Dear Willie,

AUASB Submission on the IAASB’s Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews - Responses to Questions on proposed ISQM 2, Engagement Quality Reviews

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to submit our response on the IAASB’s Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews.

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In formulating our response to these proposed standards the AUASB sought input from its stakeholders in three principal ways:

1. From hosting a series of roundtable meetings with stakeholders in three large Australian cities. These roundtable meetings were attended by over 50 stakeholders representing a broad range of backgrounds, including assurance providers from a range of audit firms, professional accounting bodies, academics, those charged with governance and preparers of financial statements.

2. Through an open invitation to provide comments on the equivalent AUASB issued Exposure Drafts via the AUASB website.

3. Formal discussions and deliberations by AUASB members at recent AUASB meetings.

The AUASB supports the IAASB’s objective to develop and maintain robust international standards that contributes to enhanced engagement quality and consistency of practice throughout the world, and strengthened public confidence in the global auditing and assurance profession. However, the AUASB notes with concern that the IAASB’s Exposure Drafts for Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews, all contain greater complexity and detail than the extant standards they are replacing. This makes the proposed standards more challenging for all auditors (especially those auditors of smaller and medium or less complex entities) to apply, and may result in increased costs with arguably no commensurate increase in the level of audit quality for auditors of all types of entities.

As the IAASB continues to revise these proposed quality management standards, the AUASB considers it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in each of the proposed standards (ISQM 1, ISQM 2 and ISA 220), and explicitly weigh these against the costs of transition and application, as a means to support the successful implementation of the proposed standards once they are finalised.

1 July 2019

Mr Willie Botha
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529 5th Avenue, 6th Floor
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Detailed responses to the questions on the key issues considered by the IAASB in developing ED-ISQM 2, Engagement Quality Reviews have been included in the Appendix to this letter. Additionally, individual responses to the questions contained in each Exposure Draft have been submitted via the IAASB’s website.

However, as part of our overall submission on the IAASB’s Exposure Drafts for Quality Management there are a number of specific matters which the AUASB would highlight in our response:

**Overall considerations**

**Implementation Period**

The AUASB considers that a longer implementation period is required, perhaps even considering a staggered implementation approach across key components. For example, commencing first with the governance and leadership components as the foundation of a firm’s System of Quality Management, followed by the other components in subsequent periods.

ISQM 1 is expected to require a significant amount of firms’ resources to put into place a risk assessment process and update firms’ methodologies for the other two quality management standards. Stakeholders expressed concern that an 18-month implementation period for some network firms will be particularly challenging as the network head office may be responsible for developing certain parts of the system of quality management, which will then need to be tailored by individual firms to address their specific facts and circumstances.

Additionally, the AUASB is concerned that there are already two additional exposure drafts currently being finalised by the IAASB (ISA 315 and ISRS 4400) on top of the three new or revised standards included in the suite of Quality Management standards. The AUASB considers that for firms to implement changes in respect of all five of these standards almost simultaneously may have an adverse impact on quality, so a longer implementation period for these standards may be in the public interest.

**ISQM 1**

**Structure and Granularity of the Standard**

The AUASB supports a quality management approach to ISQM 1, however the AUASB is not supportive of the overall standard in its current form.

The AUASB considers the proposed standard to be a hybrid of risk-based quality management requirements that retains a granular level of prescriptive requirement carried over from the extant ISQC 1 standard, which undermines the proper application of a risk-based approach.

The main theme expressed by Australian stakeholders throughout the AUASB’s outreach on ISQM 1 was related to its size and level of granularity. All practitioners, large and small, were concerned with the cost and resources needed to develop a quality management framework in line with the proposed standard as currently drafted. The AUASB encourages the IAASB to refine its drafting approach to reduce the length and complexity of the proposed standard, as well as the other proposed Quality Management Standards being exposed concurrently – ED-ISQM 2 and ED-ISA 220.

The AUASB considers that a quality management approach to ISQM 1 drafted on the same basis as the proposed new drafting approach to ISA 315 (i.e. the requirements being the “what”, and the application material, appendices and guidance constituting the “why” and “how”) would facilitate a better risk-based approach that is scalable to the specific circumstances of a firm. This may help mitigate the potentially large cost and resourcing burden that the implementation of this proposed standard imposes on practitioners.

The AUASB particularly highlights to the IAASB that the large volume of application material, appendices and guidance in the proposed standard needs to be reconsidered. Whilst these examples being included in the proposed standard may assist with implementation, the AUASB suggests the IAASB review the underlying principles in the requirements to make them simpler and more straightforward, which should alleviate the need for many of the examples and illustrations being included in the application guidance and appendices.
Additionally, the AUASB considers that the risk assessment process as designed has the potential to be particularly onerous for practitioners when considering the overall number of prescribed quality objectives required by the proposed standard. To further support a risk-based approach, the AUASB recommends the removal of pre-defined required responses to quality risks in the standard as the AUASB considers that firms should determine their own specific responses tailored to their specific risk circumstances.

