Quality Control – Issues and Working Group Recommendations

Objectives of the Discussion
The objective of the discussion is to:

- Inform the Board on alternative internal control and risk management frameworks and standards on quality management systems that could provide input into “modernizing” ISQC 1;\(^1\)
- Consider the issues identified relating to governance requirements as a result of the performance of a comparison of ISQC 1 to certain governance frameworks, internal control frameworks and standards on quality management systems;
- Explore the balance of the responsibilities in the extant standards between the engagement partner and the engagement quality control reviewer and consider the need for clarification of the responsibilities;
- Consider the issues raised from the Small and Medium-Sized Practices survey; and
- Discuss alternative methods of addressing the issues identified in this paper and in previous presentations to the Board regarding ISQC 1.

In particular, the IAASB’s views on the topics within this paper, along with the views on those topics previously discussed, will be used as the basis for:

- How these matters will be described in the Discussion Paper;\(^2\) and
- Developing the questions for respondents regarding Quality Control in the Discussion Paper.

The Decision Summary from the March 2015 Board meeting with respect to Quality Control is included below.

Quality Control
The Board generally supported soliciting the views of the Small- and Medium-Sized Practices on the topic of quality control by means of a targeted survey, together with the issuance of a Discussion Paper to obtain the views of the wider stakeholder community. However, it was suggested that the deadline for the survey be extended, given that it was issued in busy season for many firms. The Quality Control Working Group (the Working Group) was also asked to extend information-gathering activities to other stakeholders, including national auditing standard setters (NSS), professional accountancy organizations, the European Audit Inspections Group and the European Federation of Accountants and Auditors.

The Board generally expressed agreement with the topics presented for discussion. However, the Board disagreed with how the Working Group had presented potential short-term and long-term solutions to the issues in Agenda Item 3-B, and suggested this approach should be reconsidered. In particular, the IAASB acknowledged the concerns that had been raised by some CAG Representatives as well as the SMP Committee that making changes to the standards multiple times (i.e., by proposing

\(^1\) 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*

\(^2\) See Agenda Item 8 for further information on the approach to the combined Discussion Paper planned to be issued in December 2015.
responses in the short term and then making further updates at a later time) would not be preferable to those that use the standards. The Board therefore suggested it would be more appropriate for the topics to be presented more broadly in the planned Discussion Paper, allowing respondents to provide views on the priority of the topics and timeframe in which they could be addressed, and the Board emphasized particular areas that should be explored within the Discussion Paper. Specifically, the Board recommended that the Working Group:

- Reconsider whether it is appropriate to use the term “risk-based” approach, based on the possibility for different understanding of what this means in respect of ISQC 1 and relative to the intent of the Working Group or the Board.
- Take a broader focus on audit quality, highlighting that the Board’s initial discussions have been focused on quality control at the firm level and not necessarily on quality control at the engagement level.
- Take a strategic approach to the issue of managing quality risks.
- Consider having separate sections in the Discussion Paper to discuss monitoring issues and those issues relating to remediation.
- Further explore issues related to the governance of accounting firms.

**IAASB CAG CHAIRMAN’S REMARKS**

Ms. de Beer noted that the CAG was supportive overall of the approach to scoping the quality control project by means of a Small- and Medium-sized Practices survey and a wider Discussion Paper. She noted that CAG Representatives had also expressed concern about the categorization of potential actions into short-term and long-term actions, noting that it was difficult to understand the criteria used for such classification and that classifying a potential action as a long-term action may be perceived as the IAASB delaying addressing a number of issues indefinitely. She also noted that CAG Representatives had suggested the need for a longer consultation period than initially proposed.

**WAY FORWARD**

The Working Group will continue its consideration of the issues and the feedback from the CAG and Board and present further matters for the IAASB’s consideration at its June 2015 meeting.

**Introduction**

1. The objective of public consultation through a Discussion Paper (i.e., the quality control aspects of the Discussion Paper) will be to:
   - Confirm that all relevant issues have been identified regarding quality control, and that all relevant aspects of those issues have been considered.
   - Present to the stakeholders the different options available to address the identified issues, clearly highlighting which options may take longer to implement.
   - Obtain stakeholder views on the identified issues, the relative priority of those issues, related recommendations and the preferred option of addressing them.

2. The Discussion Paper will contain specific questions related to Quality Control. The responses to the Discussion Paper in general, as well as those regarding specific quality control aspects, will assist the IAASB in developing the standard-setting project proposal related to Quality Control. It is
expected that the Quality Control project will primarily consider changes to ISQC 1 and to ISA 220\textsuperscript{3} but may also result in conforming amendments to other International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs), International Standards on Assurance Engagements (ISAEs) and International Standards on Related Services (ISRSs).

3. To facilitate the development of the Quality Control Discussion Paper, the Working Group has continued to consider issues identified through the IAASB’s ISA Implementation Monitoring project and through various outreach with regulators and oversight bodies, and firms. The Working Group has also incorporated discussions from previous Board meetings and meetings of National Standard Setters (NSS) in its deliberations.

Background

4. In previous Board meetings,\textsuperscript{4} the Working Group has presented to the Board on the topics of:
   - Engagement quality control reviewer;
   - Remediation;
   - Alternative audit delivery models (also referred to as outsourcing and shared service centers);
   - Issues pertaining to governance and to small- and medium-sized practices; and
   - A comparison of the Framework for Audit Quality in the areas of Values, Ethics and Attitudes, Knowledge, Time and Experience, and Audit Process and Quality Control Procedures to the ISAs and ISQC 1.

5. At the March 2015 Board meeting, the Working Group presented to the Board its analysis of the issues relating to the above topics and its suggested approach to addressing the issues. As noted in the minutes from this meeting, included above, while not necessarily disagreeing with the issues identified and the recommendations of the Working Group, the Board did not agree with characterizing the potential actions as short-term or long-term actions.

6. This Working Group acknowledges the Board’s views on the short-term and long-term classification of the issues and will consider them when drafting the Quality Control aspects of the Discussion Paper. This paper, therefore, does not revisit all of the issues previously discussed with the Board, but explores certain issues in more depth. The Working Group is continuing its outreach on all issues identified to date.

