

## PROJECT PROPOSAL— OBJECTIVITY OF ENGAGEMENT QUALITY REVIEWER (DECEMBER 2019)

### I. Subject

1. Addressing threats that may be created when an individual who was previously involved in an engagement (whether as the engagement partner or as another member of the engagement team) is appointed as the engagement quality reviewer (EQR).<sup>1</sup>

### II. Background

2. Some respondents to the International Auditing and Assurance Standards Board's (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 objectivity of an individual being considered for appointment to an EQR role. 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, before they can act in an EQR role on the same engagement.
3. The IAASB noted that relevant ethical requirements, such as the [International Code of Ethics for Professional Accountants \(including International Independence Standards\)](#) (the Code), 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.
4. 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 should be located in proposed ISQM 2 or the Code.
5. Overall, respondents agreed that the objectivity of the EQ reviewer is critical to the effectiveness of the EQ review. Considering the responses to ED-ISQM 2, the general consensus among respondents is 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.

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<sup>1</sup> Proposed International Standard on Quality Management (ISQM) 2, *Engagement Quality Reviews*, defines an *engagement quality reviewer* as "a partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review."

Proposed ISQM 2 also defines an *engagement quality review* as "an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report."

6. At its September 2019 meeting, having been briefed on the coordination efforts between IAASB and IESBA representatives on the matter, the IESBA agreed that the matter of EQR objectivity should be addressed in the Code. The IESBA therefore agreed to initiate a project to develop provisions for inclusion in the Code as a matter of priority in order to align as much as possible with the IAASB's timeline for approval of ISQM 2, expected in June 2020.

### III. Project Objectives, Focus, Scope and Outline

#### Project Objective and Focus

7. The objective of this project is to develop provisions for the Code addressing threats that may be created when an individual who was previously involved in an audit or other assurance engagement (whether as the engagement partner or as another member of the engagement team) is appointed as the EQR on the same engagement.
8. The project is focused on audit and other assurance engagements for which an engagement quality review is determined to be an appropriate response to an assessed quality risk pursuant to [proposed] ISQM 1.<sup>2</sup>

#### Project Scope and Outline

9. This is a limited scope project addressing only the matter of threats to objectivity that may be created when an individual who was previously involved in an audit or other assurance engagement is appointed as the EQR on the same engagement. The provisions will apply only to professional accountants in public practice (Part 1<sup>3</sup> or Part 3<sup>4</sup> of the Code, as appropriate).
10. The project will involve the development of provisions that provide a clear and principles-based approach to addressing the matter, consistent with the conceptual framework. The provisions will provide guidance on:
  - The types of threat that might be created when an individual who previously served on an engagement steps into an EQR role. It is recognized that the individual's previous role (for example, engagement partner versus another engagement team member) will give rise to different levels of threat.
  - In relation to the identified threats, factors relevant to the evaluation of the level of the threats.
  - Actions that might be safeguards to reduce the level of such threats to an acceptable level.
11. In coordination with the IAASB, the project will consider whether it might be appropriate to specify a cooling-off period before an engagement partner can assume the EQR role, and if so, whether a requirement to that effect would be better placed in the IAASB's standards or the Code.

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<sup>2</sup> Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

<sup>3</sup> Part 1, *Complying with the Code, Fundamental Principles and Conceptual Framework*

<sup>4</sup> Part 3, *Professional Accountants in Public Practice*

## **IV. How the Project Serves the Public Interest and Impact Analysis**

### **How the Project Serves the Public Interest**

12. The public interest will be served by providing clarity in the Code as to how firms should deal with the threats to the objectivity of an EQR when an individual who previously served on the engagement team steps into that role. Such clarity will contribute to enhancing public confidence in the quality of audit and other assurance engagements.

### **Impact Analysis Considerations**

13. Changes to the Code will likely result in implementation costs at the national and firm levels, including translation, education and training.
14. Depending on whether a cooling-off requirement is introduced in the Code to address circumstances where an individual who served as engagement partner steps into an EQR role on the engagement, there may be a need to consider the practical implications on the availability of individuals to serve as EQR.