Public Interest Benefits
The AUASB considers that it is in the public interest for the IAASB to more clearly demonstrate and articulate the benefits of the proposed quality management approach in ISQM 1, and explicitly weigh these against the costs of transition and implementation, as a means to support the successful implementation of the proposed standard once it is finalised.

Scope of Engagements Subject to Engagement Quality Review
The AUASB does not support the explicit requirement to include ‘significant public interest’ entities in the scope of engagements subject to an engagement quality review. The AUASB supports a risk-based approach to such a determination which is already required in the proposed standard, where a firm is required to determine whether an engagement quality review is an appropriate response to assessed engagement risks.

It is unclear whether the proposed standard would result in an expectation that an engagement quality review is performed on ALL charities and ALL public sector engagements as these entities will always have a large number and wide range of stakeholders. This may be an unintended consequence of the proposed drafting. Furthermore, the AUASB is concerned that ‘significant public interest’ entity cannot be defined consistently across jurisdictions and therefore ISQM 2 would not be applied consistently.

ISQM 2

Guidance regarding a “cooling-off” period should reside in the IESBA Code
The AUASB strongly recommends that all guidance relating to the independence and objectivity of the Engagement Quality Reviewer (EQR) should reside in the IESBA Code as it already addresses these matters. Specifically the inclusion of alternative guidance regarding “cooling-off” periods in ISQM 2 increases the risk of inconsistent application and increases complexity for practitioners who may need to consider two different sources when addressing this issue. The AUASB recommends that the application material in ISQM 2 relating to any “cooling-off” period of the (EQR) should be removed from this standard and a reference to the IESBA code instead be considered (if this application guidance is to be retained).

ISA 220

Inconsistency in the engagement team definition and application guidance between ISA 220 and ISQM 1
The AUASB raises a significant concern that the definition of engagement team may be interpreted differently due to the different application and explanatory material that applies to this definition in ISA 220 (paragraphs A16-A19) not being replicated in ISQM 1. The impact may be that engagement team members are interpreted differently when the different application and explanatory material in each proposed standard is applied. For example, an Engagement Quality Reviewer (EQR) may be considered to be excluded from the engagement team under the definition and application guidance in ISA 220, but included as part of the engagement team under the definition in ISQM 1.

Should you have any queries regarding this submission, please do not hesitate to contact me or the AUASB Technical Director, Matthew Zappulla (mzappulla@auasb.gov.au).

Yours sincerely,

Professor Roger Simnett AO
Chair
Q1. Do you support a separate standard for engagement quality reviews? In particular, do you agree that ED-ISQM 1 should deal with the engagements for which an engagement quality review is to be performed, and ED-ISQM 2 should deal with the remaining aspects of engagement quality reviews?

The AUASB generally supports the IAASB creating a separate standard specific for engagement quality reviews (EQR) as set out in ED-ISQM 2. Given the importance of the EQR role the AUASB considers creating a separate standard effectively communicates the importance of the EQR’s role and responsibilities. We support the requirement in ED-ISQM 1 paragraph 37(e) which identifies those engagements where an EQR is required. This allows firms to clearly determine those engagements that do and do not require an EQR.

The AUASB agree that ED-ISQM 1 should deal with determining the criteria for which an EQR is required and ED-ISQM 2 should deal with all remaining aspects of appointment, eligibility and responsibilities for performing and documenting an EQR.

Q2. Are the linkages between the requirements for engagement quality reviews in ED-ISQM 1 and ED-ISQM 2 clear?

The AUASB believe the linkages between ED-ISQM 1 and ED-ISQM 2 are appropriate.

However we consider that the definition of an EQR in ED-ISA 220 is inconsistent with ED-ISQM 2 and this needs to be addressed. Specifically, the EQR definition in ED-ISA 220 requires that a ‘suitably qualified’ partner or other individual appointed by the firm to be responsible for the performance of the engagement quality review, but this requirements is not captured in ED-ISQM 2.

Q3. Do you support the change from “engagement quality control review/reviewer” to “engagement quality review/reviewer?” Will there be any adverse consequences of changing the terminology in respondents’ jurisdictions?

The AUASB supports the change to “engagement quality review/reviewer” as it is consistent with the proposed suite of quality management standards which now refer to quality management rather than quality control. The AUASB do not believe there would be any unintended consequences as a result of the change.

Q4. Do you support the requirements for eligibility to be appointed as an engagement quality reviewer or an assistant to the engagement quality reviewer as described in paragraphs 16 and 17, respectively, of ED-ISQM 2?

The AUASB are supportive of the eligibility requirements of the “engagement quality reviewer” as outlined in paragraphs 16 & 17.

(a) What are your views on the need for the guidance in proposed ED-ISQM 2 regarding a “cooling-off” period for that individual before being able to act as the engagement quality reviewer?