7. The Working Group has considered the feedback obtained from the Board at the March 2015 meeting and has further explored issues on the following topics:
   - A Strategic Approach to the modernization of ISQC 1;
   - Governance—A Comparison of Governance and Internal Control and Risk Management Frameworks and Standards on Quality Management Systems to ISQC 1, including:
     - Leadership Responsibilities for Quality within the Firm
     - Human Resource Related Matters; Resources and Consultations; and

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\textsuperscript{3} ISA 220, \textit{Quality Control for an Audit of Financial Statements}

\textsuperscript{4} See December 2014 Board Meeting Agenda Item 4, \url{http://www.iaasb.org/meetings/new-york-usa-8} and March 2015 Board Meeting Agenda Item 3 \url{http://www.iaasb.org/meetings/brussels-belgium-1}
8. In reflecting on the issues outlined above and those previously discussed at earlier Board meetings, the Working Group is of the view that there may be opportunities in both ISQC 1 and ISA 220 to address these issues through a variety of different methods. This could include the addition of new requirements or the clarification of existing requirements to address any perceived gaps in ISQC 1 or ISA 220. Additional application material to further explain a requirement and how it can be satisfied may be appropriate where inconsistencies are experienced in the application of that requirement. Finally additional guidance can be considered in the form of other non-authoritative guidance.

A Strategic Approach to the Modernization of ISQC 1

9. At the March board meeting, the Working Group was asked how the structure of ISQC 1 could be revised to be more responsive to identified quality risks (previously referred to as taking a “risk-based approach). The Working Group considered whether there was existing guidance that provided a framework facilitating the development of internal quality control systems that could help provide a basis for developing a revised ISQC 1. The Working Group identified several relevant and widely recognized internal control and risk management frameworks and standards on quality management systems, which incorporate guidance on the effective development and maintenance of systems of quality control and utilize a quality management approach to governance.

10. In discussing possible approaches to revising ISQC 1, the Working Group acknowledged that the Institut Der Wirtschaftsprüfer (IDW) had explored potential improvements to ISQC 1 through a quality management approach. The IDW had given a presentation to the NSS in 2013 on possible improvements that could be made to ISQC 1. This presentation incorporated the internal control and risk management frameworks and the standards on quality management systems that had been identified by the Working Group.

11. The internal control and risk management frameworks and standards on quality management systems specifically explored in the IDW presentation noted above and by the Working Group included:

- Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), (2013 COSO Internal Control Framework)
- ISO 90001: Quality Management Systems
- OCEG Red Book 2.1

12. The Working Group is of the view that there is merit to presenting an updated version of this presentation with the Board as it illustrates how ISQC 1 could be revised to include a quality management approach following the COSO ERM Framework. The Working Group’s considerations regarding these internal control and risk management frameworks and standards on quality...
Governance—A Comparison of Governance and Internal Control and Risk Management Frameworks and Standards on Quality Management Systems to ISQC 1

13. In addition to the internal control and risk management frameworks and standards on quality management systems identified and discussed as part of the IDW presentation, the Working Group identified other guidance relating to governance codes and audit quality. The Working Group thought that it would be beneficial to contrast the structure and requirements of the frameworks, the standards and other guidance with the structure and requirements in ISQC 1. The objective of this exercise was to identify any potential gaps or areas for improvement in ISQC 1.

14. The table presented below highlights the differences (i.e. the potential gaps or areas for improvement) identified in performing the review of the frameworks, standards and other guidance relating to the elements of a system of quality control, as compared to the requirements in ISQC 1. The Working Group is of the view these identified differences warrant further consideration in the Discussion Paper as there is potential for improvement or clarification of extant ISQC 1. The table also incorporates the requirements and application material in extant ISQC 1 considered by the Working Group as part of its deliberations for informational purposes.

15. The largest difference between the frameworks, standards and other guidance reviewed and the requirements and guidance in ISQC 1 relates to reporting by firms, both in terms of publishing its audited financial statements and in terms of transparency reporting. This difference is not incorporated in the following table. In general, the Working Group is of the view that specific requirements for reporting for firms go beyond the scope of a quality control standard. Further, in light of the infancy of transparency reporting and the different requirements in jurisdictions around the world, the Working Group is of the view that transparency reporting at this time may go beyond the scope of this project.

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### 16. Leadership Responsibilities for Quality within the Firm

#### Differences Identified for Further Consideration
- ISQC 1 has limited requirements and guidance on leadership responsibilities for quality within the firm.
- While ISQC 1 speaks to the promoting of an internal culture recognizing the importance of quality, it does not include certain specific terminology such as “tone at the top.”
- ISQC 1 includes the requirement for leadership to take responsibility for the audit firm’s system of quality control, which may be interpreted to be narrower in scope than accountability as described in certain of the frameworks.
- Certain of the frameworks make explicit reference to safeguarding, monitoring and acting in the public interest.

#### Relevant ISQC 1 References

<table>
<thead>
<tr>
<th>Leadership Responsibilities for Quality within the Firm</th>
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<tr>
<td><strong>Requirements</strong></td>
</tr>
<tr>
<td>18. The firm shall establish policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements. Such policies and procedures shall require the firm’s chief executive officer (or equivalent) or, if appropriate, the firm’s managing board of partners (or equivalent) to assume ultimate responsibility for the firm’s system of quality control. (Ref: Para. A4–A5)</td>
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<td>19. The firm shall establish policies and procedures such that any person or persons assigned operational responsibility for the firm’s system of quality control by the firm’s chief executive officer or managing board of partners has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: Para. A6)</td>
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</table>

**Application Material**

**Leadership Responsibilities for Quality within the Firm**

**Promoting an Internal Culture of Quality** (Ref: Para. 18)

A4. The firm’s leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the firm’s management that emphasize the firm’s quality control policies and procedures, and the requirement to:

(a) perform work that complies with professional standards and applicable legal and regulatory requirements; and

(b) issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards high quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in the firm’s internal documentation and training materials, and in partner and staff appraisal procedures such
that they will support and reinforce the firm’s view on the importance of quality and how, practically, it is to be achieved.

A5. Of particular importance in promoting an internal culture based on quality is the need for the firm’s leadership to recognize that the firm’s business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Promoting such an internal culture includes:

(a) Establishment of policies and procedures that address performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel, in order to demonstrate the firm’s overriding commitment to quality;

(b) Assignment of management responsibilities so that commercial considerations do not override the quality of work performed; and

(c) Provision of sufficient resources for the development, documentation and support of its quality control policies and procedures.

