listed entities. Having different requirements in ISQM 2 could lead to confusion and complexity for firms by applying multiple rules from multiple sources.

Location of the Guidance (or Requirement)

12. Responses to question 4(b) by theme were as follows:

Responses by theme	Addressed in proposed ISQM 2	Addressed in both proposed ISQM 2 and the IESBA Code	Addressed in the IESBA Code	Unclear
Agree				
Agree that the guidance should be addressed in proposed ISQM 2	16			
Agree but with further comments				
Agree but with further comments that the guidance (or requirement) should be addressed in proposed ISQM 2	9			
Agree but with further comments that the guidance (or requirement) should be addressed in both proposed ISQM 2 and the IESBA Code, or align with, or include reference to the IESBA Code		26		
Disagree				
Disagree that the guidance (or requirement) should be addressed in proposed ISQM 2 (i.e., should be addressed in the IESBA Code)			26	
Unclear or no specific response				14
Total	25	26	26	14

13. Respondents who commented on the location of any guidance (or requirement) for a cooling-off period for an individual moving into an EQR role were about evenly split between a preference for ISQM 2 or the IESBA Code. There were respondents who had strong views about the preferred or, in their view, most appropriate location. Other respondents suggested that the guidance could reside in either location as long as appropriate cross-references were provided while others noted that there was no harm in having the guidance in both places.

14. Other comments on location of the guidance (or requirement) included the following:

- One respondent indicated that any cooling-off requirement should be in the IESBA Code, but IAASB should address what is appropriate for non-listed entities as there is a need for more flexibility in such cases.
- Another respondent noted that clarity of guidance is more important than location.

**Proposed New Provisions to be Included in the Code
(Marked-up)**

PART 1 – COMPLYING WITH THE CODE, FUNDAMENTAL PRINCIPLES AND CONCEPTUAL FRAMEWORK

SECTION 120

THE CONCEPTUAL FRAMEWORK

Considerations for Audits, Reviews and Other Assurance Engagements

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Independence

120.12 A1 Professional accountants in public practice are required by *International Independence Standards* to be independent when performing audits, reviews, or other assurance engagements. Independence is linked to the fundamental principles of objectivity and integrity. It comprises:

- (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
- (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an audit or assurance team member's integrity, objectivity or professional skepticism has been compromised.

120.12 A2 *International Independence Standards* set out requirements and application material on how to apply the conceptual framework to maintain independence when performing audits, reviews or other assurance engagements. Professional accountants and firms are required to comply with these standards in order to be independent when conducting such engagements. The conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles applies in the same way to compliance with independence requirements. The categories of threats to compliance with the fundamental principles described in paragraph 120.6 A3 are also the categories of threats to compliance with independence requirements.

Professional Skepticism

120.13 A1 Under auditing, review and other assurance standards, including those issued by the IAASB, professional accountants in public practice are required to exercise professional skepticism when planning and performing audits, reviews and other assurance engagements. Professional skepticism and the fundamental principles that are described in Section 110 are inter-related concepts.

120.13 A2 In an audit of financial statements, compliance with the fundamental principles, individually

and collectively, supports the exercise of professional skepticism, as shown in the following examples:

- *Integrity* requires the professional accountant to be straightforward and honest. For example, the accountant complies with the principle of integrity by:
 - (a) Being straightforward and honest when raising concerns about a position taken by a client; and
 - (b) Pursuing inquiries about inconsistent information and seeking further audit evidence to address concerns about statements that might be materially false or misleading in order to make informed decisions about the appropriate course of action in the circumstances.

In doing so, the accountant demonstrates the critical assessment of audit evidence that contributes to the exercise of professional skepticism.

- *Objectivity* requires the professional accountant not to compromise professional or business judgment because of bias, conflict of interest or the undue influence of others. For example, the accountant complies with the principle of objectivity by:
 - (a) Recognizing circumstances or relationships such as familiarity with the client, that might compromise the accountant's professional or business judgment; and
 - (b) Considering the impact of such circumstances and relationships on the accountant's judgment when evaluating the sufficiency and appropriateness of audit evidence related to a matter material to the client's financial statements.

In doing so, the accountant behaves in a manner that contributes to the exercise of professional skepticism.

- *Professional competence and due care* requires the professional accountant to have professional knowledge and skill at the level required to ensure the provision of competent professional service, and to act diligently in accordance with applicable standards, laws and regulations. For example, the accountant complies with the principle of professional competence and due care by:
 - (a) Applying knowledge that is relevant to a particular client's industry and business activities in order to properly identify risks of material misstatement;
 - (b) Designing and performing appropriate audit procedures; and
 - (c) Applying relevant knowledge when critically assessing whether audit evidence is sufficient and appropriate in the circumstances.

In doing so, the accountant behaves in a manner that contributes to the exercise of professional skepticism.

Engagement Quality Reviews

120.14 A1 Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. [Proposed] International Standard on Quality Management (ISQM) 1 establishes a firm's responsibilities for its system of quality management and requires the

firm to design and implement responses to assessed quality risks related to engagement performance. Such responses include establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2.

120.14 A2 When a professional accountant who was previously involved in the engagement, whether as the engagement partner or as a member of the engagement team, is appointed as the engagement quality reviewer, threats to compliance with the fundamental principles might be created. The following are examples of threat that might be created:

(a) Self-interest threat

- The accountant serves as engagement quality reviewer for an audit engagement for which the accountant also has a reciprocal arrangement with the engagement partner.

(b) Self-review threat

- The accountant serves as an engagement quality reviewer on an audit engagement after serving as the engagement partner or other engagement team member.

(c) Familiarity threat

- The accountant who serves as engagement quality reviewer has a long association or close relationship with, or is an immediate family member of, an audit team member.

(d) Intimidation threat

- The accountant serves as engagement quality reviewer for an audit engagement when the engagement partner is also the accountant's direct report.

120.14 A3 Factors that are relevant in evaluating the level of such threats include:

- The role and seniority of the professional accountant on the engagement team prior to being appointed as the engagement quality reviewer.
- The length of time since the accountant was last a member of the engagement team prior to being appointed as engagement quality reviewer.
- The nature and extent of involvement of the accountant in the significant judgments made and conclusions reached on the engagement.
- The number and complexity of issues that required significant judgment from the accountant on the engagement.

120.14 A4 Examples of actions that might be safeguards to address such threats include:

- Having an appropriate reviewer who was not previously involved on the audit engagement review areas of significant judgment in which the professional accountant was involved.
- Implementing a period of sufficient duration (a cooling-off period) before the accountant is appointed as engagement quality reviewer.
- If the accountant is a direct report to the engagement partner, reassigning reporting

responsibilities within the firm so that the accountant no longer reports to the engagement partner.