

Extract of December 2019 IAASB Agenda Material Pertaining to EQR Objectivity

Objectives of the IAASB Discussion

The objectives of this Agenda Item are to:

- (a) Obtain the Board's views about the revised proposals of the ISQM 2 Task Force (the Task Force) relating to the following key issues:
 - (i) Engagements subject to an engagement quality (EQ) review in accordance with paragraph 41A(c) of proposed ISQM 1² (previously paragraph 37(e) in the Exposure Draft of ISQM 1 (ED-ISQM 1)); and
 - (ii) The objectivity of the EQ reviewer, including a mandatory cooling-off period for individuals moving into the role of EQ reviewer after having served as the engagement partner.
- (b) Obtain the Board's views on other matters identified by the Task Force in responding to comments received on the Exposure Draft of ISQM 2 (ED-ISQM 2) and through ongoing coordination activities.
- (c) If time permits, obtain other feedback from the IAASB on the draft of proposed ISQM 2.

Proposed ISQM 2¹: Issues and Recommendations

I. Introduction

1. 99 and 92³ comment letters from diverse stakeholder groups across different regions of the world were received in response to ED-ISQM 1 (question 11) and ED-ISQM 2, respectively. In general, there was strong support for EQ reviews as a response, among others, designed and implemented by the firm to address assessed quality risks. Respondents agreed that while the performance of an EQ review is undertaken at the engagement level, it is a response that is implemented by the EQ reviewer on behalf of the firm (i.e., a firm-level response).

Structure of this Paper

2. The matters below are discussed further in **Section II** of this paper.
 - The Task Force considered the direction received from the Board on the issues discussed at the September 2019 IAASB meeting relating to:

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

² 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*

³ The total number of comment letters has been updated to include the comment letter received from the Committee of European Auditing Oversight Bodies, which brings the total number of comment letters to 92 in response to ED-ISQM 2, from 91 as previously reported at the September 2019 IAASB meeting. This respondent's comments have been considered by the Task Force in the context of all proposals presented to the Board to date (including September 2019) and included in the analysis of comments supporting the proposals in this paper. The Task Force determined that the respondent's comments did not affect the proposals in September 2019, since many of the respondent's views were similar to the views expressed by other respondents.

- Engagements subject to an EQ review in accordance with paragraph 41A(c) of proposed ISQM 1 (i.e., scoping); and
 - Requirements relating to the objectivity of the EQ reviewer in accordance with paragraph 16 of proposed ISQM 2, including a cooling-off period for individuals moving into the role of EQ reviewer after having served as the engagement partner.
 - In addition, in the course of revising the proposed standard to address comments received on exposure, and to address feedback received from the IAASB and through coordination activities with other IAASB project task forces, the Task Force has identified the following matters for discussion:
 - Whether and, if so, how proposed ISQM 2 should address the exercise of professional skepticism by the EQ reviewer.
 - Considerations for EQ reviews for group audit engagements.
3. This paper includes the following appendices:
- **Appendix 1** provides an overview of the Task Force activities and coordination with other task forces during the fourth quarter of 2019.
 - **Appendix 2** includes an extract of the draft minutes of the September 2019 IAASB meeting.

Other Agenda Papers Accompanying this Issues Paper

4. **Agenda Item 8-A** is a clean draft of the requirements in paragraph 41A(c) of proposed ISQM 1 and related application material, regarding the scope of engagements subject to an EQ review. This draft incorporates the proposed changes made by the Task Force based on input from the Board at the September 2019 IAASB meeting and the Task Force's further discussions.
5. **Agenda Item 8-B** is a draft of the requirements in paragraph 41A(c) of proposed ISQM 1 and related application material, marked from the indicative drafting presented at the September 2019 IAASB meeting (see [Agenda Item 7](#) for that meeting).
6. **Agenda Item 8-C** provides background information on the significant changes made by the Task Force to the requirements and application material in proposed ISQM 2, as reflected in the marked draft in **Agenda Item 8-D**, and the rationale for those changes. **Agenda Item 8-C** includes cross-references to the relevant sections of this paper for the significant changes that are discussed in more detail herein.
7. **Agenda Item 8-D** is a complete draft of proposed ISQM 2, marked from ED-ISQM 2, which incorporates the proposed changes made by the Task Force in response to comments and the direction received from the Board at the September 2019 IAASB meeting.
8. **Agenda Item 8-E** is a complete clean draft of proposed ISQM 2.
9. **Agenda Item 8-F** includes an overview of respondents' feedback on questions 1 to 8 of the Explanatory Memorandum (EM) to ED-ISQM 2. As part of the presentation during the September 2019 IAASB meeting, the Task Force Chair provided a high-level overview of the responses to these questions, and the overarching comments or themes from the comment letters. **Agenda Item 8-F** excludes the responses to questions 4(a) and 4(b) of the EM to ED-ISQM 2 and question 11 of the EM to ED-ISQM 1, which were discussed at the September 2019 IAASB meeting.
10. **Agenda Item 8-G (which comprises Agenda Item 8-G.1 to Agenda Item 8-G.18)** consists of NVivo MS Excel Reports for questions 1 to 8 in the EM to ED-ISQM 2. These reports, which are provided for reference only, provide a summary of the responses by:

- Category (agree, agree but with further comments, disagree, or unclear or no specific response or refer to another respondent's views) – Level 1 Analysis; and
 - Theme (that relates to a specific requirement, application material, or topic for further consideration) – Level 2 Analysis.
11. **Agenda Item 8-H (which comprises Agenda Item 8-H.1 to Agenda Item 8-H.9)** consists of the NVivo MS Word Reports for questions 1 to 8 in the EM to ED-ISQM 2. These reports, which are provided for reference only, are a compilation of relevant extracts of comment letters by category of response.

Plan for the December 2019 Meeting Discussion

12. The key agenda papers for the Board's preparation are this Issues Paper and **Agenda Item 8-D** (the marked version of proposed ISQM 2). The focus of the discussion for the December 2019 meeting will be on the issues presented in **Section II** of this paper. However, the Task Force has provided the marked and clean versions of the complete draft of proposed ISQM 2, and welcomes offline comments from the IAASB to help the Task Force in its discussions post-December on the standard. The Task Force requests Board members to submit written comments on the draft by no later than December 20, 2019, but would appreciate if comments could be submitted in advance of the December meeting if possible.
13. As noted above, if time permits, the Task Force also will seek feedback from the IAASB on the draft of proposed ISQM 2, as described in **Section III** of this paper. **Agenda Item 8-C** (Discussion of Significant Changes to Requirements and Application Material) and **Agenda Item 8-F** (Overview of Responses to ED-ISQM 2) are key papers for this section. These papers will assist Board members in understanding the significant changes in proposed ISQM 2, and the rationale for those changes, and will be used to facilitate Board discussion of **Agenda Item 8-D** as time permits.

II. Issues for Discussion

A. Scope of Engagements Subject to an EQ Review

What We Heard from the Board at the September 2019 IAASB Meeting

14. The Board generally supported the Task Force's proposal on the scope of engagements subject to an EQ review, but suggested further refinements about the requirement for an EQ review for audits or other engagements for which the firm determines that a review is appropriate based on the 'nature of the entity.'

Task Force Discussion and Recommendations

15. The Task Force noted the Board's general support for the reference to 'nature of the entity,' while recognizing that a few Board members had concerns about the distinction between this category and the requirement in paragraph 41A(c)(iii)(a) (previously paragraph 37(e)(iii)(a)) for which the firm determines an EQ review is an appropriate response to quality risks. The Task Force also noted the strong support from the IAASB Consultative Advisory Group that moving away from the concept of 'significant public interest' (SPI) in ED-ISQM 2 to 'nature of the entity' would address concerns raised about implementation challenges, particularly in the public sector.
16. In view of the concerns raised by some Board members as described above, the Task Force considered whether the sub-requirements in 41A(c)(iii) (previously paragraph 37(e)(iii)) could be combined, i.e., have a single requirement for audits or other engagements for which the firm determines that an EQ review is an appropriate response to quality risks. After further discussion,

the Task Force continues to believe that a category separate from assessed quality risks should be retained because it is consistent with:

- The stated objective of the project, in the public interest, to extend the requirement for an EQ review to more engagements; and
 - The Task Force's understanding that the current practice in many firms is to perform EQ reviews 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 assessed quality risks.
17. Accordingly, the Task Force has revised paragraph 41A(c)(iii) in **Agenda Item 8-B** to change 'nature of the entity' to 'nature and circumstances of the engagement or the entity' in sub-requirement 41A(c)(iii)(b), as well as moving 'appropriate' to the lead-in.
18. The Task Force also has revised the related application material as follows:
- Paragraph A105A now focuses on factors the firm may consider in establishing criteria for identifying audits or other engagements for which an EQ review may be appropriate due to the nature and circumstances of the engagement or the entity. In developing this application material, the Task Force considered, and agreed with, the comments of a Board member during the September 2019 IAASB meeting that a reference should be retained to 'public interest' or 'public confidence' now that the concept of SPI has been removed from the proposed standard. In addition, paragraph A105A no longer references the IESBA Code⁴ because Board members commented that the references were overly specific, or would continue to raise questions about how or whether the reference to 'nature and circumstances of the engagement or the entity' relates to the concept of 'public interest entity' (PIE) in the Code.
 - Paragraph A105B was added to clarify that the reference to 'public interest' or 'public accountability' in paragraph A105A does not suggest that proposed ISQM 2 requires the performance of an EQ review for all PIEs.
 - The application material paragraphs have been re-ordered, and relevant sub-headings have been added, to address comments from Board members that it was not always clear how the application material corresponded to the requirements.

Matter for IAASB Consideration

1. Does the IAASB support the proposed changes to the requirements in paragraph 41A(c) of proposed ISQM 1 and related application material, relating to the scope of engagements subject to an EQ review?

B. Objectivity and Cooling-Off Period

What We Heard from the Board at the September 2019 IAASB Meeting

19. The Board generally supported the Task Force's proposal to address objectivity and include a cooling-off period in proposed ISQM 2 for individuals moving into the role of EQ reviewer after serving as the engagement partner. However, some Board members did not support a mandatory

⁴ International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)*

cooling-off period in ISQM 2, or supported flexibility for firms to develop policies and procedures to determine an appropriate cooling-off period.

20. While indicating a preference for objectivity and cooling-off period to be addressed in the IESBA Code and applauding the IESBA's willingness to address these matters, Board members expressed views about whether the time needed for IESBA's due process would result in changes to the IESBA Code by the expected finalization of the IAASB's quality management standards in June 2020.

Task Force Discussion and Recommendations

21. The Task Force considered specific comments from Board members during the discussion on this topic at the September 2019 IAASB meeting, including the following:

- The cooling-off period for individuals moving into an EQ reviewer role after serving as the engagement partner should be addressed in proposed ISQM 2 if not addressed in the IESBA Code.
- Including a requirement for a mandatory cooling-off period in proposed ISQM 2 would help to achieve consistency in practice.
- Any requirement in proposed ISQM 2 could be amended or deleted depending on the outcome of IESBA's activities.
- Ongoing coordination with IESBA will be important (see paragraphs 32-35 below).

22. The Task Force further reviewed and discussed the various comments from respondents to ED-ISQM 2 as summarized in **Agenda Item 7** for the September 2019 IAASB meeting. The Task Force acknowledges that varying views were expressed by respondents regarding a requirement for, or guidance relating to, a cooling-off period and whether it should be located in proposed ISQM 2 or the IESBA Code. However, the Task Force discussions and conclusions were influenced by the following points:

- Overall, respondents 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).
- Other respondents also agreed with the need for guidance on a cooling-off period, but had concerns or comments about the lack of clarity and potential for inconsistent application of the related application material (paragraph A5 of ED-ISQM 2).
- Certain respondents, including two Monitoring Group members, commented that there should be a requirement for a specific cooling-off period for an individual stepping into an EQ reviewer role after serving as engagement partner, or indicated that proposed ISQM 2 should be more specific in requiring the firm to establish policies or procedures that include a cooling-off period.

Mandatory Cooling-Off Period

23. The Task Force continues to believe strongly that a mandatory cooling-off period is in the public interest, and is the most appropriate approach to drive consistency in practice, while awaiting the outcome of the IESBA's planned activities to address this matter in the IESBA Code. 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. As has been noted in previous

discussions with the IAASB on this topic,⁵ 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.

24. Accordingly, the Task Force has included a requirement in paragraph 16A (see **Agenda Item 8-D**) 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. This requirement is based on Alternative 2 in the indicative drafting presented in **Agenda Item 7** for the September 2019 IAASB meeting. Following is paragraph 16A marked from the indicative drafting:

16A. The firm's policies or procedures established in accordance with paragraph 16(b) ~~also~~ shall address threats to objectivity created by an individual being appointed as an engagement quality reviewer after previously serving as the engagement partner. ~~For [audits of financial statements of listed entities], s-~~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.

