Agenda Item 5-F

PROPOSED INTERNATIONAL STANDARD ON AUDITING 220 (REDRAFTED)

QUALITY CONTROL FOR AUDITS ~~ENGAGEMENTS~~ ENGAGEMENTS ~~OF HISTORICAL FINANCIAL INFORMATION~~

(revisions to April 20, 2007 version)

(Effective for audits of historical financial information for periods beginning on or after [date])*

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* See footnote 1.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the specific responsibilities of firm personnel regarding quality control procedures for audits of financial statements. This ISA is to be read in conjunction with relevant ethical requirements. It is to be adapted as necessary in the circumstances when applied to audits of other historical financial information.

2. Under [proposed] International Standard on Quality Control 1 (Redrafted), "Quality Control for Firms that Perform Audits and Reviews of ~~Historical~~ Financial Statements~~Information~~, and Other Assurance and Related Services Engagements," a firm has an obligation to establish a system of quality control designed to provide it with reasonable assurance that:

   (a) The firm and its personnel comply with professional standards and regulatory and legal requirements; and

   (b) The auditors' reports issued by the firm or engagement partners are appropriate in the circumstances.

3. ~~This ISA describes how e~~Engagement teams:

   (a) ~~i~~Implement quality control procedures that are applicable to the audit engagement;~~.~~

   (b) Provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence; and

   (c) ~~In doing so, the engagement team can~~Are entitled to rely on the firm's systems (for example, in relation to capabilities and competence of personnel through their recruitment and formal training; independence through the accumulation and communication of relevant independence information; maintenance of client relationships through acceptance and continuance systems; and adherence to regulatory and legal requirements through the monitoring process), ~~in meeting the requirements of this ISA~~ unless information provided by the firm or other parties suggests otherwise. ~~However, the engagement team also contributes to the effective operations of the firm's system of quality control. For example, engagement teams provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence~~.

Effective Date

4. This ISA is effective for audits of ~~historical financial information~~financial statements for periods beginning on or after [date].[1]

[1] This date will not be earlier than December 15, 2008.

Objective

5. The objective of the auditor is to obtain reasonable assurance that the audit complies with professional standards and regulatory and legal requirements, through the implementation of appropriate quality control procedures at the engagement level.

Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) Engagement partner[1] – The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

   (b) Engagement quality control review – A process designed to provide an objective evaluation, before the auditor's report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the auditor's report.

   (c) Engagement quality control reviewer – A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, who is not part of the engagement team, with sufficient and appropriate experience and authority to perform the engagement quality control review.

   (d) Engagement team – [All ~~personnel~~ partners and staff performing ~~an~~ the ~~audit~~ engagement, including ~~any~~ those who are experts ~~contracted by the firm in connection with that audit engagement~~in a field other than accounting or auditing, and any other person performing accounting or auditing tasks on the engagement regardless of their contractual relationship with the firm.][2] ~~[Proposed Section 290 of the IFAC Code of Ethics of the International Ethics Standards Board for Accountants proposes the following definition – all partners and staff performing the engagement and any individuals contracted by the firm who provide services on the engagement that might otherwise be provided by a partner or staff of the firm.]~~

   (e) Firm – A sole practitioner, partnership, corporation or other entity of professional accountants.

   (f) Inspection – In relation to completed audit engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.

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1 "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents.

2 This definition is subject to further consideration by the IAASB and the International Ethics Standards Board for Accountants.

(g) Listed entity[#] – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

(h) Monitoring – A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to enable the firm to obtain reasonable assurance that its system of quality control is operating effectively.

(i) Network firm[#] – A firm or entity that belongs to a network.

(j) Network[#] – A larger structure:

(i) That is aimed at cooperation, and

(ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.

(k) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

(l) Personnel – Partners and staff.

(m) Professional standards – IAASB Engagement Standards, as defined in the IAASB's "Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services," and relevant ethical requirements.

(n) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A and B of the International Federation of Accountants' Code of Ethics for Professional Accountants (IFAC Code) related to an audit of financial statements together with national requirements that are more restrictive.

(o) Staff – Professionals, other than partners, including any experts the firm employs.

(p) Suitably qualified external person – An individual outside the firm with the capabilities and competence to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits of historical financial information or of an organization that provides relevant quality control services.

[#] As defined in the IFAC *Code of Ethics for Professional Accountants* issued in July 1996 and revised in January 1998, November 2001, June 2004 and July 2006.