Assigning Operational Responsibility for the Firm’s System of Quality Control (Ref: Para. 19)

A6. Sufficient and appropriate experience and ability enables the person or persons responsible for the firm’s system of quality control to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

Potential Recommendations for Incorporation in the Discussion Paper

The Working Group identified this as an important area of ISQC 1 and is of the view that the following suggestions should be incorporated into the Discussion Paper to obtain stakeholder views on the appropriateness and importance of suggested changes:

- Incorporate specific references to the “tone at the top” to emphasize the importance of setting an appropriate culture for an organization using terminology easily recognized and understood by users of the standards, through the clarification of existing requirements, additional application material or both. Additionally incorporate as additional application material further explanation on such a culture including:
  - The concept of “leading by example” in application material associated with the updated tone at the top requirement; and
  - Guidance that highlights the responsibility of firms to determine that outsourced service providers (including shared service centers) have appropriate systems of quality control.
  - References to outsourced service providers to make it explicit that the tone set or the culture encouraged extends to those contracted by the firm as well as those employed directly by the firm, irrespective of
whether those individuals reside at the local office or at a remote location as part of an alternative audit delivery model.\footnote{See Agenda Item 3-B from the March 2015 Board meeting for discussion on Alternative Audit Delivery Models (shared service centers and outsourcing) http://www.ifac.org/system/files/meetings/files/20150316-IAASB-Agenda_Item_3-B-Quality%20Control-final.pdf}

- Incorporate the concept of public interest. The Working Group is of the view that the ISAs are set up such that compliance with the ISAs would result in acting in the public interest; however, it is also of the view that there is benefit from making explicit reference to this in introductory paragraphs or application material associated with leadership to highlight the fundamental principle underpinning the responsibilities of the auditor for all engagements to which ISQC 1 applies, not just audits.

- Definition and confirmation of responsibilities, in particular in relation to the discussion on the engagement partner and the engagement quality control reviewer, will assist in determining accountability for quality at the engagement level. Other aspects of accountability are considered in more detail in the section “Engagement partner responsibilities” below.

- The Working Group is of the view that any updates to ISQC 1 should be flexible enough to allow the leadership of firms to establish the policies and procedures they feel necessary, taking into account circumstances relevant to the firm. This could include, for example, policies that allow firms to consider the performance of reviews other than engagement quality control reviews such as IFRS reviews, hot reviews and pre-issuance reviews, as quality control procedures. In such instances, the relationship between the “other” reviews performed by the firm and the engagement quality control review should be clear.

17. **Human Resource Related Matters; Resources and Consultations**

| Differences Identified for Further Consideration | The Working Group considered the topic of resources in its entirety, thus including the elements of human resources and engagement performance that are separately identified in ISQC 1. Differences highlighted included:
|                                                    | ISQC 1 does not include requirements or guidance in respect of:
|                                                    | o HR policies governing fixed and variable remuneration for partners or remuneration based on the provision or cross selling of services additional to those contracted for.
|                                                    | o A continuity plan, encompassing loss of a key partner, loss of an office or the introduction of sanctions affecting a key partner or the firm.
<p>|                                                    | While ISQC 1 includes requirements and application material in respect of policies and procedures regarding consultation with individuals within or outside the firm that have specialized expertise, this guidance is not as in depth or as explicit as some of the quality control frameworks. |</p>
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<tr>
<th>Relevant ISQC 1 References</th>
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<td></td>
<td><strong>Human Resources</strong></td>
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<tr>
<td>29. The firm shall establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to:</td>
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<tr>
<td>(a) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and</td>
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<td>(b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances. (Ref: Para. A24–A29)</td>
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<td><strong>Assignment of Engagement Teams</strong></td>
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<td>30. The firm shall assign responsibility for each engagement to an engagement partner and shall establish policies and procedures requiring that:</td>
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<td>(a) The identity and role of the engagement partner are communicated to key members of client management and those charged with governance;</td>
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<td>(b) The engagement partner has the appropriate competence, capabilities, and authority to perform the role; and</td>
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<td>(c) The responsibilities of the engagement partner are clearly defined and communicated to that partner. (Ref: Para. A30)</td>
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<td>31. The firm shall also establish policies and procedures to assign appropriate personnel with the necessary competence, and capabilities to:</td>
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<tr>
<td>(a) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and</td>
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<td>(b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances. (Ref: Para. A31)</td>
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<tr>
<td><strong>Engagement Performance</strong></td>
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<td>32. The firm shall establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements, and that the firm or the engagement partner issue reports that are appropriate in the circumstances. Such policies and procedures shall include:</td>
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<td>(a) Matters relevant to promoting consistency in the quality of engagement performance; (Ref: Para. A32–A33)</td>
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<tr>
<td><strong>Consultation</strong></td>
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<td>34. The firm shall establish policies and procedures designed to provide it with reasonable assurance that:</td>
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<tr>
<td>(a) Appropriate consultation takes place on difficult or contentious matters;</td>
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<td>(b) Sufficient resources are available to enable appropriate consultation to take place;</td>
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(c) The nature and scope of, and conclusions resulting from, such consultations are documented and are agreed by both the individual seeking consultation and the individual consulted; and

(d) Conclusions resulting from consultations are implemented. (Ref: Para. A36–A40)

Application Material

Expectation to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 13)

Human Resources (Ref: Para. 29)

A24. Personnel issues relevant to the firm’s policies and procedures related to human resources include, for example:

- Recruitment.
- Performance evaluation.
- Capabilities, including time to perform assignments.
- Competence.
- Career development.
- Promotion.
- Compensation.
- The estimation of personnel needs.

Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm’s work and possess the appropriate characteristics to enable them to perform competently.

A25. Competence can be developed through a variety of methods, including the following:

- Professional education.
- Continuing professional development, including training.
- Work experience.
- Coaching by more experienced staff, for example, other members of the engagement team.
- Independence education for personnel who are required to be independent.

A26. The continuing competence of the firm’s personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for continuing training for all levels of firm personnel, and provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.

