

July 1, 2019

IFAC Small and Medium Practices Committee Response to the IAASB's Exposure Draft for International Standard on Quality Management – Engagement Quality Reviews (or Proposed ISQM 2)

INTRODUCTION

The SMP Committee (SMPC) is pleased to respond to the IAASB (the Board) Exposure Draft (the ED), for *Quality Management at the Firm and Engagement Level, including Engagement Quality Reviews (EQR)*. The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMPC are small- and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members and Technical Advisers serving the SMPC are drawn from IFAC member bodies representing 22 countries from all regions of the world.

GENERAL COMMENTS

The proposed ISQM standards and ISA 220 (Revised) are two sets of very important standards as they will shape the foundation of quality management (QM) of SMPs going forward. We commend the significant amount of work that has been undertaken by the Board in progressing these projects and we continue to support the objective of enhancing QM.

The SMPC is pleased to have had the various opportunities to contribute to this project as it has progressed over the last three years.

We continue to believe that an appropriate overall quality objective ought to be about establishing and maintaining the firm capabilities to perform quality engagements on a consistent basis but being scalable enough to accommodate firms of all sizes. Hence, we believe that more direction is needed and provide suggestions to enhance the clarity below.

Based on how the standard is currently being drafted, the ISQM 2 is unique as it commingles firm wide requirements for policies and procedures and engagement level requirements relating to EQR with the objective of the firm being framed in part, as the responsibility of the EQ reviewer. Although the IAASB is confident that such an approach is not an issue (since the standard is intended to be outcome-oriented), the SMPC has some concerns over the approach. The lack of clear demarcation of responsibilities between the firm, the engagement partner and the EQR may lead to confusion as to who is ultimately responsible, particularly in the case of breaches and where the remedial action should be taken. The risks associated with this might be reduced if the standard was restructured to deal with firm wide policies and procedures and engagement level procedures separately.

We question whether the three EDs as a whole will really increase audit quality from an SMP perspective.

We are also concerned that the complexity of the standards taken together may drive a compliance mindset, especially amongst smaller firms who become subject to proportionately greater documentation burdens to



“explain/ prove” their compliance. In our view, it is important that IAASB ensure the final suite of QM Standards addresses this issue in order to foster an effective focus on the quality of the services each individual firm delivers, as opposed to compliance with complex standards.

DETAILED COMMENTS

We have outlined our responses to the questions (in bold) in the ED below.

Overall Questions

- 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?**

There are mixed views among the SMPC members. A separate standard for EQR is considered by some to increase scalability because if a firm determines that an EQR is not a required response to a quality risk, then the requirements of the standard will not apply.

However, a separate standard may potentially overemphasize the role of EQR as opposed to the engagement partner in ensuring engagement quality. This position has previously been articulated in our [comment letter to the ITC](#) as well as our response to the Board paper in September 2017. As we have explained before, we agree that EQR is a means to address public perception that quality must be specifically ensured by EQR for entities with a specific degree of public interest, which are listed entities and any others required by law to have an EQR. As stated in para 6, an EQR is an objective evaluation of significant judgments made by the engagement team, and the conclusions reached thereon. The EQR therefore lends comfort to users of the engagement report as to the quality of the engagement only in that respect. However, quality is primarily achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements (para 5).

EQR is only one possible response to a firm’s engagements quality risks. It is not necessarily the most appropriate or most effective response to (internal) quality risks in all circumstances. It would not be helpful if engagements that did not involve an EQR (many will be performed by SMPs) were considered to be of a different standard to those subject to EQR. As a separate standard, ISQM 2 may give the impression that an EQR might be “best practice” for far more engagements than under the current quality control standards. Thus, IAASB may want to reflect on how to ensure such messaging will not gain traction as the standard is being finalized. A suggestion is for the IAASB to emphasize in ISQM 1 that an EQR is one response to quality risk but is not the only one. It would be helpful to include wording similar to that in the Explanatory Memorandum that “an EQR is a response, among others, that is designed and implemented by a firm to address its assessed quality risks.”

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

Yes, the linkages are sufficiently clear. However, as IAASB has acknowledged, there are considerable issues in defining what constitutes a public interest entity (PIE) globally.



- 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?**

Yes, we support the changes in terminology. National regulators and PAOs will need to revise their national legislations and other regulations to reflect this change of terminology. The time frame will vary from country to country. In our response to the over-arching explanatory memorandum that was issued with the three EDs, the SMPC had voiced concern about the IAASB proposed 18 months implementation period, which we believe is too short for effective implementation of such critical standards.

- 4) **Do you support the 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 guidance in proposed ISQM 2 regarding a “cooling off” period for that individual before being able to act as the engagement quality reviewer?**

As the SMPC has previously commented to the IAASB, smaller firms often have relatively small pool of individuals with both the seniority and experience to act as engagement partners and engagement quality reviewers. For this reason, the practicalities associated with internal rotation generally poses specific challenges to such firms. We would caution that the use of any external third party adds significant costs that will disadvantage SMPs and/ or the SMEs they serve.

We are therefore concerned to note that the IAASB is seeking to go beyond the requirements of the IESBA Code, by looking beyond the notion of long association with the client to association with the engagement itself, i.e., where an individual becoming EQR had previously served as the engagement partner. In para 16, the IAASB purports that such an individual’s objectivity will be compromised, by requiring limitations on eligibility in all cases. However, para A5 suggests that it is not likely that threats to objectivity can be reduced to an acceptable level, although it also implies that there is still exception in very rare circumstances. In our view, para 16 should be revised to reflect this, as whilst we appreciate that there could be risks to objectivity by such a move in certain circumstances, this may not be the case in all engagement circumstances where an EQR is performed. There may be possible safeguards available apart from subjecting the individual to a cooling off period. The approach taken should mirror that of para 21(c).