Requirements

Leadership Responsibilities for Quality on Audits

7. The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is so assigned. (Ref: Para. A1)

Relevant Ethical Requirements

8. The engagement partner shall evaluate whether members of the engagement team have complied with relevant ethical requirements:

   (a) Through inquiry and observation regarding ethical matters among the engagement team as necessary throughout the audit engagement; and

   (b) By remaining alert for evidence of non-compliance with ~~relevant ethical~~those requirements. (Ref: Para. A2)

9. If matters come to the engagement partner's attention through the firm's systems or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the partner, in consultation with others in the firm, shall determine the appropriate action.

Independence

10. The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

    (a) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

    (b) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and

    (c) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards. The engagement partner shall promptly report to the firm any failure to resolve the matter for appropriate action. (Ref: Para. A3-A4)

Acceptance and Continuance of Client Relationships and Audit Engagements

11. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A5-A6)

12. Where the engagement partner obtains information that would have caused the firm to decline the audit engagement if that information had been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.

Assignment of Engagement Teams

13. The engagement partner shall be satisfied that the engagement team collectively has the appropriate capabilities, competence and time to perform the audit engagement in accordance with professional standards and regulatory and legal requirements, and to enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: Para. A7-A8)

Engagement Performance

Direction, Supervision and Performance

14. The engagement partner shall take responsibility for:

    (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and regulatory and legal requirements; and (Ref: Para. A9-A11)

    (b) Whether the auditor's report that is issued is appropriate in the circumstances.

Review

15. Review responsibilities shall be determined on the basis that the work of a less experienced team member is reviewed on a timely basis by a more experienced team member. (Ref: Para. A12)

16. Before the auditor's report is issued, the engagement partner shall, through a timely review of the audit documentation and discussion with the engagement 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. A13)

17. An engagement partner taking over responsibility for the audit during the course of an audit engagement shall review the work performed to the date of the change in order to determine that the audit work has been planned and performed in accordance with professional standards and regulatory and legal requirements. ~~(Ref: Para. A14)~~

Consultation

18. The engagement partner shall:

    (a) Take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters;

    (b) Be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within 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 ~~documented and~~ agreed with the party consulted; and

    (d) Determine that conclusions resulting from such consultations have been implemented ~~and documented~~. (Ref: Para. A14-A15~~-A16~~)

Engagement Quality Control Review

19. For audits of financial statements of listed entities, and those other audit engagements for which an engagement quality control review is performed, the engagement partner shall:

    (a) Determine that an engagement quality control reviewer has been appointed;

    (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and

    (c) Not issue the auditor's report until the completion of the engagement quality control review. (Ref: Para. A16-A17~~-A18~~)

20. An engagement quality control review shall include an objective evaluation of~~, and a review of selected audit documentation relating to,~~ the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report.

21. The engagement quality control review shall include a review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions they reached.

22. The engagement quality control review shall also include discussion with the engagement partner, a review of the financial ~~information~~ statements and the auditor's report, and consideration of whether the auditor's report is appropriate. The engagement quality control review shall include consideration of the following:

    (a) The engagement team's evaluation of the firm's independence in relation to the audit engagement;

    (b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and

    (c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached. (Ref: Para. A18~~9~~-A21~~2~~)

    The engagement partner remains responsible for the audit engagement and its performance, notwithstanding involvement of the engagement quality control reviewer.

Differences of Opinion

23~~1~~. Where differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's procedures for dealing with and resolving differences of opinion.

Monitoring

24~~2~~. [Proposed] ISQC 1 (Redrafted) requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating

to the system of quality control are relevant, adequate, operating effectively and complied with in practice. The engagement partner shall consider the results of the monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and shall determine whether:

(a) Deficiencies noted in that information may affect the audit engagement; and

(c) Any additional procedures are required. (Ref: Para. A22~~3~~)

Documentation

25~~3~~. The engagement partner and, where appropriate, other members of the engagement team, shall document:

(a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.

(b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.

(c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.

(d) The nature and scope of, and conclusions resulting from consultations undertaken during the course of the audit engagement.

~~(e) The completion of the engagement quality control review, where such a review is required.~~ (Ref: Para. A23~~4~~)

26. The engagement quality control reviewer shall document, for the audit engagement reviewed, that:

(a) The procedures required by the firm's policies on engagement quality control review have been performed;

(b) The engagement quality control review has been completed before the report is issued; and

(c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

* * *

Application and Other Explanatory Material

Leadership Responsibilities for Quality on Audits (Ref: Para. 7)

A1. The actions of the engagement partner and appropriate messages to the other members of the engagement team emphasize:

(a) The importance to audit quality of:

(i) Performing work that complies with professional standards and regulatory and legal requirements;

(ii) Complying with the firm's quality control policies and procedures as applicable;

(iii) Issuing auditor's reports that are appropriate in the circumstances; and

(iv) The engagement team's ability to raise concerns without fear of reprisals; and

(b) The fact that quality is essential in performing audit engagements.