A27. The firm may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.
A28. Performance evaluation, compensation and promotion procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps a firm may take in developing and maintaining competence and commitment to ethical principles include:

- Making personnel aware of the firm’s expectations regarding performance and ethical principles;
- Providing personnel with evaluation of, and counseling on, performance, progress and career development; and
- Helping personnel understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the firm’s policies and procedures may result in disciplinary action.

Considerations Specific to Smaller Firms

A29. The size and circumstances of the firm will influence the structure of the firm’s performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

Assignment of Engagement Teams

Engagement Partners (Ref: Para. 30)

A30. Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

Engagement Teams (Ref: Para. 31)

A31. The firm’s assignment of engagement teams and the determination of the level of supervision required, include for example, consideration of the engagement team’s:

- Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
- Understanding of professional standards and applicable legal and regulatory requirements;
- Technical knowledge and expertise, including knowledge of relevant information technology;
- Knowledge of relevant industries in which the clients operate;
- Ability to apply professional judgment; and
- Understanding of the firm’s quality control policies and procedures.

Engagement Performance

Consistency in the Quality of Engagement Performance (Ref: Para. 32(a))

A32. The firm promotes consistency in the quality of engagement performance through its policies and procedures. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include:
<table>
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<tr>
<th>Potential Recommendations for Incorporation in the Discussion Paper</th>
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<tr>
<td>• The Working Group considered the possibility of including additional requirements or application material in ISQC 1 that would identify audit quality as a key remuneration consideration for the engagement partner (or engagement team); however, it noted that quality was one of many factors that could and should be considered as part of a remuneration structure and therefore concluded that added emphasis in ISQC 1 to this particular aspect of remuneration would be unwarranted.</td>
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<tr>
<td>• However, the Working Group did believe that better linkage between audit quality and remuneration could be established in ISQC 1, where practicable, and that as part of these considerations additional requirements or application material could be incorporated on the impact of the results of internal and external inspections of the engagement including the severity of any findings therefrom.</td>
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<tr>
<td>• The Working Group is of the view that ISQC 1 should not be used as a vehicle to mandate the structure of engagement partner’s (or other engagement team members’) remuneration, specifically with respect to compensation that may be withheld and paid out in the longer term based on the results of pre-determined criteria in the intervening period, and as such this should not form part of the requirements and guidance contained in ISQC 1.</td>
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<td>• The Working Group’s antepenultimate consideration in this area concerned the provision of application material indicating that when setting remuneration policies, consideration should be given to achieving consistency with the spirit of the requirements under the applicable Code of Ethics.</td>
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<td>• The Working Group also is of the view that the incorporation into ISQC 1 of continuity planning requirements would be an appropriate addition to the standard. This would include incorporation of requirements or application material on:</td>
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<td>• The loss of a key audit partner;</td>
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<td>• The loss of a network office, or</td>
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### 18. Monitoring, Addressing the Results of Inspections Performed by External Inspectors

#### Differences Identified for Further Consideration
- ISQC 1 does not contain explicit requirements for firms in respect of policies and procedures to address and respond to the results of inspections performed by external inspectors.
- While ISQC 1 notes a number of actions that can be taken in respect of findings, it is not explicit in providing guidance on how a firm considers how these findings may impact other engagements within the firm.
- ISQC 1 does not contain any documentation requirements regarding the consideration of findings from inspections, including their evaluation and resolution.

#### Relevant ISQC 1 References

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<th>Requirements</th>
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<td>Monitoring</td>
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#### Monitoring the firm’s quality control policies and procedures

48. The firm shall establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process shall:

   (a) Include an ongoing consideration and evaluation of the firm’s system of quality control including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner;

   (b) Require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and

   (c) Require that those performing the engagement or the engagement quality control review are not involved in inspecting the engagement. (Ref: Para. A64–A68)

#### Evaluating, Communicating and Remediying Identified Deficiencies

49. The firm shall evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either:

   (a) Instances that do not necessarily indicate that the firm’s system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable legal and

   - The imposition of sanctions affecting a key partner, office or firm within a network.

   - The Working Group is of the view that the requirements of ISQC 1 appropriately consider the need for consultations on significant or contentious matters, however, the Working Group is of the view that further guidance could be provided in the application material in this area that may also help to address concerns of small- and medium-sized practices.
regulatory requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or
(b) Systemic, repetitive or other significant deficiencies that require prompt corrective action.

50. The firm shall communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action. (Ref: Para. A69)

51. Recommendations for appropriate remedial actions for deficiencies noted shall include one or more of the following:
(a) Taking appropriate remedial action in relation to an individual engagement or member of personnel;
(b) The communication of the findings to those responsible for training and professional development;
(c) Changes to the quality control policies and procedures; and
(d) Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.

52. The firm shall establish policies and procedures to address cases where the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement. Such policies and procedures shall require the firm to determine what further action is appropriate to comply with relevant professional standards and applicable legal and regulatory requirements and to consider whether to obtain legal advice.

53. The firm shall communicate at least annually the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm, including the firm’s chief executive officer or, if appropriate, its managing board of partners. This communication shall be sufficient to enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities. Information communicated shall include the following:
(a) A description of the monitoring procedures performed.
(b) The conclusions drawn from the monitoring procedures.
(c) Where relevant, a description of systemic, repetitive or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.

54. Some firms operate as part of a network and, for consistency, may implement some of their monitoring procedures on a network basis. Where firms within a network operate under common monitoring policies and procedures designed to comply with this ISQC, and these firms place reliance on such a monitoring system, the firm’s policies and procedures shall require that:
(a) At least annually, the network communicate the overall scope, extent and results of the monitoring process to appropriate individuals within the network firms; and

(b) The network communicate promptly any identified deficiencies in the system of quality control to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken, in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

Application Material

Monitoring

Monitoring the Firm’s Quality Control Policies and Procedures (Ref: Para. 48)

A64. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- Adherence to professional standards and applicable legal and regulatory requirements;
- Whether the system of quality control has been appropriately designed and effectively implemented; and
- Whether the firm’s quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

A65. Ongoing consideration and evaluation of the system of quality control include matters such as the following:

- Analysis of:
  - New developments in professional standards and applicable legal and regulatory requirements, and how they are reflected in the firm’s policies and procedures where appropriate;
  - Written confirmation of compliance with policies and procedures on independence;
  - Continuing professional development, including training; and
  - Decisions related to acceptance and continuance of client relationships and specific engagements.

