

Exposure Draft

January 2020

Comments due: March 16, 2020

*International Ethics Standards Board
for Accountants®*

Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers

IESBA

International
Ethics Standards
Board for Accountants®

About the IESBA

The [International Ethics Standards Board for Accountants](#)® (IESBA®) is an independent global standard-setting board. The IESBA's mission is to serve the public interest by setting ethics standards, including auditor independence requirements, which seek to raise the bar for ethical conduct and practice for all professional accountants through a robust, globally operable [International Code of Ethics for Professional Accountants \(including International Independence Standards\)](#) (the Code).

The IESBA believes a single set of high-quality ethics standards enhances the quality and consistency of services provided by professional accountants, thus contributing to public trust and confidence in the accountancy profession. The IESBA sets its standards in the public interest with advice from the IESBA Consultative Advisory Group (CAG) and under the oversight of the Public Interest Oversight Board (PIOB).

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REQUEST FOR COMMENTS

This Exposure Draft, *Proposed Revision to the Code Addressing the Objectivity of Engagement Quality Reviewers*, was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. Comments are requested by **March 16, 2020**.

Respondents are asked to submit their comments electronically through the IESBA website, using the [“Submit a Comment”](#) link. Please submit comments in both PDF and Word files. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IESBA prefers that comments are submitted via its website, comments can also be sent to Ken Siong, IESBA Senior Technical Director at KenSiong@ethicsboard.org

This publication may be downloaded from the IESBA website: www.ethicsboard.org. The approved text is published in the English language.

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OBJECTIVITY OF ENGAGEMENT QUALITY REVIEWERS
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EXPLANATORY MEMORANDUM

I. Introduction

1. This memorandum provides background to, and an explanation of, the proposed addition of application material to Section 120¹ of the Code to address the objectivity of engagement quality reviewers.
2. The IESBA approved this Exposure Draft (ED) in December 2019.

II. Background

3. Some respondents to the International Auditing and Assurance Standards Board's (IAASB's) December 2015 [Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*](#), questioned whether the global auditing or ethics and independence standards should clarify issues relating to an engagement quality control reviewer's² (EQCR) objectivity. Specifically, it was pointed out that some jurisdictions require firms to establish mandatory "cooling-off periods" for individuals previously involved in the audit engagement, in particular engagement partners, before they can act in an EQCR role on the same engagement.
4. The IAASB noted that relevant ethical requirements, such as the IESBA Code, may not specifically address threats to objectivity that may arise in these circumstances. For example, a self-review or self-interest threat might be created when judgments made by the individual in the previous engagement continue to influence subsequent periods, as is often the case in an audit of financial statements.
5. The IAASB issued the exposure draft [Proposed International Standard on Quality Management \(ISQM\) 2, *Engagement Quality Reviews*](#) (ED-ISQM 2) in February 2019. Among other matters, the IAASB proposals included changes in terminology from "engagement quality control review" to "engagement quality review" and "engagement quality control reviewer" to "engagement quality reviewer" (EQR).³ The Explanatory Memorandum (EM) to proposed ISQM 2 included a specific request to respondents for input on whether there is a need for guidance in the proposed ISQM 2 to address the matter of cooling off as an eligibility requirement for the EQR (e.g., where an individual

¹ Section 120, *The Conceptual Framework*

² International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, defines an engagement quality control reviewer as follows:

A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the report.

³ Proposed ISQM 2 also proposed the following definitions of the terms 'engagement quality review' and 'engagement quality reviewer':

Engagement quality review: An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed on or before the date of the engagement report.

Engagement quality reviewer: A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

has served previously as an engagement partner on the same engagement), and whether such guidance should be located in proposed ISQM 2 or the Code.

6. Paragraphs [23-28 of the EM to ED-ISQM 2](#) describe the IAASB discussion and views relating to the eligibility of an individual to be appointed as the EQR immediately after serving as the engagement partner.

Responses to ED-ISQM 2

7. Overall, respondents agreed that the objectivity of the EQR is critical to the effectiveness of the engagement quality review (EQ review). Considering the responses to ED-ISQM 2⁴, the general consensus among respondents was that threats to the objectivity of an engagement partner stepping into an EQR role are an important issue that needs to be addressed.

