



Agenda Item 4

Quality Management

Objective

To obtain feedback from the Auditing Standards Board (ASB) on the drafts of the following proposed standards:

- [Proposed] Statement on Quality Management Standards (SQMS) *A Firm's System of Quality Control*
- [Proposed] SQMS *Engagement Quality Reviews*; and
- [Proposed] Statement on Auditing Standards (SAS) *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*, (collectively the "Proposed Standards").

Quality Management Task Forces

Following the model used by the IAASB, the Quality Standards Task Force has been divided into two groups:

QM1

Sara Lord, *Chair*
Sherry Chesser
Kathryn Fletcher
Kristen Kociolek
Alan Long
Tania Sergott
Kimberly Stazyk

QM2/220

Jon Heath, *Chair*
Harry Cohen
Tom Parry
Jeff Rapaglia
Rick Reeder

Background

At its September 2020 meeting, the IAASB voted to issue the following as final standards:

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

- ISQM 2, *Engagement Quality Reviews* (ISQM 2); and
- International Standard on Auditing (ISA) 220 (Revised), *Quality for an Audit of Financial Statements* (ISA 220 (Revised)).

The ASB discussed preliminary issues at its May and July 2020 meetings. The ASB agreed to change the title of its Statements on Quality Control Standards to “Statements on Quality Management Standards” and, accordingly, change references to quality control in its standards to refer to quality management. In addition, the consensus of the ASB was agreement with the Task Force recommendations to converge with the IAASB quality management standards on four specific requirements:

- Inspection of engagements only by those not involved in the engagement (ISQM 1)
- Mandatory inspection of at least one completed engagement for each engagement partner on a cyclical basis as a monitoring procedure (ISQM 1)
- Not dating the report before the engagement quality review (EQR) has been completed (ISQM 2, ISA 220)
- Mandatory cooling-off period for engagement partners to serve as engagement quality reviewers. However, the ASB did not reach consensus on the length of the required cooling-off period, with many members expressing support for risk-based flexibility to support a period shorter than two years. (ISQM 2) (See Matters for ASB Consideration below).

Matters for ASB Consideration

1. Cooling-Off Period

At its July meeting, the ASB discussed the mandatory cooling-off period for engagement partners to serve as engagement quality reviewers. The ASB agreed with the Task Force that, consistent with the requirements of the IAASB’s standards, a mandatory cooling-off period should be required. However, there was not agreement about the length of the cooling-off period.

Concerns about requiring that the cooling-off period be two years included the belief that two years is overly prescriptive and excessively rigorous for non-issuers, and concerns about unintended consequences, which may include firms choosing not to rotate engagement leadership and firms setting more stringent criteria for which engagements would be subject to engagement quality review than they otherwise might have. There is also a concern about firms struggling to find sufficiently qualified external reviewers, particularly in specialized industries.

Arguments against diverging from ISQM 2 in this regard include the following:

- ISQM 2 applies to be listed and non-listed entities, and there is nothing unique in the U.S. with regard to engagement quality reviews of non-issuers.

- One additional year (for a two-year period instead of one-year) is not so burdensome as to warrant divergence.

While neither the ASB at its July meeting nor the Task Force at its subsequent meetings reached consensus on this issue, the proposed draft presented for ASB review at this meeting includes a mandatory cooling-off period of at least one-year, because that seems to have been the majority view.

Accordingly, paragraph 19 of proposed SQMS *Engagement Quality Reviews* was revised from ISQM 2 as follows:

19. The firm's policies or procedures established in accordance with paragraph 18(b) ~~shall~~should also address threats to objectivity created by an individual being appointed as ~~an~~the engagement quality reviewer after previously serving as the engagement partner. Such policies or procedures ~~shall~~should specify a cooling-off period of ~~two years~~at least one year, or a longer period if required by relevant ethical requirements, before the engagement partner can assume the role of engagement quality reviewer. (Ref: ~~Parapar. A1714~~A1816)

In addition, the ASB directed the Task Forces to consider the following:

- Identifying other safeguards against the self-review threat or determine that no other viable safeguards exist
- Developing a principles-based framework for guidance on determining the appropriate cooling-off period, including consideration of different periods based on the quality risks of the engagement
- Drafting application material addressing options other than engagement quality reviews for objective reviews of engagements to enhance quality, such as “in-flight” and “pre-issuance”
- Performing targeted outreach to regulators on this issue
- Requesting feedback on this specific issue when the standards are exposed for comments

The Task Force discussed but was unable to not identify any other safeguards against the self-review threat.

Additional application material was developed and added as follows:

[A17. Determining the appropriate length of the cooling-off period depends upon the facts and circumstances of the engagement and engagement partner, and may include the following considerations:](#)

- [Whether the changes in the matters on which significant judgments are made and the facts and circumstances around those significant judgments compared to the period\(s\) in which the individual was the engagement partner vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the previous period \(For example, if comparative financial](#)

statements are presented, in the absence of other appropriate safeguards, an engagement partner might not be able to act as the engagement quality reviewer until no period in which the individual served as engagement partner is presented).

- The procedures and incentives placed by the firm’s system of quality management on objective reviews
- The results of other monitoring procedures (for example, in-process reviews and post-issuance inspection on the prior year engagement)

Paragraph A142 of proposed SQMS *A Firm’s System of Quality Management* includes the following guidance about reviews other than engagement quality reviews:

A142. ~~A135.~~ The firm’s responses to address quality risks may include other forms of engagement reviews that are not an engagement quality review. 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 personnel who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.

Question for the ASB:

1. Should the mandatory cooling-off period be two years or one year?

2. Effective Date of the Proposed Standards

The IAASB Standards use December 15, 2022 in their effective dates, which is roughly two years after issuance. The Proposed Standards have provisional effective dates of December 15, 2023, to be changed, if necessary, to an effective date approximately two years after issuance.

Although the ASB uses “periods ending” as the default convention, the Task Forces recommend using “periods beginning” for these proposed standards. SQMS *A Firm’s System of Quality Control* is effective for the firm’s system as of December 15, **2023** and the proposed SAS is effective for audits for periods beginning on or after December 15, **2023**. The alternative for the proposed SAS would be for periods ending on or after December 15, **2024** and having different years in the effective dates of the two standards might cause confusion.

SQMS *Engagement Quality Reviews* applies at the engagement level, to all engagements in the firm’s accounting and auditing practice. The effective date language is worded to apply to engagements that are conducted after SQMS *A Firm’s System of Quality Control* becomes effective.

Quality Management Issues
ASB Meeting, October 19-22, 2020

7. This ~~ISQM~~[\[proposed\] SQMS](#) is effective for:
- (a) Audits and reviews of financial statements for periods beginning on or after [December 15, 2022](#)~~2023~~^{*}; and
 - (b) Other assurance and ~~related-services~~[attest](#) engagements beginning on or after [December 15, 2022](#)~~2023~~^{*}.

Question for the ASB:

2. Does the ASB agree with the Task Force recommendation regarding the effective date of the Proposed Standards?

Agenda Items Presented:

- **4A** Proposed SQMS *A Firm's System of Quality Control*
- **4B** Proposed SQMS *Engagement Quality Reviews*
- **4C** Proposed SAS *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*

[* This date is provisional but will not be earlier than December 15, 2023.](#)

[* This date is provisional but will not be earlier than December 15, 2023.](#)