- Determination of corrective actions to be taken and improvements to be made in the system, including the provision of feedback into the firm’s policies and procedures relating to education and training.
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with it.
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.
A66. Inspection cycle policies and procedures may, for example, specify a cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:
- The size of the firm.
- The number and geographic location of offices.
- The results of previous monitoring procedures.
- The degree of authority both personnel and offices have (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them).
- The nature and complexity of the firm’s practice and organization.
- The risks associated with the firm’s clients and specific engagements.

A67. The inspection process includes the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of an independent external inspection program. However, an independent external inspection program does not act as a substitute for the firm’s own internal monitoring program.

Considerations Specific to Smaller Firms

A68. In the case of small firms, monitoring procedures may need to be performed by individuals who are responsible for design and implementation of the firm’s quality control policies and procedures, or who may be involved in performing the engagement quality control review. A firm with a limited number of persons may choose to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, the firm may establish arrangements to share resources with other appropriate organizations to facilitate monitoring activities.

Communicating Deficiencies (Ref: Para. 50)

A69. The reporting of identified deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, although there may be cases where such identification may be necessary for the proper discharge of the responsibilities of the individuals other than the engagement partner.

Potential Recommendations for Incorporation in the Discussion Paper

- The Working Group recognizes that firms have likely developed their own methodologies to address findings from external inspections; however it is of the view that ISQC 1 should contain explicit requirement for firms to consider findings from external inspectors, including:
  o Analysis of findings and appropriate responses thereto in the same way that other internal and professional body findings are considered.
  o Consideration of whether such findings would have an impact on other engagements.
The Working Group also felt that consideration of requirements or application material addressing documentation of the evaluation and resolution of external inspection findings would be appropriate.

The Working Group also considered other types of reviews not specifically defined in ISQC 1 that may be performed to monitor the quality of engagements, as described in paragraph 15, noting that firms may perform such reviews but not consider them quality control procedures.

Matters for IAASB Consideration
1. The IAASB is asked for its views on the matters identified above regarding governance, for inclusion in the Discussion Paper, including:
   (a) The nature of the topics identified;
   (b) The completeness of these topics;
   (c) The potential recommendations made by the Working Group; and
   (d) The relative priority of the topics.

Engagement Partner Responsibilities
19. Based on feedback obtained from the Board to consider quality control both at the firm level and at the engagement level and, in particular, the balance of responsibilities between the engagement partner and the engagement quality control reviewer, the Working Group performed a number of analyses to determine what gaps, if any, existed in the quality control requirements at the engagement level and if there was an imbalance of responsibilities. These analyses included:
   • A comparison of the Framework for Audit Quality (the Framework) to ISA 220;
   • A comparison of IES 8\(^7\) to the ISAs and ISQC 1; and
   • A comparison of engagement partner responsibilities identified throughout the ISAs with the responsibilities of the engagement quality control reviewer, as described in ISQC 1 and in ISA 220.

20. The Working Group has included in this paper the results of the comparisons noted above where any gaps or potential improvements had been identified. The Working Group felt that there was merit to providing the Board with the analysis of engagement partner responsibilities and of engagement quality control reviewer responsibilities in light of previous discussions on this topic (see Agenda Item 12-B).

Comparison of the Framework for Audit Quality and ISA 220
21. The Working Group compared at the engagement level, Values, Ethics and Attitudes; and Knowledge, Experience and Time to the requirements and application material included in ISA 220 and other ISAs as necessary to identify differences, (i.e. potential gaps or areas for improvements).

\(^7\) International Education Standard (IES) 8, Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)
22. The Working Group is of the view that Values, Ethics and Attitudes at the engagement level are adequately addressed in the ISA; however, the Working Group did identify the potential for improvement in the area of Knowledge, Time and Experience as follows:

<table>
<thead>
<tr>
<th>Knowledge, Experience and Time – Engagement Level</th>
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</thead>
<tbody>
<tr>
<td>Differences Identified for Further Consideration, indicated in bold text</td>
</tr>
<tr>
<td>7. The audit engagement partner is responsible for being satisfied that the engagement team collectively has the appropriate competences and that the team has <strong>sufficient time</strong> to be able to obtain sufficient appropriate audit evidence before issuing the audit opinion.</td>
</tr>
<tr>
<td>8. Key attributes are:</td>
</tr>
<tr>
<td>- Partners and staff have the necessary competences</td>
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<tr>
<td>- Partners and staff understand the entity's business.</td>
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<tr>
<td>- Partners and staff make reasonable judgments.</td>
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<tr>
<td>- <strong>The audit engagement partner is actively involved in risk assessment, planning, supervising, and reviewing the work performed.</strong></td>
</tr>
<tr>
<td>- <strong>Staff performing detailed &quot;on-site&quot; audit work has sufficient experience, its work is appropriately directed, supervised and reviewed, and there is a reasonable degree of staff continuity.</strong></td>
</tr>
<tr>
<td>- Partners and staff have <strong>sufficient time to undertake the audit in an effective manner.</strong></td>
</tr>
<tr>
<td>- The audit engagement partner and other experienced members of the engagement team are accessible to management and those charged with governance.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Relevant ISA 220 References</th>
</tr>
</thead>
<tbody>
<tr>
<td>Requirements</td>
</tr>
<tr>
<td>15. The engagement partner shall take responsibility for:</td>
</tr>
<tr>
<td>(a) The direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements; and (Ref: Para. A13—A15, A20)</td>
</tr>
<tr>
<td>(b) The auditor’s report being appropriate in the circumstances.</td>
</tr>
<tr>
<td>16. The engagement partner shall take responsibility for reviews being performed in accordance with the firm’s review policies and procedures. (Ref: Para. A16—A17, A20)</td>
</tr>
<tr>
<td>17. On or before the date of the auditor’s report, the engagement partner shall, through a review of the audit documentation and discussion with the audit team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued. (Ref: Para. A18—A20)</td>
</tr>
<tr>
<td>18. The engagement partner shall:</td>
</tr>
<tr>
<td>(a) Take responsibility for the engagement team by undertaking appropriate consultation on difficult or contentious matters;</td>
</tr>
</tbody>
</table>
(b) Be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement both with the engagement team, and between the engagement team and others at the appropriate level within or outside the firm;

(c) Be satisfied that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted; and

(d) Determine that the conclusions resulting from such consultations have been implemented (Ref. Para. A21—A22)

**Application Material**

A12. In the public sector, additional appropriate competence may include skills that are necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such competence may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing or a comprehensive assessment of compliance with law, regulation or other authority and preventing and detecting fraud and corruption.

