

Agenda Item 5-B UPDATED

Paragraph 41A(e) of Proposed ISQM 1¹ and Related Application Material - Draft (Marked from Agenda 5-B)

This paper is a marked draft of the requirements in paragraph 41A(e) of proposed ISQM 1 and related application material, which incorporates the proposed changes made by the ISQM 2 Task Force in response to the comments received during the March 2020 IAASB meeting and the written comments received, and further coordination with the ISQM 1 Task Force.

Paragraph 41A(e) Requirement

41A. In designing and implementing responses, the firm shall include the following responses in accordance with paragraph 22F: (Ref: Para. A153A)

...

- (e) The firm establishes policies or procedures addressing engagement quality reviews in accordance with proposed ISQM 2, and requiring an engagement quality review for:
- (i) Audits of financial statements of listed entities;
 - (ii) Audits or other engagements for which an engagement quality review is required by law or regulation; and (Ref: Para. A153H)
 - (iii) Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to assessed quality risks ~~relating to the engagement performance quality objectives~~. (Ref: Para. A153I-A153K)

Application and Other Explanatory Material

Engagements Subject to an Engagement Quality Review (Ref: Para. 41A(e))

Engagement Quality Review Required by Law or Regulation (Ref: Para. 41A(e)(ii))

A153H. Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that:

- Are public interest entities as defined in a particular jurisdiction;
- Operate in the public sector or which are recipients of government funding, or entities with public accountability;
- Operate in certain industries (e.g., financial institutions such as banks, insurance companies and pension funds);
- Meet a specified asset threshold; or
- Are under the management of a court or judicial process (e.g., liquidation).

¹ Proposed International Standard on Quality Management (ISQM) 1 (Previously International Standard on Quality Control 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

Engagement Quality Review as a Response to Assessed Quality Risks (Ref: Para. 41A(e)(iii))

A153I. When identifying and assessing quality risks, paragraph 22E(a)(ii) requires the firm to understand factors relating to the nature and circumstances of the firm and the engagements performed by the firm that may adversely affect the achievement of its quality objectives. In designing and implementing responses to address assessed quality risks ~~relating to the engagement performance quality objectives~~, certain conditions and circumstances may lead the firm to determine that an engagement quality review (i.e., an objective evaluation of significant judgments made by the engagement team and the conclusions reached thereon) is the appropriate response.

Examples of such conditions and circumstances may include:

Conditions and circumstances relating to the types and characteristics of engagements performed:

- Engagements that involve a high level of complexity or judgment, such as:
 - Audits of financial statements for entities operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (e.g., certain large financial institutions or mining entities), or for entities for which uncertainties exist related to events or conditions that may cast significant doubt on their ability to continue as a going concern.
 - Assurance engagements that require specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (e.g., a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein).
- Engagements on which issues have been encountered, such as audit engagements with recurring internal or external inspection findings, unremediated deficiencies in internal control, or a material restatement of comparative information in the financial statements.
- Engagements for which unusual circumstances have been identified during the firm's acceptance and continuance process (e.g., a new client that had a disagreement with its previous auditor or assurance practitioner).
- Engagements that involve reporting on financial or non-financial information that is expected to be included in a regulatory filing, or that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus.

Conditions and circumstances relating to the types of entities for which engagements are undertaken:

- Entities in emerging industries or that involve emerging technologies, or for which the firm has no previous experience.
- Entities for which concerns were expressed in communications from securities or prudential regulators.
- Entities with public interest or public accountability characteristics, such as entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders including financial institutions, such as certain banks, insurance companies, and pension funds for which an engagement quality review is not otherwise required by law or regulation.
- Entities with a high public profile, or whose management or owners have a high public profile.
- Entities with a large number or diverse range of shareholders.

A153J. In some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review is appropriate as a response to assessed quality risks (e.g., when other responses to assessed quality risks are determined by the firm to be appropriate).

A153JJ. The firm also may determine that responses other than an engagement quality review are appropriate to respond to assessed quality risks. In these circumstances, the firm may design and implement other types of responses, including other forms of engagement reviews that are not engagement quality reviews. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures relating to significant risks, or reviews of certain significant judgments, by individuals within the firm who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.

Public sector considerations

A153K. The firm may determine that an engagement quality review is appropriate as a response to assessed quality risks for larger public sector entities (for example, utilities, hospitals or universities) based on the social or economic influence on the community or region in which the entity operates. Another consideration for public sector engagements for which is whether law or regulation establishes additional reporting requirements (e.g., a separate report on instances of non-compliance with law or regulation to the legislature or other governing body or communicating such instances in the auditor's report on the financial statements). ~~Another factor that may be considered for larger public sector entities is the social or economic influence on the community or region in which the entity operates.~~