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<https://www.ifac.org/publications-resources/submit-comment?exposure-draft=273190>

Mr Willie Botha
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Dear Willie

Comments on the IAASB's Exposure Draft on proposed ISQM 2, *Engagement Quality Reviews*

The Independent Regulatory Board for Auditors (IRBA) is both the audit regulator and national auditing standard setter in South Africa. Its statutory objectives include the protection of the public by regulating audits performed by registered auditors, and the promotion of investment and employment in South Africa.

We appreciate this opportunity to comment on the IAASB's Exposure Draft on proposed ISQM 2, *Engagement Quality Reviews*, developed by the International Auditing and Assurance Standards Board (IAASB).

In the compilation of this letter we have sought the inputs of representatives from large and medium-sized firms, academics, the Auditor-General South Africa, quality management consultants, the Johannesburg Stock Exchange and the South African Institute of Chartered Accountants. Internal IRBA consultations with our Inspections and Investigations departments, brought regulatory perspectives such as an understanding of the expected impact of the proposed quality management standards on regulatory processes, and existing inspections and investigations findings related to quality management.

The comments are presented under the following sections:

- A. Overall comments; and
- B. Specific questions.

Kindly e-mail us at creintjes@irba.co.za, or phone directly on +27 87 940 8828, if further clarity is required on any of our comments.

Yours faithfully,

Signed electronically

Bernard Peter Agulhas
Chief Executive Officer

A. OVERALL COMMENTS

- a) The IRBA welcomes and supports the IAASB's proposed new ISQM 2, *Engagement Quality Reviews*; to ensure robust requirements and improved guidance to:
- i. Modernise the standards for an evolving and increasingly complex environment, including addressing the impact of technology, networks and use of external service providers;
 - ii. Increase firm leadership responsibilities and accountability, and improve firm governance;
 - iii. Ensure more rigorous monitoring of quality management systems, and remediate deficiencies;
 - iv. Enhance the engagement partner's responsibility for audit engagement leadership and audit quality; and
 - v. Address the robustness of engagement quality reviews, including engagement selection, documentation and performance.
- b) The extant ISQC 1, including the engagement quality control requirements, is now 10 years old. During this period the audit environment changed substantially, and in many countries audit quality challenges have been encountered. In the current environment where there is a need to restore trust in the auditing profession in several countries, the IAASB's project on quality management is commended.
- c) We are supportive of the length of the standard and the conciseness of its requirements and application material.

B. SPECIFIC QUESTIONS

Question 1

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?

- a) We support a separate standard for engagement quality reviews (EQRs) and the role of engagement quality reviewers (EQ reviewers). EQRs are an important response to quality risks and having a separate standard that is focused on this subject is in the public interest and gives this subject the necessary prominence.
- b) We agree with the "link" to the scoping of requirement for EQRs in ED-ISQM 1.
- c) We further suggest that paragraphs 37(e) and A101-A105 of ED-ISQM 1 also be included in ISQM 2, without deleting it from ED-ISQM 1. This will make ISQM 2 contain everything relevant to EQRs, and may improve navigation between the standards, and aid in understanding.

Question 2

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

- a) Yes, the linkages are clear. However, as per our response to question 1 above, we suggest that the scope of EQRs also be included in ISQM 2, for completeness of the standard.
- b) Paragraph 15 of ED-ISQM 2 requires the audit firm (firm) to establish policies and procedures that require the assignment of responsibility for the appointment of EQ reviewers to an individual/s. However, who is responsible if an EQ reviewer is not appointed on an engagement where this was a requirement? Is it the engagement partner's responsibility for not appointing the EQ reviewer, or the individual/s identified in this paragraph? Paragraph A22 of ED-ISQM 2 states that it is the responsibility of the engagement partner, and this may then imply that it is not the responsibility of the individual/s identified. We recommend that this responsibility be clarified.

Question 3

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?