## **V. Implications for any Specific Persons or Groups**

15. This project will be fully coordinated with the IAASB in relation to the IAASB's ISQM 1, ISQM 2 and ISA 220 (Revised)<sup>5</sup> projects.
16. The project has implications for, in particular:
  - (a) National standard setters (NSS) and IFAC member bodies that have adopted the Code or used it as a basis or a benchmark for their own ethics and independence standards.
  - (b) Firms that are subject to the requirements of the Code and/or national ethics standards based on the Code, in particular auditors who perform audits of financial statements under the ISAs and firms that perform engagements using the IAASB's other International Standards.
  - (c) Those charged with governance in relation to their interactions with auditors on audit quality matters, and the regulatory and audit oversight community in relation to their enforcement of ethical requirements.

## **VI. Development Process, Project Output and Project Timetable**

### **Development Process**

17. It is anticipated that the project will follow due process with an accelerated timeline for changes to the Code to try to align as much as possible with the anticipated completion of the IAASB's quality management projects by Q2 2020.

### **Project Output**

18. The output of the project will be revisions to Part 1 or Part 3 of the Code as appropriate.

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<sup>5</sup> Proposed International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*

19. Depending on the issues identified and revisions made, consequential and conforming amendments will be made to relevant sections of the Code as appropriate.

**Project Timetable**

20. Subject to the IESBA’s approval of the project proposal, this project will commence immediately. The specific project milestones and outputs will be dependent on the matters that the project Task Force ultimately determines are appropriate to address as part of the project, and the priorities assigned to those matters.
21. The table below provides indicative timing for the project up to and including approval of an exposure draft (ED) or consultation paper.

Indicative Timing	Milestone
December 2019	<ul style="list-style-type: none"> <li>• IESBA consideration and approval of project proposal</li> <li>• IESBA approval of ED</li> </ul>
December 2019	<ul style="list-style-type: none"> <li>• Teleconference with CAG: discussion of project proposal and ED</li> <li>• CAG approval of project proposal and ED</li> </ul>
January 2020	<ul style="list-style-type: none"> <li>• Issuance of ED with a 45-day comment period</li> </ul>
June 2020	<ul style="list-style-type: none"> <li>• IESBA: Deliberation of responses to the ED and resulting proposed changes to the Code</li> </ul>
September 2020	<ul style="list-style-type: none"> <li>• CAG and IESBA: Deliberation of final text of the proposed changes to the Code</li> <li>• IESBA approval of proposed changes</li> </ul>

**VII. Resources Required**

22. A project Task Force consisting of two IESBA members.
23. IESBA Staff will provide support to the project Task Force.

## APPENDIX

### Comments from Standard-Setting Board (SSB)/IFAC Technical Managers

Due process requires that project proposals be circulated to SSB Staff and IFAC Staff for the technical areas within, or supported by, IFAC for comments on any matters of possible relevance to the project.

#### Consolidated comments from senior Staff of the following IFAC committees and departments:

- **Quality and Development**
- **Education**
- **Professional Accountants in Business (PAIB) Committee**
- **Small and Medium Practices (SMP) Committee**
- **Transnational Auditors Committee (TAC)**

The proposed IESBA project to address the matter of objectivity of an Engagement Quality Reviewer (EQR) in the Code is an area of considerable focus for the Transnational Auditors Committee (TAC) and likely to impact small- and medium-sized practices (SMPs). SMPs often have a relatively small pool of individuals with both the seniority and experience to act as engagement partners and EQR and therefore the practicalities associated with such matters and internal rotation generally present specific challenges.

The proposed project scope and outline that the provisions will be principles-based to address this matter is critical. The provisions (e.g. the consideration of safeguards to reduce the level of threat to an acceptable level) need to be scalable, not overly prescriptive and not detrimental to engagement quality in a small firm environment. It is important for the IESBA to conduct outreach to fully understand the practical implications and potential impact on SMPs. The IFAC SMP Committee would be happy to provide feedback on this in due course. Close coordination with IAASB is also essential as it finalizes the quality management standards.

Signed: C. Arnold and Barry Naik

Date: December 2, 2019