A13. Direction of the engagement team involves informing members of the team of matters such as:

- Their responsibilities, including the need to comply with relevant ethical requirements and to plan and perform an audit with professional skepticism as required by ISA 200.8
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- The objectives of the work to be performed
- The nature of the entity’s business
- Risk related issues
- Problems that may arise
- The detailed approach to the performance of the engagement.

Discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members so that appropriate communication can occur within the engagement team.

A14. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the work.

A15. Supervision includes matters such as:

- Tracking the progress of the audit engagement.
- Considering the competence and capabilities of individual members of the engagement team including whether they have sufficient time to

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8 ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of An Audit in Accordance with International Standards on Auditing*
<table>
<thead>
<tr>
<th>Potential recommendations for incorporation in the Discussion Paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The Working Group is of the view that more guidance would be helpful to clarify what is meant by performance, direction, supervision and review of the audit engagement, through additional requirements or application material that discusses the responsibilities of the engagement partner.</td>
</tr>
<tr>
<td>• The Working Group noted that the engagement partner’s responsibilities are not consolidated in one location and are included throughout the ISAs. As such, consideration could be given to creating an appendix to ISA 220 or non-authoritative guidance that consolidates all the responsibilities of the engagement partner.</td>
</tr>
<tr>
<td>• The Working Group also considered that additional guidance could be provided concerning the engagement partner’s considerations of the sufficiency of the engagement team members’ experience and the sufficiency of time available to perform the engagement.</td>
</tr>
<tr>
<td>• The Working Group also considered the appropriateness of incorporating reference to consideration of the public interest in a similar manner to ISQC 1 discussed above, if changes were ultimately to be made to ISA 220.</td>
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</table>

- carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the audit engagement.
- Addressing significant matters arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced team members during the audit engagement.
- The engagement partner shall take responsibility for reviews being performed in accordance with the firm’s review policies and procedures. (Ref: Para. A16—A17, A20)
- On or before the date of the auditor’s report, the engagement partner shall, through a review of the audit documentation and discussion with the audit team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued. (Ref: Para. A18—A20)

A18. Timely reviews of the following by the engagement partner at appropriate stages during the engagement allow significant matters to be resolved on a timely basis to the engagement partner’s satisfaction on or before the date of the auditor’s report:

- Critical areas of judgment, especially those relating to difficult or contentious matters identified during the course of the engagement;
- Significant risks; and
- Other areas the engagement partner considers important.
Comparison of IES 8 to the ISAs and ISQC 1

23. The Working Group compared the competencies articulated in IES 8 with the requirements and associated application material incorporated in the ISAs. The Working Group found to a large extent that the competencies were appropriately addressed in the ISA; however, it did identify improvements that could be made to ISQC 1 or ISA 220 concerning appropriate engagement partner characteristics. The characteristics considered by the Working Group include:

- **Intellectual**—Resolve audit issues using inquiry, abstract and logical thought, and critical analysis to consider alternatives and analyze outcomes.
- **Interpersonal and communication**—Communicate effectively and appropriately with the engagement team, management, and those charged with governance of the entity; and resolve issues through effective consultation when necessary.
- **Personal**—Promote and undertake lifelong learning; act as a role model to the engagement team; and act in a mentoring or coaching capacity to the engagement team.
- **Organizational**—Evaluate whether the engagement team, including auditor’s experts, collectively has the appropriate objectivity and competence to perform the audit; and manage audit engagements by providing leadership and project management of the engagement teams.
- **Commitment to the public interest**—Promote audit quality in all activities with a focus on protecting the public interest.
- **Professional skepticism and professional judgment**—Apply a skeptical mindset and professional judgment in planning and performing an audit and reaching conclusion on which to base an audit opinion.
- **Ethical principles**—Apply the ethical principles of integrity, objectivity, professional competence and due care, confidentiality, and professional behavior in the context of an audit and determine an appropriate resolution to ethical dilemmas; evaluate and respond to threats to objectivity and independence that can occur during an audit; and protect the confidential information of the entity in accordance with ethical responsibilities and relevant legal requirements.

Potential Recommendations for Incorporation in the Discussion Paper

24. The Working Group recommends that consideration be given to updating requirements or application material within ISQC 1 or ISA 220 to better reflect the characteristics identified in IES 8.

Analysis of Engagement Partner Responsibilities and Engagement Quality Control Reviewer Responsibilities

Analysis

25. The Working Group recognized that requirements concerning engagement partner’s responsibilities can be found in a number of the ISAs. To facilitate a better understanding of those responsibilities, the Working Group prepared a table consolidating those responsibilities. The Working Group then considered those responsibilities in juxtaposition with the responsibilities of the engagement quality control reviewer with a view to identifying any potential imbalance between the responsibilities of the
engagement partner and of the engagement quality control reviewer. As part of its analysis and discussions, the Working Group further considered the sufficiency of the engagement partner requirements. See Agenda Item 12-B for the detailed analysis.

26. The Working Group is of the view that there is merit to providing the Board with this analysis, as the analysis provides an opportunity to reflect on where ultimate responsibility for the engagement lies and demonstrates the sufficiency of the requirements for both the engagement partner and the engagement quality control reviewer. Further, it was felt that the analysis generally reflected the relative responsibilities that attach to the different roles of the engagement partner and the engagement quality control reviewer.

27. As a result of performing this analysis, and in conjunction with previous analyses and discussions, the Working Group identified a potential gap and a number of areas where it was felt that the requirements or application material addressing both the engagement partner and the engagement quality control reviewer could be improved.

Potential Recommendations for Incorporation in the Discussion Paper

28. The Working Group is of the view that requirements or application material addressing documentation of the timing and substance of the procedures performed and significant discussions held by both the engagement partner and the engagement quality control reviewer would be helpful to enable both parties to evidence their respective involvement in the execution of the audit engagement.