Coordination with the IAASB

8. The IAASB is of the view that when an individual is appointed as the EQR immediately after serving as the engagement partner, the threats to the individual's objectivity are significant. Consequently, the IAASB concluded that a cooling-off period was the most appropriate safeguard. This view recognizes that the EQR is responsible for objectively evaluating the significant judgments made by the engagement team and the conclusions reached thereon. In recurring engagements, the matters on which significant judgements are made may not vary and therefore significant judgments made in prior periods may continue to affect judgements of the engagement team in subsequent periods. The ability of an EQR to perform an objective evaluation of significant judgements is therefore affected when the individual was previously involved with those judgements as the engagement partner. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity, in particular the self-review threat, to an acceptable level.
9. Currently, the Code does not explicitly address the issue of the objectivity of the EQR. Following coordination with the IAASB, the IESBA came to the view that it is necessary to address the issue of EQR objectivity holistically in the Code. The IESBA considered that this would be best achieved by having guidance in the Code to explain clearly the application of the conceptual framework when considering the objectivity of the EQR. This guidance would then provide the context for and support any specific provisions the IAASB might determine necessary to promulgate in proposed ISQM 2 to address the specific matter of an individual being appointed to the EQR role after having served on the engagement team (especially in an engagement partner role).
10. Given the IAASB's aim to finalize proposed ISQM 2 by mid-2020, the IESBA therefore decided to start a project on an accelerated basis to develop appropriate guidance in the Code on the topic of EQR objectivity. In progressing this project, the IESBA will continue its close coordination with the IAASB to ensure that the proposed guidance in the Code will be consistent and interoperable with the final ISQM 2.

⁴ Refer to IAASB September 2019 Board Meeting Agenda Item 7 [Proposed ISQM 2 Issues Final \(September 2019\)](#) to sight analysis of the ED responses.

III. Significant Matters

A. Application of the Conceptual Framework to Address the Objectivity of an Engagement Quality Reviewer

11. To provide explicit guidance on the application of the conceptual framework to address the topic of the objectivity of an EQR, the IESBA is proposing adding application material at the end of Section 120 (within the subsection dealing with considerations for audits, reviews and other assurance engagements) to explain the different types of threat to compliance with the fundamental principle of objectivity that might be created in circumstances where an individual is being considered for appointment as an EQR for a particular engagement. The IESBA considers that this would help enhance firms' awareness of the range of possible threats to the objectivity of an EQR and assist them in identifying threats given the specific facts and circumstances. (See paragraph 120.14 A2.)
12. The IESBA is also proposing guidance on factors to consider in evaluating the level of the identified threats, as well as actions that might be safeguards to address the threats. (See paragraphs 120.14 A3-A4.)

B. Location and Scope of the Proposed Guidance

13. The IESBA considered different locations in the Code for the proposed guidance. The IESBA did not consider that it would be appropriate to place the guidance in the International Independence Standards as it is addressing the objectivity of the EQR. After considering possible locations in the Code, including in a new standalone section, the IESBA viewed Section 120 as the most appropriate location given that it already deals with separate topics pertinent to audits, reviews and other assurance engagements, i.e., the linkage between independence and the fundamental principles, and professional skepticism.
14. The IESBA considers that adding guidance on the application of the conceptual framework on the topic of EQR objectivity would fit well with the present structure of Section 120. In addition, the guidance is fairly self-contained.
15. The IESBA notes that while the proposed guidance is located within the subsection "Considerations for Audits, Reviews and Other Assurance Engagements" in Section 120, the scope of the guidance is effectively all the engagements for which an EQ review is determined to be an appropriate response to an assessed quality risk(s) under proposed ISQM 1.⁵ In finalizing the proposed guidance, the IESBA will ensure that the scope of the guidance aligns with the final ISQM 1.

C. Need for a "Cooling-Off" Period Before an Individual is Appointed to the EQR Role After Having Served on the Engagement

16. The IESBA recognizes the importance of protecting the objectivity of the EQR and therefore considered whether the Code should prescribe a cooling-off period specifically to address the situation where an individual is appointed to an EQR role after having served on the engagement. The IESBA was mindful that a strict prohibition on an individual serving in the EQR role in that situation unless the individual has served a cooling-off period may not be proportionate in certain circumstances. The IESBA took the view that any prohibition or limitation should result from the

⁵ Proposed ISQM 1, [Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements](#).

application of the conceptual framework to the specific facts and circumstances, and that the Code should remain principles-based.