Relevant Ethical Requirements (Ref: Para. 8-9)

A2. The IFAC Code establishes the fundamental principles of professional ethics, which include:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

Independence (Ref: Para. 10)

A3. The engagement partner may identify a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level. In that case, as required by paragraph 10(c), the engagement partner reports to the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement.

Considerations Specific to Public Sector Entities

A4. The independence of public sector auditors may be protected by statutory measures. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to promote compliance with the spirit of paragraph 10. This may include, where the public sector auditor's mandate does not permit withdrawal from the engagement, disclosure through a public report, of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: Para. 11-12)

A5. [Proposed] ISQC 1 (Redrafted) requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Information such as the following assists the

engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is competent to perform the audit engagement and has the necessary time and resources;
- Whether the firm and the engagement team can comply with relevant ethical requirements; and
- Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Considerations Specific to Public Sector Entities

A6. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs 11, 12 and A6 may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

Assignment of Engagement Teams (Ref: Para. 13)

A7. When reviewing the appropriate capabilities and competence expected of the engagement team as a whole, the engagement partner may take into consideration such matters as:

- An understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- An understanding of professional standards and regulatory and legal requirements.
- Appropriate technical knowledge and expertise, including knowledge of relevant information technology.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- An understanding of the firm's quality control policies and procedures.

Considerations Specific to Public Sector Entities

A8. In the public sector, additional appropriate capabilities and competence may include skills that are necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such capabilities and 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 legislative authorities and preventing and detecting fraud and corruption.

Engagement Performance

Direction, Supervision and Performance (Ref: Para. 14)

A9. Direction of the engagement team involves informing the members of the engagement team of matters such as:

- Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with an attitude of professional skepticism as required by [proposed] ISA 200 (Revised and Redrafted), "Overall Objective of the Independent Auditor, and ~~Concepts Relevant to an Audit of Financial Statements~~the Conduct of an Audit in Accordance with ISAs."
- 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.

A10. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

A11. Supervision includes matters such as:

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

Review (Ref: Para. 15-17)

A12. A ~~R~~review ~~responsibilities include~~consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the engagement procedures have been achieved.

A13. 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 before the auditor's report is issued:

- 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.

The engagement partner need not review all audit documentation, but may do so. However, as required by [proposed] ISA 230 (Redrafted), "Audit Documentation," the partner documents the extent and timing of the reviews.

~~A14. Reviewing the work performed to the date of the change allows an engagement partner taking over an audit to determine that the work performed to the date of the review has been planned and performed in accordance with professional standards and regulatory and legal requirements.~~

Consultation (Ref: Para. 18)

A14~~5~~. Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice ~~on technical, ethical or other matters.~~; and
- Have appropriate knowledge, seniority and experience.

A15~~6~~. It may be appropriate for the engagement team to consult outside the firm, for example, where the firm lacks appropriate internal resources. They may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

Engagement Quality Control Review (Ref: Para. 19-22~~0~~)

A16~~7~~. The extent of the engagement quality control review depends, among other things, on the complexity of the audit engagement, whether the entity is a listed entity, and the risk that the auditor's report might not be appropriate in the circumstances.

A17~~8~~. Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the reviewer's satisfaction before the report is issued.

A18~~9~~. Matters of significant judgment include, for example:

- Significant risks identified during the engagement (in accordance with ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"), and the responses to those risks (in accordance with ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks"), including the engagement team's assessment of, and response to, the risk of fraud.
- Judgments made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the audit.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

A19~~20~~. Remaining alert for changes in circumstances allows the engagement partner to identify situations in which an engagement quality control review is necessary, even though at the start of the engagement, such a review was not required.

Considerations Specific to Public Sector Entities

A20~~1~~. Listed entities are not common in the public sector, however, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, public sector auditors evaluate which entities may be of sufficient significance to warrant performance of an engagement quality control review.

A21~~2~~. In the public sector, a single statutorily appointed Auditor General, or other suitably qualified person appointed on behalf of the Auditor General, may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

Monitoring (Ref: Para. 24~~2~~)

A22~~3~~. A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and regulatory and legal requirements, or that the auditor's report was not appropriate.

Documentation (Ref: Para. 25~~3~~-26)

A23~~4~~. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.