29. The Working Group is also of the view that including an objective of the engagement quality control review and additional application material that clarifies the role of the engagement quality control reviewer would facilitate a better understanding of the purpose of the review and the responsibilities of the engagement quality control reviewer and would provide a better basis for the engagement quality control reviewer to carry out these responsibilities. The Working Group was of the preliminary view that this would not result in a change to the requirements.

30. Similar to the comparison of the Framework to ISA 220, the Working Group is of the view that this comparison also demonstrates that it would be helpful to clarify what is meant by performance, direction, supervision and review of the audit engagement. The Working Group noted that performance, direction, supervision and review of an engagement can mean very different things depending on the type and size of the engagement, for example, in the direction and supervision of a large listed entity more emphasis will likely be on the appropriate delegation and supervision of the engagement team whereas on a small private entity, direction and supervision will likely emphasize a more “hands on” approach by the engagement partner. The Working Group is of the view that firms have likely already developed guidance in this area, and that it is important to understand the current practices in advance of developing this consideration in the Discussion Paper.

31. The Working Group was also of the view that additional consideration needs to be given to the [group] engagement partner’s responsibilities as outlined in ISA 600.\(^9\) The Working Group noted a number of requirements that ISA 600 specified should be performed by the group engagement partner, while

\(^9\) ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)
for similar requirements outside of a group audit engagement, the auditor\textsuperscript{10} was allowed to perform such procedures. The Working Group will liaise with the Group Audits Working Group on these requirements.

**Matters for IAASB Consideration**

2. The IAASB is asked for its views on the matters identified for inclusion in the Discussion Paper, including:
   (a) The completeness of the matters identified as it relates to engagement partner responsibilities;
   (b) The potential recommendations made by the Working Group; and
   (c) The relative priority of this topic.

**Small- and Medium-Sized Practice Survey**

*Background*

32. The Working Group designed and issued a survey aimed at obtaining a better understanding of the issues experienced by small- and medium-sized practices in implementing and complying with the requirements of ISQC 1 and ISA 220.

33. The survey asked questions in four areas: Implementation of ISQC 1, Application and Scalability of ISQC 1, Engagement Quality Control Reviewer Requirements, and remediation. The survey also incorporated a section to allow those taking the survey to provide any other information deemed necessary. The key themes from the survey are discussed further below.

*Results – General Findings*

34. At the request of the Board, the Working Group agreed to extend the closing date of the survey to allow for as many responses as possible, with the final responses being received in early May. Almost 300 responses\textsuperscript{11} to the survey were received from firms of all sizes and from around the world. A geographical analysis of the responses is included below.

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\textsuperscript{10} The auditor is defined as follows, “Auditor” is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team or, as applicable, the firm. Where an ISA expressly intends that a requirement of responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “auditor” is used. “Engagement partner” and “firm” are to be read as referring to their public sector equivalents when relevant.

\textsuperscript{11} Not all of the respondents to the survey selected to respond to all the questions included therein.
35. An analysis of responses by size of practice is as follows:

36. Regarding the adoption and implementation of ISQC 1, the results of the survey indicated the following:

- Approximately 87% of those that had adopted ISQC 1 had done so in its entirety and without supplementing the requirements with additional policies and procedures;
- Approximately 71% applied ISQC 1 in the same way to the different parts of their practices;
- Approximately 65% indicated that they were aware of application tools or guidance made available by NSS or other professional bodies to assist with the application of ISQC 1 to small- and medium sized practices; however, only approximately 56% of the respondents indicated that they used the guidance.
• Approximately 79% also indicated that they were of the view that sufficient guidance has already been issued.

37. The availability of resources across all areas of ISQC 1 was a key issue for small- and medium-sized practices. This was not limited to the cost of compliance with ISQC 1 but also encompassed matters such as:
  • The attraction and retention of appropriate talent;
  • Conflicting priorities where there is limited personnel with the necessary skills;
  • Insufficient personnel to meet rotation requirements; and
  • The increasing number of partner hours required to complete an engagement in a market with declining fees.

Results - Monitoring

38. In general, the area identified as the most difficult to implement and comply with was monitoring. The specific difficulties noted related to the size of the firm or office and resource constraints and funding the cost of compliance.

39. Other responses indicated that:
  • The monitoring requirements were excessive for certain types of engagements such as compilation engagements; and
  • From a timing perspective, it was difficult to complete an annual cold review of an engagement; conclude on its results; share those results with the organization; and determine and act on training needs and policy and procedure improvements before the start of the following year’s engagement.

Results – Engagement Quality Control Review

40. Respondents indicated that they appointed an engagement quality control reviewer on engagements involving, in addition to listed entities, subsidiaries of listed entities and public interest entities and engagements such as:
  • Audits and/or assurance engagements of other entities that met an internal pre-determined criteria, such as number of engagement hours, assessed risk of the engagement, or industry in which the entity operates;
  • Public sector engagements;
  • Compilations;
  • Agreed-upon procedures and review engagements; and
  • Group audits.
41. Issues in the area of engagement quality control reviews were largely related to resources, with more than half of the survey respondents indicating that they used third-party resources in this area. Specifically, respondents cited the identification of engagement reviewers possessing the appropriate competence to perform the review, and other resources issues, including sufficient number of partners in the firm, sufficient time to adequately perform and document the review and to arrange review and sign off meetings.

42. It was also suggested that more clarity was needed on application of engagement quality review requirements in a group audit situation, and the objective and purpose of an engagement quality control review. It was noted that it would be helpful for the IAASB to explain the connection between engagement quality control reviews and risk mitigation, the relevance for all sizes of firms, and types of engagements that should be subject to an engagement quality control review in certain circumstances as part of risk mitigation.

Results – Additional Guidance

43. Although 79% of respondents to the survey initially indicated that sufficient guidance was already available, others indicated that users would find further guidance useful in the form of more simplified examples of the application of the requirements, checklists and case studies.

Results - Documentation

44. A common theme throughout all sections of the survey was the documentation requirements associated with maintaining a system of quality control. Responses indicated that the documentation requirements in some areas were too extensive and a few firms noted less formal documentation policies.

Key Themes

45. Based on the analysis above, the Working Group identified three key themes as a result of the survey responses:
   - The application of ISQC 1 to review, other assurance, and related services engagements;
   - The performance of engagement quality control reviews; and
   - Challenges in the documentation of systems of quality control.