25. The Task Force also has the view that a mandatory cooling-off period is consistent with the fundamental principles of, and the conceptual framework in, the IESBA Code. Paragraph A15 of proposed ISQM 2 provides examples of threats to objectivity of the EQ reviewer. Paragraph A17A of the proposed standard explains how a self-review threat to objectivity, in particular, is created when an individual stepping into the EQ reviewer role previously served as the engagement partner and was involved with significant judgments made by the engagement team. The proposed mandatory cooling-off period is intended to address the uniqueness of the threats in this circumstance, given the importance of maintaining objectivity in performing an objective evaluation of the significant judgments made by the engagement team.

Possibility of Flexibility in Firm Policies or Procedures

26. In view of comments from respondents to ED-ISQM 2, and comments from some IAASB members, the Task Force discussed alternatives to a mandatory cooling-off period. The Task Force considered whether the requirement in proposed ISQM 2 could be drafted to provide flexibility for firms to decide whether a cooling-off period is the appropriate safeguard in the circumstances to address the threats to objectivity created by an engagement partner stepping into the role of EQ reviewer and, if so, the length of the cooling-off period.
27. The Task Force concluded that providing flexibility for firms, although possible, would give rise to other questions about how this would be implemented, and that could likely result in inconsistencies in practice. For example:
- How would firms evaluate the severity of the threats to objectivity in determining whether a cooling-off period is needed?
 - What factors would need to be considered in making this evaluation, e.g., the nature of the entity (size, complexity and risk), or the number or nature of significant judgments with which the former engagement partner was involved?
 - What criteria or guidance would need to be provided to drive consistency in practice, assuming that such consistency is considered necessary and in the public interest?

⁵ See, for example, [Agenda Item 5-B](#) for the December 2018 IAASB meeting, paragraphs 24-27.

- Aside from a cooling-off period, what other safeguards or actions could be put into place to eliminate the threats to objectivity or reduce them to an acceptable level? For example, would the firm identify another individual to assist or 'shadow' the appointed EQ reviewer, and would that apply for all or only certain significant judgments? Or would the firm require that an assistant be appointed?
28. Based on the above considerations, the Task Force believes that the requirement as drafted in paragraph 16A is the most appropriate approach.

Applicability of Mandatory Cooling-Off Period

29. The Task Force also deliberated whether the requirement for a cooling-off period should apply to:
- Audits of listed entities only, all PIEs, or all audit engagements; or
 - All engagements for which an EQ review is required or is determined to be an appropriate response in accordance with paragraph 41A(c) of proposed ISQM 1.
30. In this regard, the Task Force believes that the requirement should apply to all engagements for which an EQ review is performed. The view of the Task Force is 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 Task Force 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 employ responses other than an EQ review to address assessed quality risks. 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 Task Force believes 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.

Changes to Related Application Material

31. The following changes to application material were made to support the requirement in paragraph 16A:
- Paragraph A5 of ED-ISQM 2 has been moved to become new paragraph A17A, and has been revised to explain the importance of the cooling-off period to address the threats to objectivity, in particular the self-review threat, created when an individual moves into an EQ reviewer role after serving as the engagement partner.
 - A new paragraph (A17B) was added in response to comments from respondents to ED-ISQM 2 that a cooling-off period may also be appropriate for individuals other than the engagement partner who are moving into the EQ reviewer role.
 - Paragraph A17C indicates that relevant ethical requirements may include provisions that address threats created by the long association of individuals with an audit client. Respondents to ED-ISQM 2 had various comments about how a cooling-off period in the revised standard would relate to, or interact with, the long association provisions in the IESBA Code. The Task Force plans to have further discussions on this point with IESBA Staff and Board representatives, and will revise paragraph A17C as needed based on those discussions.