- a) We support the change. The term "control" sometimes implies an action after an event, i.e. it is reactive or detective in nature, and not preventative. The new standards refer to "quality management", which implies a pre-emptive, proactive action, which seeks to prevent problems from arising. We therefore agree with the removal of the word "control" in this context.
- b) In South Africa we do not foresee any adverse consequences of changing the terminology.

Question 4

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?

- 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?*

- a) We support the requirements for eligibility to be appointed as an EQ reviewer or an assistant to the EQ reviewer. These are significant and necessary improvements to the eligibility requirements.
- b) Our inspections findings have indicated that often EQ reviewers are not sufficiently objective. Partners in a firm who are appointed as EQ reviewers, even if they are neither the engagement partner nor involved in the engagement, sometimes have interests that are too closely aligned with those of the engagement partner to offer an objective view or challenge of the significant judgments made by the audit team. We therefore question whether for high-risk public interest

entities (PIEs), may be necessary to take further steps to ensure that the EQ reviewer is objective. The nature of what constitutes high risk could be informed by the firm's risk assessment process, and the firm's client acceptance and continuance process. It may include for example entities experiencing negative media reporting of relevance to financial reporting. The nature of steps that could be taken, revolve around the selection of the EQ reviewer, and could include the further strengthening of objectivity by engaging an eligible EQ reviewer from outside the firm (whether from the network, or an external service provider).

- c) Regarding the appropriate authority of the EQ reviewer paragraph A11 of ED-ISQM 2 states that such authority may be diminished when the EQ reviewer has a reporting line to the engagement partner, or when the engagement partner is responsible for determining the compensation of the EQ reviewer. While we recognise that this provision may address the situation of very small firms, our view is that such reporting lines "will" diminish authority. We therefore recommend that such conditions be set out in ISQM 2 as threats that should be avoided (and if need be, an external EQ reviewer should be appointed).
- d) We suggest that a further factor that could be included in paragraph A20 of ED-ISQM 2 is to address circumstances that could arise during an engagement that result in the EQ reviewer no longer being objective.
- e) In the absence of the IESBA addressing issues related to cooling-off in the IESBA Code, we recommend that the cooling-off guidance included in paragraphs A5 and A14 be elevated to a requirement in ISQM 2. It is our view that requirements related to cooling-off should preferably be addressed in the IESBA Code. Users currently must reconcile local legislation with the IESBA Code requirements; so, including EQ reviewer independence requirements in the quality management standards will further complicate the matter. However, in the absence of such a requirement in the IESBA Code, it is necessary that it be addressed in ISQM 2.
- f) Regarding an EQ reviewer, the IESBA Code deals with a cooling-off period that follows a 7 years "on" period, as well as a cooling-off period for an individual who performed different key audit partner roles for seven years. The IESBA Code does not deal specifically with the cooling-off period where the engagement partner transitions to be an EQ reviewer. While the conceptual framework of the IESBA Code will apply to considerations of threats to objectivity and independence, our view is that the conceptual framework would not be sufficiently robust in addressing the risks. Alternatively, the IESBA Code could be used to prescribe a cooling-off period (e.g. two or three years). This, however, would require a change to the IESBA Code and liaison between the IAASB and the IESBA.
- g) A further question to consider is whether the cooling-off period for a transition from being an EQR to an engagement partner, or vice versa, should be the same for PIEs (as defined) and non-PIEs. The IESBA Code does not generally see this in the same light, i.e. it has different requirements for the auditors of PIEs versus the auditors of non-PIEs. Additionally, the IESBA Code requires the firm to consider all individuals that may require a rotation period (R540.4). This may seem like a provision that needs to include, specifically, the eligibility of the various roles related to the engagement.

Question 5

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)?