The AUASB notes that IESBA has changed the IESBA code to include more detailed and specific requirements for auditor rotation for Public Interest Entities (PIEs) with detailed rotational rules and limits for combined roles of Audit Partner, Key Audit Partner, and EQR roles, as well as specified clean periods depending on the combination of the roles held by the partner.

The AUASB considers that any reference to the “cooling-off” period, including the guidance currently included in paragraph A5 of ED-ISQM 2 “that firms establish the cooling-off period
and that the determination of a suitable cooling-off period depends upon the facts and circumstances of the engagements (and applicable provisions of law or regulation or relevant ethical requirements)” should reside in the IESBA code. If these principles reside within the IESBA code they will apply to all professional accountants (or their firms, as applicable) and address the fundamental principles, including independence, and apply the conceptual framework. This would then support consistency across jurisdictions. The test of partner rotation and suitable cooling-off periods is linked to independence and as such should therefore be addressed within the IESBA code.

Accordingly, the AUASB is of the view that the application material in paragraph A5 relating to any “cooling-off” period should be removed from ISQM 2 and a reference to the IESBA code instead be considered if this application guidance is to be retained.

(b) If you support such guidance, do you agree that it should be located in proposed ED-ISQM 2 as opposed to the IESBA Code?

The AUASB strongly recommends that all guidance relating to the independence and objectivity of the EQR should reside in the IESBA Code as it already addresses these matters. The inclusion of alternative guidance regarding “cooling-off” periods in ISQM 2 increases the risk of inconsistent application and increases complexity for practitioners who may need to consider two different sources when addressing this issue.

Q5. Do you agree with the requirements relating to the nature, timing and extent of the engagement quality reviewer’s procedures? Are the responsibilities of the engagement quality reviewer appropriate given the revised responsibilities of the engagement partner in proposed ISA 220 (Revised)?

The AUASB agrees with the requirements in ED-ISQM 2 relating to the nature, timing, and extent of EQR’s procedures, with the following exceptions:

- Paragraph 22(c), the use of “identify the areas involving significant judgments” could be viewed as expanding the role of the EQR beyond what is intended. We recommend replacing “identify” with “evaluate”.

- Paragraph 22(f), it is uncertain as to how an EQR would “evaluate the basis for the engagement partner’s conclusion” and the related application guidance does not provide further clarity. We recommend further clarification around the documentation of the evaluation of the conclusion.

We also refer to the AUASB’s submission on ED-ISA 220 and our response to Question 2 of the ‘Request for Comments’ where we comment further on the proportionality between the roles of the engagement team and the EQR.

Q6. Do you agree that the engagement quality reviewer’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional scepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional scepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

The AUASB agrees that the EQR’s evaluation of the engagement team’s significant judgments includes evaluating the engagement team’s exercise of professional scepticism.

The AUASB does not believe that ED-ISQM 2 should further address the exercise of professional scepticism by the EQR. The role of the EQR is limited to evaluating the significant judgments made by the engagement team, and whether an appropriate level of professional scepticism has been
Responses to Questions on proposed ISQM 2, Engagement Quality Reviews

The AUASB agrees that the EQR’s evaluation of the engagement team’s significant judgements includes evaluating the engagement team’s exercise of professional scepticism, however consider additional application guidance to make it clear how this is appropriately documented in the audit file.

The AUASB is not supportive of the use of the term ‘professional scepticism’ in place of what we regard as really being ‘professional judgement’ by the EQR. Specifically we consider the IAASB needs to review the current requirements in ED-ISQM 2 that require the EQR to evaluate and document the exercise of professional scepticism in relation to significant judgements made by the engagement team.

Q7. Do you agree with the enhanced documentation requirements?

The AUASB is supportive of the enhanced documentation requirements.

Q8. Are the requirements for engagement quality reviews in ED-ISQM 2 scalable for firms of varying size and complexity? If not, what else can be done to improve scalability?

The AUASB agrees that the requirements in ED-ISQM 2 are scalable for firms of varying sizes and complexity.

Additional matters for further consideration in relation to ISQM 2 by the IAASB

- The AUASB is generally supportive of ED-ISQM 2 applying to other assurance and related services engagements and not just audits of financial statements if a risk-based approach to ED-ISQM 1 is appropriately adopted. However the AUASB do note for the IAASB’s consideration where there may be areas within ISQM 2 that may not extend themselves as logically to non-financial statement audit engagements - e.g. cooling-off periods (independence test) and escalation of issues to the EQR on significant judgements where this concept may not apply to other assurance and related services engagements.

- The AUASB is not supportive of the inclusion of the “stand back” requirement in paragraph 24 as currently drafted. The AUASB notes that the stand back provision may represent good practice for some recently revised auditing standards, however there needs to be a clearer articulation of the purpose of the stand back requirement as it relates to the role of the EQR in ISQM 2. The AUASB is supportive of the second limb of paragraph 24 being that the EQR shall notify the engagement partner that the EQR is complete.