

Quality Control: Background and Significant Issues

1. Introduction

- 1.1 This document briefly outlines the significant issues arising relating to the quality control project since the June 2002 IAASB meeting.
- 1.2 The existing ISA 220 establishes standards and provides guidance relating to both an audit firm (paragraphs 4 – 7) and an individual audit engagement (paragraphs 8 – 17). Up until the June 2002 IAASB meeting, it was generally envisaged that a revised ISA 220 would be similarly structured with a similar scope. However, after careful consideration during the June 2002 meeting, the IAASB agreed to issue two separate documents as follows:
 - A new standard, in a series of International Standards on Quality Control (ISQCs), which applies to a firm's system of quality control for those services addressed by IAASB engagement standards.
 - A revised ISA 220, covering quality control for audit engagements only.
- 1.3 The IAASB Quality Control Task Force was reconstituted after this meeting to include two individuals external to the IAASB, who have experience in setting up and managing firm-wide quality control activities.
- 1.4 The Task Force has highlighted the following significant issues:
 - The scope and interrelation of the draft ISQC 1 and the draft ISA 220.
 - The proposed ISA 220 black letter requirement for engagement partners to determine that a current written acknowledgement of independence exists from each member of the engagement team relating to independence and objectivity.
 - Independent review.

2. The scope and interrelation of ISQC 1 and ISA 220

- 2.1 The draft ISQC 1 applies to a firm's system of quality control for those services addressed by the IAASB engagement standards. It adopts a principles based approach establishing high-level principles rather than detailed procedural requirements and guidance. The majority of the black letter paragraphs impose requirements on "the firm." While the IAASB engagement standards ordinarily impose requirements on "the auditor," the Task Force believes that the quality assurance framework envisaged in the creation of SMO 1 and ISQC 1 and the revision of ISA 220 necessitates requirements directed at the level of the firm and expressed in those terms.
- 2.2 The draft ISQC 1 addresses elements of a system of quality control including the following:
 - Leadership and responsibilities within the firm.
 - Engagement acceptance and continuance.
 - Independence and objectivity.

- Resources.
- Assignment.
- Engagement performance (including consultation and differences of opinion).
- Independent review.
- Monitoring.
- Documentation of compliance with quality control policies and procedures.

2.3 As noted above, these elements are addressed at the level of the firm. The draft ISQC 1 contains the following statement (in paragraph 62):

Deficiencies in individual engagements do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with applicable professional standards.

This reflects the Task Force's understanding of the wishes of the IAASB as expressed during the June 2002 meeting. The IAASB argued that requirements aimed at the level of the firm should not be incorporated in ISAs, as this potentially could lead to instances where an auditor has difficulty in stating that he/she performed an audit in accordance with ISAs, not as a result of any failure in the conduct of the audit, but as a result of deficiencies or breakdowns in firm wide policies and/or procedures.

Action Required by IAASB

Is the IAASB comfortable with the level of detail included in the current draft of ISQC 1?

Is the IAASB of the opinion that the wording in general (and in particular in paragraph 62) appropriately reflects the wishes expressed in June 2002?

2.4 The draft ISA 220 addresses issues including the following:

- Leadership and responsibilities.
- Accepting an audit engagement.
- Continuing an audit engagement.
- Independence and objectivity.
- Assignment of audit engagement teams.
- Engagement performance.
- Independent review.

The requirements and related guidance in this document are specific to audit engagements. While the section headings in general match those in the draft ISQC 1, this is not intended to produce duplication, but rather to articulate how the engagement partner should specifically apply the policies and procedures at engagement level.

The draft ISA 220 contains the following statement (in paragraph 27):

In accordance with ISQC 1, the firm's system of quality control includes monitoring of quality control policies and procedures. Deficiencies in the firm's system of quality control do not, in and of themselves, indicate that a particular engagement was not performed in accordance with applicable professional standards.

Action Required by IAASB

Is the IAASB comfortable with the level of detail included in the current draft of ISA 220?

Is the IAASB of the opinion that the wording in general (and in particular in paragraph 27) appropriately reflects the wishes expressed in June 2002?

The Task Force would welcome any additional input from IAASB regarding the scope and interrelation of the draft ISQC 1 and the draft ISA 220.

3. Written acknowledgement of independence

- 3.1 The draft ISA 220 contains, in paragraph 9(d), the black letter requirement that the engagement partner should determine that a current written acknowledgement of independence exists from each member of the engagement team. The Task Force is not unanimous in its support for this requirement.
- 3.2 One view is that independence is hugely important, especially in the current climate, and that such a requirement is both necessary and reasonable in the circumstances. Adherents to this view point out that if the partner was to rely on the firm's system of quality control and enforcement of a requirement to provide an annual acknowledgement of independence in relation to all the firm's clients for which independence is required, then in fact the partner might be relying on information that was out of date.
- 3.3 The opposing view is that such a requirement might result in an administrative nightmare which might possibly make the information obtained unusable. Adherents to this view also point out that the major firms have invested significant sums in sophisticated tracking systems in an attempt to ensure independence. They believe that the partner should be entitled to rely on these systems.

Action Required by IAASB

The Task Force would welcome the view of the IAASB on this issue.

4. Independent review

- 4.1 During the recent CAG meeting, concerns were expressed over the following aspects of independent review:
- The title "independent review".
 - The restriction of mandatory review to audits of listed entities.
 - The scope of the review.

- 4.2 The IAASB will be aware of the drawn out procedure by which the Task Force has arrived at the title “independent review”. Following the comments from CAG, the Task Force again considered whether it would be appropriate to find another title for the review; however, it was unable to find an alternative title which it considered to be an improvement.

Action Required by IAASB

Is the IAASB comfortable with the title “independent review”?

- 4.3 The current draft of ISQC 1 requires firms to establish policies and procedures which require the performance of an independent review for all audits of financial statements of listed entities and set out criteria for determining whether an independent review should be performed for other audit, assurance and related services engagements.
- 4.4 The Task Force has discussed the requirement for mandatory independent review at great length. In deciding to mandate independent review for audits of listed entities and require the establishment of criteria for determining whether independent reviews should be performed for all other audit, assurance and related services engagements the Task Force is seeking to:
- Recognize:
 - That the primary focus of public interest (and hence of interest from parties such as IOSCO and the EU Committee on Auditing) is on audits of listed entities.
 - That there is also significant public interest in audits, assurance and related services engagements for certain other types of entity.
 - The potential impact on smaller firms.
 - Resolve the difficulties that arose when attempting to define public interest entities.
 - Require firms to use their professional judgment.
- 4.5 The current draft of ISQC 1 lists the following as included in criteria which may be considered when determining which relevant engagements other than audits of listed entities may be subject to independent review:
- The number and range of stakeholders who may use the subject matter of the practitioner’s report to make decisions.
 - The extent to which the subject matter and the practitioner’s report are of interest to the public, or may affect the public’s confidence in public institutions or public administration.
 - The identification of specific circumstances or risks in an engagement.

There are those within the Task Force who believe that a more detailed list of criteria, perhaps including examples of engagements that might be ‘caught’ by the criteria, would be helpful to the users of the ISQC.

Action Required by IAASB

The Task Force would welcome input from IAASB regarding:

- The restriction of a mandatory requirement for independent review to audits of listed entities.
- The suggested criteria that may be included when considering whether a non listed entity audit engagement requires an independent review.
- The approach to determining whether all other audit, assurance and related services engagements require an independent review.

[Blank Page]