- a) We are concerned that the responsibilities of the EQ reviewer seem to be greater or more explicit than those of the engagement partner. Paragraph 22 of ED-ISQM 2 lists the review work that the EQ reviewer must perform. Paragraphs 29-31 of ED-ISA 220 list the review work that the engagement partner must perform. Although the engagement partner, and not the EQ reviewer, takes overall responsibility for the conduct of the engagement, it seems that the engagement partner's required work effort is substantially less, with fewer working papers needing to be reviewed. In considering the quality management standards together, the IAASB may wish to consider what further enhancements are necessary to emphasise the engagement partners responsibilities.
- b) Paragraph 21(c) of ED-ISQM 2 requires the firm to establish policies or procedures regarding the performance of the EQR that address circumstances when the nature and extent of engagement team discussions with the EQ reviewer about a significant judgment give rise to a threat to the objectivity of the EQ reviewer, and appropriate actions to take in these circumstances. When these circumstances arise, it is necessary for the standard to clarify how it should be documented. If it is not documented, how would an audit regulator or those doing file monitoring know that this issue arose and was appropriately resolved?
- c) It is not clear whether paragraph 22(a)(ii) of ED-ISQM 2 means the results of the firm's monitoring and remediation at the firm level or at the engagement level. We recommend that it should be for both. Firm level deficiencies may affect all or many engagements, and this should have been addressed at the engagement level too by the engagement partner. Engagement level deficiencies should have been resolved by the engagement partner.
- d) ED-ISQM 2 allows other individuals to assist the EQ reviewer. We recommend that clarity be provided regarding:
 - i. The work, and how much of it, could be assigned to these individuals.
 - ii. The direction and oversight of the individuals assisting the EQ reviewer.
- e) A description of "significant judgments" is included in paragraph A79 of ED-ISA 220 (Revised). We urge the IAASB to elevate the description of "significant judgments" to a definition in ISA 220 (Revised), and to then include this as a definition in ISQM 2 also. This will avoid the review of certain significant judgments being omitted, e.g. materiality and risk assessment (listed in ED-ISA 220 (Revised), paragraph A79).
- f) What is the level of the "reading and understanding" expected from the EQ reviewer, as per paragraph 22(a) of ED-ISQM 2? How would this understanding be evidenced? How could different interpretations of expectations be avoided? Also, how is "understanding" demonstrated?
- g) We recommend that the following requirements be added to paragraph 22 of ED-ISQM 2:
 - i. A debriefing or similar action between the EQR and those responsible for quality management in the firm, soon after the EQR is completed. Guidance could include that the debriefing might take place at any time during the EQR, if a significant deficiency in the audit is detected and cannot be resolved, or the engagement partner does not intend to resolve it. The debriefing will give an EQ reviewer the opportunity to raise concerns encountered during the EQR, without having the engagement partner or members of the engagement team present. We recommend that the debriefings should be routine or mandatory so that there is no opportunity to pressure the EQ reviewer to dispense with the debriefing.
 - ii. The EQR to include a requirement to consider whether the most recent acceptance/continuance assessment decision should be revised, or whether additional safeguards should be put in place, if there are indicators that the acceptance/continuance decision may have either been incorrect, or that information is now available that would lead to

a change in the decision.

- iii. The EQ reviewer to be required to review the schedule of unadjusted audit differences (corrected and uncorrected misstatements).
- iv. The EQ reviewer to be required to review all working papers related to assertions of a significant risk area. Paragraph 21 of ISA 330, *The Auditor's Responses to Assessed Risks*, states that if the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to the risk. The EQ reviewer should be required to inspect documentation in this regard.
- v. The EQ reviewer to be required to inspect the risk assessment at the financial statement and assertion levels in order to obtain an understanding of the risks and significant risks.
- vi. (Added to paragraph 22(d)):
 - Significant risks identified during the engagement and the responses to those risks.
 - Judgments made, particularly with respect to materiality and significant risks.
 - The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
 - The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.
- h) We recommend that the depth of the review of the financial statements and the auditor's report thereon (as well as the engagement report and, when applicable, the subject matter information for an assurance or related services engagement) be clarified (paragraph 22(g) of ED-ISQM 2). It is necessary to clarify whether the EQ reviewer needs to perform a detailed review of the financial statements to determine whether the reporting framework has been complied with, or whether the EQ reviewer need to review only the disclosures in the financial statements that relates to the significant judgments? With regards to the audit report, does the EQ reviewer need to review the audit report in detail (each sentence) or just that the audit opinion is correct? These responsibilities need to also be compared with the responsibilities of the engagement partner.
- i) We recommend that a timeframe be included in the requirement in paragraph 23 of ED-ISQM 2. A suggestion is that the individual/s be notified promptly or immediately.
- j) Our inspections have found that:
 - i. Some firms rely heavily on the services of external consulting firms to perform their EQRs, and did not accept full responsibility for the EQR function as it had been outsourced. Paragraph A4 states that:

“In some circumstances, there may not be a partner or other individual within the firm who is eligible to perform the engagement quality review and the firm may therefore contract with, or obtain the services of, external individuals to perform the engagement quality review. An external individual may be a partner or an employee of another firm within the firm's network or a service provider. When using such an external individual, the firm is subject to the requirements for network requirements or network services in paragraphs 59–60 of proposed ISQM 1, or the requirements for service providers in paragraph 65 of proposed ISQM 1, respectively.”

In order to emphasise that the firm is still fully responsible for the EQR function, we suggest

that the IAASB elevates content from this paragraph to a requirement.

- ii. It was not evident that the EQR was started sufficiently early in the engagement to allow for timely consultation on significant matters identified during the engagement, as some of the planning working papers (for example, client acceptance) were reviewed on the same date as the auditor's report. Paragraph A26 of ED-ISQM 2 provides examples of the stages of planning, risk assessment, performance, completion and reporting as appropriate points in time. We suggest that the IAASB elevates content from this paragraph to a requirement.

Question 6

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 skepticism? Do you believe that ED-ISQM 2 should further address the exercise of professional skepticism by the engagement quality reviewer? If so, what suggestions do you have in that regard?

- a) We agree that the EQ reviewer's evaluation of the engagement team's significant judgments should include evaluating the engagement team's exercise of professional skepticism. We question, however, how this evaluation would take place, as this would require professional judgment to be applied by the EQ reviewer to the engagement team's professional skepticism, and both are subjective concepts. We recommend that a framework for this evaluation be included in ISQM 2.
- b) We believe that ISQM 2 could place more emphasis on professional skepticism. We encourage the IAASB to add a requirement that the EQ reviewer demonstrate his/her professional skepticism by documenting his/her considerations where he/she has applied professional skepticism.

Question 7

Do you agree with the enhanced documentation requirements?

- a) We would prefer clarity on how the evaluation discussed in question 6(a) above would be evidenced on the file. A possible solution is to include commentary on how the EQ reviewer was able to conclude on significant judgments, following the review of selected working papers. An alternative solution is to include mandatory minimum criteria in terms of significant matters and judgments, as interpretations differ from individual to individual and firm to firm. The level of subjectivity in this area makes it difficult to inspect and report on deficiencies.
- b) By default, the EQ reviewer should also scope in all working papers related to assertions of a significant risk area.
- c) We recommend that the requirements need to clarify that the documentation should include the scope of the EQR, and which assertions were reviewed.
- d) We recommend that the EQ reviewer be required to document the discussions between him/her and the engagement team/partner.
- e) Would an EQ reviewer be expected to document why they have not raised an issue or finding? In areas of professional judgment, for example, this may assist with explaining to an audit regulator or those performing file monitoring that an issue was considered but not progressed.

- f) Although paragraph 25 of ED-ISQM 2 states that it is the EQ reviewer's responsibility to document the EQR, it is not clear whose responsibility it is to ensure that the documentation is included in the audit file. If documentation regarding the EQR is omitted from the file, the engagement partner may not be able to prove that the EQR was performed.
- g) Further, we recommend that where findings are raised by the EQ reviewer, and these are resolved by way of a discussion, that discussion and conclusion be documented. Our inspections have raised findings that EQ reviewers did not raise certain matters, and the response was then that the matters were resolved verbally, but that was not documented.

Question 8

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?

- a) We are confident that the requirements are sufficiently scalable.