As an example, a cooling off period only makes sense where the individual had made one or more decisions of a contentious nature and no other quality related measures had been taken at that time (e.g., previous EQR, consultation or external advice). The IAASB itself recognizes the value of such measures in discussing the issue of objectivity in para A24. Indeed, in a small firm environment, requiring a cooling off period unless absolutely essential (risk cannot be reduced to an acceptably low level by other means) may well deprive the EQR of the services of the best placed individual, and thus be detrimental to engagement quality.



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

We believe that matters that are assurance related should be included in the IAASB Handbook and matters relating to ethics should be in the IESBA Handbook (and there should not be duplication of content). As eligibility to act as an EQR is directly related to ISQM 2, it should be within the standard.

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)?

The SMPC noted that para 12 of the Explanatory Memorandum to ISQM 2 states: "The IAASB agreed that ... the EQR is a response to an assessed quality risk(s)". Thus the IAASB is proposing a significant change from the extant ISQC 1, as EQR would be applicable for engagements that have (only) some (internal) quality risk attached. Unless the impact of such quality risks is entirely pervasive (impacting all significant judgments) – in which case it is likely that the firm should not have accepted the engagement in the first place – a full EQR would appear to be excessive, because the focus should instead be on isolated areas of risk. Such focus could be more appropriately achieved by other means of e.g., subject matter review or consultation on a specific issue. An EQR may add to the perception that a really effective QM measure is in place, irrespective of whether it is in fact always warranted in the individual circumstances. Such perception may be of importance for the PIE market but may not necessarily be so outside this market.

As such, in our view, it is questionable whether EQR should be viewed as an appropriate measure to deal with pervasive (firm - internal) quality risks, as it should not be seen as a remedy allowing a firm to take on engagements for which it is unable to handle. For this reason, the preliminary decision on whether or not an EQR is needed should be made at engagement acceptance (and reviewed, if circumstances have changed).

This change as highlighted here will, as a consequence, impact the overall nature, timing and extent of the EQR's procedures. The IAASB may want to re-evaluate the rationale of such an approach.

Para 16 (a) of the ED further states that "Those policies and procedures shall require that the EQR not be a member of the engagement team and have the competence and capabilities, including sufficient time and the appropriate authority to perform the EQR". Such conditions may be possible if the EQR is sourced internally within the firm but may prove difficult to ensure in practice if an external EQR is engaged, as his or her time commitment may depend on their other personal engagements or commitments to which the firm may not be privy.

We would like the IAASB to clarify whether the reviewer is required to consider the completeness of significant judgements i.e. is the reviewer required to consider whether there is anything that they deem to be a significant judgement that the engagement partner and team have possibly overlooked?



The explanation in the Explanatory Memorandum (paras 34 to 36) may need more clarity when finally communicated.

We also foresee some issues with para 22(f) as it seems very unlikely that the engagement partner will conclude that they have not taken overall responsibility for managing and achieving quality. The focus should instead be on what the reviewer will expect to see on the audit file to support this conclusion.

- 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?**

We agree that the engagement quality reviewer's evaluation of the engagement team's significant judgements should include evaluating the engagement team's exercise of professional skepticism. We believe that the ED-ISQM 2 adequately provided for this.

- 7) Do you agree with the enhanced documentation requirements?**

We agree that that documentation has to be sufficient to enable an experienced practitioner and individuals who assist the reviewer, having no previous connection to the engagement, to understand the nature, timing and extent of the EQR procedures performed. However, the SMPC would like to request for IAASB to provide more guidance about the form, content and extent of the documentation of the EQR. Some of this guidance could be in the form of staff publication.

One suggestion is for para 27 to be re-positioned as Application Material (AM). This will allow flexibility and further support the AM in para A37 which recognizes that the form, content and extent of documentation depends on a number of factors.

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

The SMPC would like to commend the Board for providing the Appendix under page 14 and 15. This table provides the reader an understanding of the scalability of the standard for firms of different sizes and for engagement where nature and circumstances differ. However, in our view, more can still be done in this context. For example, providing practical examples based on a SMP environment would be helpful for SMPs implementing the standard. The SMPC would be happy to work with the Board in this respect.

As indicated under Question (5) above, we are concerned that the work required of an engagement quality reviewer is not wholly tailored (hence, lack of scalability) to the quality risks applicable to the individual engagement circumstances. For example, a going concern risk demanding specific experience in this area could focus more on work performed in this aspect of the engagement but may not need the EQR to look at all areas including all other judgements made during the



engagement that may or may not be considered significant (e.g., a contentious matter would require more detailed consideration by the EQR than an uncontentious issue).

We note the relationship between ISQM 2 and ISA 220, but suspect that a robust definition of the term “significant judgment” will be needed to foster a common understanding between the engagement partner and the EQR and that this is where the IAASB could introduce the need to focus on really key judgments arising from those significant matters.

The cooling off period, appointment and eligibility of the EQR is still overly prescriptive with little recognition of how smaller firms will manage the EQR process. The IAASB could reflect on what additional support and guidance could be developed to assist SMPs.

CONCLUDING COMMENTS

We hope that the IAASB finds this letter useful. We are committed to helping the Board in whatever way we can to build upon the results of the ED.

Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

Monica Foerster

Monica Foerster
Chair, SMP Committee