



**INTERNATIONAL FEDERATION  
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# Agenda Item

# 4

**Committee:** Ethics

**Meeting Location:** New York

**Meeting Date:** February 2-3, 2004

## Section 8

### Rotation of Engagement Quality Control Reviewer

#### Objectives of Agenda Item

1. To discuss a proposed amendment to Section 8 to address rotation of an engagement quality control reviewer

#### Discussion

The IAASB plans to approve two quality control documents at its meeting on February 16-19. The International Standard on Quality Control (ISQC 1) contains the following requirement (paragraph 61 of Agenda Paper 5-A):

The firm should establish policies and procedures requiring, for appropriate engagements, an engagement quality control review that provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. Such policies and procedures should:

- (a) Require an engagement quality control review for all audits of financial statements of listed entities;
- (b) Set out the criteria against which all other audits and reviews of historical financial information, and other assurance and related services engagements should be evaluated to determine whether an engagement quality control review should be performed; and
- (c) Require an engagement quality control review for all engagements meeting the criteria established in compliance with subparagraph (b) above.

Section 8 of the Code states that “using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat.” (8.150).

Paragraph 8.151 currently states that the lead engagement partner for the audit of listed entities should be rotated after a pre-defined period, normally no more than seven years. In November 2003, the Committee issued an ED clarifying the “time-out” period for a lead engagement partner. Under the ED the partner “rotating after a pre-defined period should not participate in the assurance engagement until a further period of time, normally two years, has elapsed.”

Committee members are asked to consider whether it would be appropriate to propose an amendment to the Code to require rotation of the engagement quality control reviewer (EQCR). The Committee is asked to consider the following facts:

- An EQCR is required for all audits of listed entities but firms may establish internal policies and procedures to require an EQCR on other engagements;
- The EU does not explicitly address rotation of the EQCR;
- The SEC requires rotation after five years with a five year “time-out” period (this is consistent with SEC lead partner rotation requirements).

#### **Staff recommendation:**

The Code should be amended to require rotation of the EQCR on the audit of listed entities. The rotation cycle should be the same as for the lead engagement partner i.e. rotate after seven years with a two year “time-out” period. The threats and safeguards approach would apply to EQCR’s (if any) on other engagements.

The above recommendation would result in the following proposed changes to the Code:

New definition:

Engagement Quality Control Reviewer – A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, with sufficient and appropriate experience and authority to objectively evaluate, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report. (This is consistent with the latest draft of ISQC 1)

8.151 (Text is shown as mark-up from the proposed text contained in the November ED):

Using the same lead engagement partner on an audit over a prolonged period of time may create a familiarity threat. The threat is particularly relevant in the context of the audit of listed entities and safeguards should be applied in such circumstances to reduce such threat to an acceptable level. Accordingly for the audit of listed entities:

- (a) The lead engagement partner and the engagement quality control reviewer should be rotated after a pre-defined period, normally no more than seven years; and
- (b) Such a A partner person rotating after a pre-defined period should not participate in the assurance engagement until a further period of time, normally two years, has elapsed.

The comment period for the November ED ends on February 15, 2004. The Ethics Committee will discuss the comments received on exposure at the May 2004 meeting.

Staff recommends that, if the IAASB approve the QC documents at its February meeting and if the Committee agrees with the proposed wording above, a new ED addressing rotation of the EQCR be approved at the May meeting.

#### **Action Requested**

1. Ethics Committee members are asked to consider the proposed change to Section 8 and the proposed approach.