

Agenda Item 3-A (Updated)

REQUIREMENTS AND RELATED APPLICATION MATERIAL ON ENGAGEMENTS SUBJECT TO AN EQ REVIEW IN PROPOSED ISQM 1

(MARKED FROM SEPTEMBER 15)

Requirements

34. In designing and implementing responses in accordance with paragraph 26 and in order to achieve the quality objectives, the firm shall include the following responses: (Ref: Para. A116)

...

- (f) The firm establishes policies or procedures that address engagement quality reviews in accordance with ISQM 2, and require an engagement quality review for:
- (i) Audits of financial statements of listed entities;
 - (ii) Audits or other engagements for which an engagement quality review is required by law or regulation; and (Ref: Para. A133)
 - (iii) Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risk(s). (Ref: Para. A134-A137)

Application and Other Explanatory Material

Engagements Subject to an Engagement Quality Review

Engagement Quality Review Required by Law or Regulation (Ref: Para. 34(f)(ii))

A133. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that:

- Are public interest entities as defined in a particular jurisdiction;
- Operate in the public sector or which are recipients of government funding, or entities with public accountability;
- Operate in certain industries (e.g., financial institutions such as banks, insurance companies and pension funds);
- Meet a specified asset threshold; or
- Are under the management of a court or judicial process (e.g., liquidation).

Engagement Quality Review as a Response to Address One or More Quality Risk(s) (Ref: Para. 34(f)(iii))

A134. The firm's understanding of the conditions, events, circumstances, actions or inactions that may adversely affect the achievement of the quality objectives, as required by ~~understood by the firm in accordance with~~ paragraph 25(a)(ii), relates to the nature and circumstances of the engagements performed by the firm. In designing and implementing responses to address one or more quality risk(s), the firm may determine that an engagement quality review is an appropriate response that is based on, and responsive to, the reasons for the assessments given to the quality risks arising from

~~certain conditions, events, circumstances, actions or inactions.~~

Examples of conditions, events, circumstances, actions or inactions giving rise to one or more quality risk(s) for which an engagement quality review may be an appropriate response

Those relating to the types of engagements performed by the firm and reports to be issued:

- Engagements that involve a high level of complexity or judgment, such as:
 - Audits of financial statements for entities operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g., certain large financial institutions or mining entities), or for entities for which uncertainties exist related to events or conditions that may cast significant doubt on their ability to continue as a going concern.
 - Assurance engagements that require specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (e.g., a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein).
- Engagements on which issues have been encountered, such as audit engagements with recurring internal or external inspection findings, unremediated **significant** deficiencies in internal control, or a material restatement of comparative information in the financial statements.
- Engagements for which unusual circumstances have been identified during the firm's acceptance and continuance process (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).
- Engagements that involve reporting on financial or non-financial information that is expected to be included in a regulatory filing, or that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus.

Those relating to the types of entities for which engagements are undertaken:

- Entities in emerging industries, or for which the firm has no previous experience.
- Entities for which concerns were expressed in communications from securities or prudential regulators.
- Entities other than listed entities, ~~which that~~ may have public interest ~~considerations~~ or public accountability characteristics, for example:
 - Entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders including financial institutions, such as certain banks, insurance companies, and pension funds for which an engagement quality review is not otherwise required by law or regulation.
 - Entities with a high public profile, or whose management or owners have a high public profile.
 - Entities with a large number ~~of and diverse wide~~ range of ~~shareholdersstakeholders~~.

A135. The firm's responses to address quality risks may include other forms of engagement reviews that are not an engagement quality review. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures relating to significant risks, or

reviews of certain significant judgments, by individuals within the firm who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.

A136. In some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review or another form of engagement review is an appropriate response to address the quality risk(s).

Public sector considerations

A137. The ~~nature and circumstances of firm may identify and assess quality risks specific to a~~ public sector ~~entities~~ entity (e.g., ~~its~~ due to their size and complexity, the range of ~~their~~ its stakeholders, or the nature of the services ~~they~~ it provides) ~~may give rise to quality risks~~. In these circumstances, the firm may determine that an engagement quality review is an appropriate response to address such quality risk(s). Law or regulation may establish additional reporting requirements for the auditor of a public sector entity (e.g., a separate report on instances of non-compliance with law or regulation to the legislature or other governing body or communicating such instances in the auditor's report on the financial statements). In such cases, the firm may also consider the complexity importance to users of ~~that such~~ reporting, and its importance to users, in ~~identifying and assessing quality risks and~~ determining whether an engagement quality review is an appropriate response.