Potential Recommendations for Inclusion in the Discussion Paper

46. As noted in paragraph 16, the Working Group is of the view that the idea of flexibility in the review process should be explored, to allow firms to utilize other reviews, such as peer reviews and other inspections, as part of its monitoring plan. Such types of reviews could function as a detective control in the area of monitoring of quality control.

47. The Working Group also is of the view that a framework or chart that indicates the types of engagements that ISQC 1 applies to, similar to that included in the Assurance Framework, may provide clarity on the applicability of the requirements in ISQC 1 to different types of engagements.

48. As noted in the Working Group’s analysis of the engagement partner and engagement quality control reviewer section of this paper, the Working Group is of the view that including an objective and
clarification of the role of the engagement quality control review would help users to better apply ISQC 1.

49. As to providing more examples, checklists and case studies, the Working Group suggests identifying and using best practice examples currently included in application tools and guidance materials. The Working Group is of the view, that better dissemination of these best practice examples would assist small- and medium-sized practices in determining the sufficiency of documentation for its systems of quality control.

50. The Working Group is also of the view that some form of publication would be an appropriate method to provide more clarity on the differences between ISQC 1 and ISA 220. Such publication could also provide rationale for the existing documentation requirements and information on where documentation examples may be found.

Matters for IAASB Consideration
3. The IAASB is asked for its views on:
   (a) The issues identified through the small- and medium-sized practices survey and their impact on the quality control aspects of the Discussion Paper; and
   (b) The recommendations of the Working Group for consideration in the Discussion Paper.

Ways to Update ISQC 1 and ISA 220
51. The Working Group is of the view that alternative methods of dealing with the identified issues should be presented in the Discussion Paper to allow stakeholders to indicate a preference on the ultimate scoping of the project. The Working Group proposes that two options on the way forward with the quality control project be incorporated into the Discussion Paper. The first option is a strategic update to ISQC 1 using a quality management approach. Exploration of this approach also responds to the Board’s request to look at the project on a more strategic basis. The second option is to amend extant ISQC 1 for the various issues previously identified and discussed (a quality control approach).

Quality Management Approach
52. This approach would better align ISQC 1 with other internal control, quality and risk management frameworks and would be a proactive improvement that would lead the profession in this area. A quality management approach would require firms to engage in objective setting with respect to quality, assessing quality risks and responding to those risks. Accordingly, this approach would strengthen quality at the firm and engagement level.

53. A quality management approach would place more emphasis on policies and procedures that are preventative in nature, such as those around leadership and engagement performance, rather than detective in nature, such as those around quality reviews and inspections.

54. This would involve some restructuring of the existing requirements in ISQC 1 into a logical flow of elements and incorporate a quality risk assessment and response, which aligns with the approach used in the ISAs. The Working Group proposes that such a revision be based on a recognized framework; more specifically, it is of the view that the COSO ERM Framework would be appropriate.

55. The COSO ERM Framework is a three-dimensional model that can easily be adapted to address some of the current challenges, such as those with group audits; it can be responsive as the
environment in which firms operate evolves, including adaption to changes in regulatory requirements; and it can be applied in a similar way at various levels within the quality control system, for example, at the firm level or at the engagement level.

56. In addition to restructuring of the existing requirements, this would present the opportunity to make requirements conditional where appropriate and address agreed gaps within the standard. This would then naturally address many of the concerns raised by the small- and medium-sized practices about the scalability of ISQC 1, and would result in ISQC 1 only being updated once with all issues being addressed simultaneously.

57. However, the Working Group recognizes that such an undertaking would require more effort than the alternative of a “quality control” approach, as a more fundamental review of the form, content and approach of ISQC 1 would be envisaged. This would likely result in an extended timeframe in which to complete the project. Given the extended timeframe, if this option is considered preferable by the stakeholders, it may be possible to provide other forms of guidance in the interim period in relation to specific issues (subject to available resources and Board’s consideration of its priorities in relation to issues within the Quality Control project as well as other topics).

58. This following steps could be taken in the interim period to address specific issues:
   - Limited changes to ISQC 1 and ISA 220.
   - The issuance of an International Practice Note or an International Auditing Practice Note indicating how ISQC 1 could be applied in a scalable manner, noting however, that this would not address additional requirements related to alternative audit delivery models or external inspections.
   - The identification of existing best practice documents issued by NSS and others, promoting use of such through mediums such as the SMP Committee and the IFAC Gateway.

Quality Control Approach

59. This approach would involve adding additional requirements and application material to extant ISQC 1 for the identified gaps and a revision of the existing text where appropriate. These updates would be determined based on the topics discussed in this paper and at previous Board meetings.

60. Under this approach, it would be envisaged that the current structure and approach within ISQC 1 would be retained, rather than a fundamental consideration of the standard under the “Quality Management Approach”. While this may result in less cost implications for practitioners as a result of the changes, from a small- and medium-sized practice’s perspective, it may not sufficiently address the scalability issues that have been identified or may not adequately highlight the relevance of ISQC 1 to small- and medium-sized practices.

61. The majority of the Working Group is of the view that maintaining the current format would perpetuate the inability of the standard to be adaptable to quality risks and a changing environment. Further, the emphasis between quality control policies and procedures that are detective in nature, rather than preventative, would remain the same. Unlike a quality management approach, a quality control approach would not encompass concepts related to objective setting, enterprise risk assessment and response, and information and communication.
62. This approach may also result in additional updates to ISQC 1 being required to address any issues that could not be dealt with in a quality control approach depending on debates at the Board level and response to the Discussion Paper. This could ultimately necessitate two updates to practitioner’s systems which will have obvious cost implications.

Working Group’s Recommended Approach

63. Based on the relative merits of each approach, the vast majority of the Working Group supports the quality management approach to updating ISQC 1 and ISA 220. There is some support, however, for pursuing the quality control approach, as there is a view that such an approach would allow for only the specific issues identified to be addressed, result in targeted changes to the standards which can be clearly articulated and communicated to practitioners and other stakeholders, and be more practically implemented, particularly for small- and medium-sized practices.

Matters for IAASB Consideration

4. The IAASB is asked for its views on:

(a) The inclusion in the Discussion Paper of potential approaches to understand stakeholder preferences.

(b) The appropriateness of the two identified proposed approaches and their advantages and disadvantages.

(c) The Working Group’s recommended approach.