

# Overview of Proposed ISQM 2, Engagement Quality Reviews

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In February 2019, the International Auditing and Assurance Standards Board (IAASB) issued three exposure drafts for quality management at firm and engagement levels, with a comment deadline of 1 July 2019. This included Proposed International Standard on Quality Management 2, *Engagement Quality Reviews* (ED-ISQM 2). This article provides an overview of the proposed requirements contained in ED-ISQM 2.

## Background to ED-ISQM 2

The most visible change from the IAASB's project on quality management relates to engagement quality reviews (EQRs) in that it resulted in the drafting of a separate standard, namely ED-ISQM 2. High value is placed on the role that the engagement quality reviewer plays within an engagement by stakeholders. A separate standard was proposed in an attempt to emphasise the importance of the EQR. This was also seen as a means to address concerns around the extant quality control standards not being scalable, as well as a mechanism for elaborating on the requirements and application material for EQRs.

The objectives of the project to develop ED-ISQM 2 included the following:

- setting more robust criteria for firms to apply when determining which engagements should be subject to an EQR;
- establishing the objective of an EQR;
- clarifying the nature, timing and extent of the EQR, and
- enhancing the requirements for the eligibility of the individuals who perform the review<sup>1</sup>.

## Overview of ED-ISQM 2

In line with the objectives of the project, ED-ISQM 2 includes the requirements in relation to the appointment and eligibility for the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an EQR. The requirements for engagements subject to an EQR remains within Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control (ISQC) 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1). The proposal included in ED-ISQM 1 is that a firm is required to perform EQR for:

- Audits of financial statements of listed entities;
- Audits of financial statements of entities that the firm determines are of significant public interest; and
- Audits or other engagements, which:
  - An EQR is required by law or regulation; or

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<sup>1</sup> <http://www.iaasb.org/projects/engagement-quality-reviews-isqm-2>

- The firm determines that an EQR is an appropriate response to assessed quality risks, based on the reasons for the assessments given to those risks<sup>2</sup>.

An EQR is a firm level response to identified and assessed quality risks that is implemented by the engagement quality reviewer on behalf of the firm. ED-ISQM 2 is clear in stating that the performance of an EQR does not reduce the responsibilities of the engagement partner for achieving quality on the engagement, nor does it change the nature, timing and extent of procedures that need to be performed by the engagement team<sup>3</sup>.

Another important point to note is the interaction between the three quality management standards. ED- ISQM 1 retained the requirements for engagements subject to the EQR. ED-ISQM 2 now includes the requirements in relation to the appointment and eligibility of the engagement quality reviewer and the related responsibilities, with Proposed International Standard on Auditing 220 (Revised), Quality Management for an Audit of Financial Statements (ED-220) dealing with the requirements applicable to the engagement partner's responsibilities in relation to the EQR.

#### Eligibility for the engagement quality reviewer

ED-ISQM 2 indicates that the firm shall establish policies or procedures that set forth the criteria for the eligibility to be appointed as an engagement quality reviewer. Such policies or procedures must include limitations on the eligibility of an individual to be appointed as engagement quality reviewer for an engagement on which the individual previously served as engagement partner. Such firm policies or procedures must include the following criteria to be applied in evaluating whether the individual to be appointed as the engagement quality reviewer is eligible for that appointment. The individual:

- is not a member of the engagement team;
- have the competence, capabilities, sufficient time and appropriate authority to perform the EQR;
- complies with the relevant ethical requirements, including that threats to objectivity of the engagement quality reviewer related to the engagement or the engagement team are eliminated or reduced to an acceptable level; and
- comply with requirements of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer <sup>4</sup>.

#### Engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review

In initial communication from the IAASB in relation to the ISQM 2 project, it was indicated that there will be a strong message that the EQR should be undertaken at appropriate points in time throughout the engagement and not just at the end of the engagement right before the report is due to be issued. In response to this, ED-ISQM 2 requires that the engagement quality reviewer perform procedures at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgements made by the engagement team and the conclusions reached thereon<sup>5</sup>.

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<sup>2</sup>ED-ISQM 1. 37(e)

<sup>3</sup> ED-ISQM 2.7

<sup>4</sup> ED-ISQM 2.16

<sup>5</sup> ED-ISQC 2.21(a)

ED-ISQM 2 is not prescriptive in terms of what is considered to be appropriate points in time. The related application material indicates that the timing of the procedures performed by the engagement quality reviewer may depend on the nature and circumstances of the engagement and continues to state that timely review of the engagement documentation by the engagement quality reviewer at appropriate points in time throughout all stages allows significant matters to be promptly resolved to the engagement quality reviewer's satisfaction and may reinforce the engagement team's application of professional judgment and its exercise of professional scepticism in performing the engagement<sup>6</sup>.

In terms the nature and extent of procedures performed by the engagement quality reviewer, the application material of ED-ISQM 2 indicates that this may be dependent on:

- The reasons for the assessment given to quality risks;
- Findings arising from firm's monitoring activities, which may indicate areas where more extensive procedures need to be performed by the engagement quality reviewer;
- The complexity of the engagement;
- The nature and size of the entity, including whether the entity is a listed entity;
- Other information relevant to the engagement such as results of external inspections or concerns noted about the commitment to quality of the firm or its personnel;
- The firm's acceptance and continuance of client relationships and specific engagements, which may indicate new risks to achieving quality for an engagement;
- Whether members of the engagement team have cooperated with the engagement quality reviewer; and
- For assurance engagements, the engagement team's consideration of, and responses to, areas of risks of material misstatement in the engagement<sup>7</sup>.

The objective of the EQR to provide an objective evaluation of the significant judgments made the engagement team and the conclusions reached thereon<sup>8</sup>. In my view, ED-ISQM 2 provides little guidance in identifying areas where significant judgments have been made. The application material relating to significant matters and significant judgments merely refers to ED-220 and the engagement partner's responsibility to review audit documentation relating to significant matters and other areas involving significant judgment<sup>9</sup> and the examples provided in ED-220 of significant judgments<sup>10</sup>. ED-ISQM 2 continues to indicate that for engagements other than audits, i.e. where the reference back to ED-220 is not applicable, the engagement quality reviewer may consider the nature and circumstances of the engagement in identifying significant matters, and significant judgments made by the engagement team<sup>11</sup>.

### In concluding

The introduction of a separate firm level standard relating to quality management increases the prominence of an EQR, emphasises the importance thereof and enhances scalability. The appropriate

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<sup>6</sup> ED-ISQM 2.A26

<sup>7</sup> ED-ISQM 2.A27

<sup>8</sup> ED-ISQM 2.11(a)

<sup>9</sup> ED-ISQM 2.A29

<sup>10</sup> ED-ISQM 2.A30

<sup>11</sup> ED-ISQM 2.A31

use of the EQR as a firm level response to quality risks will contribute to achieving the objectives of enhancing and improving audit quality.

Source:

- Proposed International Standard on Quality Management 2, *Engagement Quality Reviews*.