Coordination with the IESBA Staff and Board Representatives

32. The Task Force acknowledges the importance of coordinating closely with the IESBA regarding the proposed requirement and related application material in ISQM 2 for purposes of alignment with the general principles in, and planned revisions to, the IESBA Code. The Task Force understands that the IESBA coordination representatives will present a project proposal and draft ED of the proposed changes to the IESBA Code for the IESBA's consideration and approval at its December 2019 meeting.
33. The Task Force further understands the importance of linking the requirements and guidance in proposed ISQM 2 regarding objectivity, including a cooling-off period, to the responsibility for the firm and its personnel to comply with relevant ethical requirements.
34. As noted in paragraph 21 above, comments during the September 2019 IAASB discussion suggested that any requirement in proposed ISQM 2 for a cooling-off period could be amended, or deleted if necessary, depending on the outcome of IESBA's activities. This option would be consistent with the IAASB views expressed during the September 2019 meeting that the threats and safeguards regarding the objectivity of the EQ reviewer preferably are addressed in the IESBA Code. In addition, this flexibility would allow the IAASB to move forward with the finalization of proposed ISQM 2, while continuing to monitor the IESBA's project, which is expected to proceed on an accelerated timeline.
35. A discussion with IESBA Staff and Board representatives is planned prior to the December 2019 IAASB meeting. Their views will be summarized and presented to the IAASB by the Task Force Chair during the December 2019 plenary session.

Matters for IAASB Consideration

2. With respect to the proposed requirement in paragraph 16A for firm policies or procedures to specify a mandatory cooling-off period, and the related application material:
 - (a) Is the proposed requirement in the public interest, and appropriate to drive consistency in practice?
 - (b) Does the IAASB agree that the requirement in paragraph 16A could be amended or deleted, depending on the outcome of the IESBA's planned activities?

D. Group Audit Considerations

What We Heard in Responses to ED-ISQM 2

47. Respondents had comments or questions about how the requirements and guidance in proposed ISQM 2 would be applied in the context of group audits. For example, a Monitoring Group member noted that the ED does not address whether significant components in a group audit context should be subject to the scope of the EQ review.

Task Force Discussion and Recommendations

48. The Task Force discussed how an EQ review would be performed for a group audit engagement and determined that, although there may be complexities due to the nature of the engagement and the fact that audit procedures may be performed on the financial information of components, the objective of the EQ review is still the same, i.e., an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon.
49. For a group audit engagement, the Task Force view is that the focus of the EQ review are those significant judgments relating to the group financial statements, which may relate to significant judgments made at one or more components. In this regard, the performance of an EQ review

for a group audit engagement may involve additional considerations by the EQ reviewer depending on the size and complexity of the group. For larger, more complex group audits, the EQ reviewer may need to discuss significant matters and significant judgments with other key members of the engagement team (e.g., the partners or other individuals responsible for performing audit procedures on the financial information of a component). In these circumstances, it may be appropriate for the EQ reviewer to be assisted by an individual or team of individuals, either internal or external, with the relevant expertise, in accordance with paragraph 17 of the standard, including, when applicable, individuals appointed to perform an EQ review of a component.

50. New application material (see paragraph A28A in **Agenda Item 8-D**) was added to provide guidance for group audit considerations in an EQ review as described above. This proposed guidance reflects discussions with the ISA 600 Task Force, and any further changes will be coordinated with that Task Force.

Matter for IAASB Consideration

3. The IAASB is asked for its views on the proposed application material in paragraph A28A regarding guidance for group audit considerations in an EQ review.

Appendix 1

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

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

Task Force Activities in the Fourth Quarter of 2019

2. In the fourth quarter of 2019, the Task Force held two teleconferences and met once in person to discuss the Task Force's consideration of the direction received at the September 2019 IAASB meeting and the additional key issues arising from the comment letters, and develop the Task Force's recommendations for the IAASB's consideration.

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

IAASB Task Forces – ISQM 1, ISA 220 and ISA 600 Task Forces

3. In the fourth quarter of 2019, the Chairs of the four Task Forces and Staff held one teleconference and plan another. Further coordination has also been facilitated through Staff liaison on specific matters.

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4. **Scope of Engagements Subject to EQ Review** – In Q4 of 2019, the Task Force shared the post-ED revisions on the requirements and relevant application material for the scope of engagements subject to an EQ review.
5. **Objectivity and Cooling-Off Period** – In Q4 of 2019, the Task Force shared the post-ED revisions on the requirements and relevant application material for the objectivity and the mandatory cooling-off period of an individual being appointed as an EQ reviewer after previously serving as the engagement partner.