17. After giving the matter due consideration, the IESBA considers that it would be more appropriate for the IAASB to determine whether a cooling-off requirement should be introduced in proposed ISQM 2, following the proposed guidance set out in Section 120, and if so, the circumstances in which the requirement should apply, to whom it should apply, and what the minimum cooling-off period should be.⁶ The IESBA considers that this approach is appropriate on the grounds that:
- Under proposed ISQM 1, an EQ review may be performed for a variety of engagements (i.e., not only audits of financial statements, and not only for audits of listed entities), depending on whether the firm determines that an EQ review is an appropriate response to a quality risk. The IESBA considers that it would be more appropriate for the scope of any cooling-off requirement to be specified in the standard that establishes the requirement for an EQ review, i.e., proposed ISQM 1.
 - If the Code were to establish a cooling-off requirement, a breach of such a requirement would trigger a breach of the Code, which may call into question the firm's compliance with relevant ethical requirements. The IESBA is of the view that it would be more appropriate for a breach of such a requirement to be remediated as a quality issue through the firm's system of quality management.
 - If a cooling-off requirement is to be established, it would be better located together with other eligibility criteria for the EQR in proposed ISQM 2 so that all the relevant material can be found in one place.

IV. **Project Timetable and Effective Date**

18. The following timetable is planned for this project:
- June 2020 IESBA consideration of responses to ED and first read of proposed revised text post-exposure
 - September 2020 IESBA approval of revised provisions
19. Subject to meeting the above timetable, the IESBA proposes that the effective date of the proposed guidance in Section 120 be aligned with the proposed effective date of ISQM 2.

V. **Guide for Respondents**

20. The IESBA welcomes comments on all matters addressed in this ED, but especially those identified in the Request for Specific Comments below. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this ED, it will be helpful for the IESBA to be made aware of this view.

⁶ The February 2019 Exposure Draft of proposed ISQM 2, paragraph A5, included guidance stating that in the case of an audit of financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

Request for Specific Comments

21. The IESBA welcomes views from respondents on the following matters.

1. Do you support the proposed guidance addressing the topic of the objectivity of an EQR?
2. If so, do you support the location of the proposed guidance in Section 120 of the Code?
3. Do you agree with the IESBA that it would be more appropriate for the IAASB to determine whether a cooling-off requirement should be introduced in proposed ISQM 2 as discussed in Section III.C above, and that the Code should not be prescriptive in this regard?

Request for General Comments

22. In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:

- (a) *Regulators and Audit Oversight Bodies* – The IESBA invites comments on the proposed guidance from an enforcement perspective from members of the regulatory and audit oversight communities.
- (b) *Small and Medium Practices (SMPs)* – The IESBA invites comments regarding the impact of the proposed guidance for SMPs.
- (c) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposed guidance, and in particular, on any foreseeable difficulties in applying it in their environment.
- (d) *Translations*—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposed guidance.

EXPOSURE DRAFT: PROPOSED REVISION TO THE CODE ADDRESSING THE OBJECTIVITY OF ENGAGEMENT QUALITY REVIEWERS

SECTION 120

THE CONCEPTUAL FRAMEWORK

Considerations for Audits, Reviews and Other Assurance Engagements

...

Engagement Quality Reviews

120.14 A1 Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. [Proposed] ISQM 1 establishes a firm's responsibilities for its system of quality management and requires the firm to design and implement responses to assessed quality risks related to engagement performance. Such responses include establishing policies or procedures addressing engagement quality reviews in accordance with ISQM 2.

120.14 A2 Threats to compliance with the fundamental principle of objectivity might be created in certain circumstances in which a professional accountant is appointed as the engagement quality reviewer. The following are examples of threat that might be created:

(a) Self-interest threat

- Two engagement partners who serve as an engagement quality reviewer for each other's engagement.

(b) Self-review threat

- The accountant serves as an engagement quality reviewer on an audit engagement after serving as the engagement partner or other engagement team member.

(c) Familiarity threat

- The accountant who serves as engagement quality reviewer has a long association or close relationship with, or is an immediate family member of, an audit team member.

(d) Intimidation threat

- The accountant who serves as engagement quality reviewer for an audit engagement also has a direct reporting line to the engagement partner.

120.14 A3 Factors that are relevant in evaluating the level of such threats include:

- The role and seniority of the professional accountant.
- The length of time since the accountant was last a member of the engagement team prior to being appointed as engagement quality reviewer.
- The nature and complexity of issues that required significant judgment from the accountant when previously a member of the engagement team.

120.14 A4 Examples of safeguards or actions that might address such threats include:

- Implementing a period of sufficient duration (a cooling-off period) before the professional accountant is appointed as engagement quality reviewer.
- Having an appropriate reviewer review specific areas of significant judgment.
- Reassigning reporting responsibilities within the firm.

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