

Agenda Item
3-B

Quality Control – Table of Issues¹

Area	Summary of the Issues Presented up to December 2014 ²	View of the Board – as at December 2014	Working Group Interpretation of the Discussion with Regulators ³	Working Group Interpretation of the Issue and Suggested Approach	Potential Actions	
					Discussion Paper –Short Term ⁴ Actions	Discussion Paper - Long Term ⁵ Actions
Framework for Audit Quality (The Framework)	<ul style="list-style-type: none">The Framework highlights factors relating to systems of quality control that may need to be further addressed to ensure alignment with ISQC 1 in the following areas:<ul style="list-style-type: none">Values, Ethics and AttitudesKnowledge, Time and Experience	<ul style="list-style-type: none">The Framework can be used in revision of ISQC 1⁶ and the ISAs.	<ul style="list-style-type: none">Regulators noticed that there was some disconnect between the Framework and ISQC 1.	<ul style="list-style-type: none">The Framework has a more comprehensive and broader perspective on audit quality than ISQC 1.Compare the Framework with ISQC 1 and identify the relevant differences.Determine the potential changes needed to ISQC 1 to address the relevant differences.	<ul style="list-style-type: none">Make limited changes to ISQC 1 / ISA 220⁷ to incorporate concepts/language from the Framework this is not currently reflected in the standards. These changes would be limited to areas that are within the current objectives of ISQC 1 and ISA 220.	<ul style="list-style-type: none">Consider how the Framework can be used in developing a risk based approach to ISQC 1.

¹ This table represents a compendium of issues noted from the previous Board Discussions and is presented starting with the issues the Working Group believes may have some aspect of a short-term solution progressing to those that are more long-term in nature.

² For detail of previous Board agenda items discussing these issues, see June 2014 Board Meeting Agenda Item 6 <http://www.ifac.org/auditing-assurance/meetings/new-york-usa-6> and December 2014 Board Meeting Agenda Item 4 <http://www.ifac.org/auditing-assurance/meetings/new-york-usa-8>

³ The views of regulators interpreted in this column do not represent the views of all regulators, nor do they represent findings on all audits inspected.

⁴ For the purposes of this analysis, the short-term is defined as a time frame of approximately two years

⁵ For the purposes of this analysis, the long-term is defined as a time frame of significantly greater than two years

⁶ 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*

⁷ ISA 220, *Quality Control for an Audit of Financial Statements*

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	<ul style="list-style-type: none">Audit Process and Quality Control Procedures				<p>Examples of such changes include:</p> <ul style="list-style-type: none">Add the concept of providing partners and staff with continuing professional development opportunities.Add the concept of providing access to high quality technical support.Add the concept of timely appraisals and evaluations.	
Governance issues	<ul style="list-style-type: none">The Framework included the following factors that may need to be further addressed to ensure alignment with	<ul style="list-style-type: none">Incorporate governance issues into the project scoping,	<ul style="list-style-type: none">Regulators believe that:<ul style="list-style-type: none">Firm governance arrangements do	<ul style="list-style-type: none">The Framework indicates that financial considerations should not drive actions and	<ul style="list-style-type: none">Consider making limited changes to existing requirements, application material or	<ul style="list-style-type: none">Consider broader changes in ISQC1 to provide clearer linkage between

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	<p>ISQC 1 in the area of governance:</p> <ul style="list-style-type: none"> Governance arrangements—including guidance relating to the public interest nature of the audit function such that other areas of the practice are not inappropriately promoted; and the frequency of communication and expected behaviors. Necessary personal characteristics are promoted through appraisal and reward systems—including guidance relating to the use of competence frameworks in the appraisal and reward systems that embed appropriate personal 	<p>given its relative importance.</p> <ul style="list-style-type: none"> Specifically, how a firm compensates and rewards its personnel is a key aspect of the “tone at the top” and the attitude to audit quality through-out the firm. 	<p>not appropriately promote a tone at the top that facilitates audit quality.</p> <ul style="list-style-type: none"> That there is no formal anchor in the standards referencing the tone at the top and that ISQC 1 does not capture the full suite of what is necessary to ensure the appropriate tone at the top. Quality control policies and procedures in firms do not adequately address incentives for audit quality such 	<p>decisions that impair audit quality.</p> <ul style="list-style-type: none"> This concept is addressed by the requirements and guidance in ISQC 1, however may consider additional clarification or additional emphasis. Look to identify where additional guidance / clarification may be necessary. 	<p>both in ISQC 1 to clarify the linkage between governance and audit quality including the impact of incentives and disincentives. Examples of such changes for additional clarification include:</p> <ul style="list-style-type: none"> Add an explicit reference to the “tone at the top.” Add clarification that financial considerations do not drive actions and decisions that impair quality. 	<p>governance in ISQC 1 and audit quality.</p>

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	<p>characteristics and behaviors.</p> <ul style="list-style-type: none"> Financial considerations – including more guidance on actions that may be considered to be detrimental to audit quality. 		as promotion and remuneration.			
Shared service centers and outsourcing	<ul style="list-style-type: none"> Regulators had expressed concerns about the effect of outsourcing on audit quality, including whether the staff at the outsourcing location are sufficiently integrated into the team and possess sufficient knowledge. Other feedback indicated that the procedures assigned to staff at outsourcing locations is typically in lower risk areas of the audit. 	<ul style="list-style-type: none"> Outsourcing is not always detrimental to audit quality. Improvements to audit quality are possible through standardization. Continue to research this area Would be addressed by ISQC 1 if firms have proper quality control process in place. 	<ul style="list-style-type: none"> Regulators believe that: <ul style="list-style-type: none"> Use of shared service centers and other locations outside of the traditional engagement team are focused on efficiency and may reduce audit quality because the firm’s policies and procedures (related to the type of work outsourced, supervision and review of that work, 	<ul style="list-style-type: none"> Define what is meant by the terms shared service center and outsourcing and their potential impact on audit quality. Using a non-traditional audit team can improve efficiency and quality of audits through standardization or specialization but adequate policies and procedures are needed to deal with the specific circumstances of these audits. Engagement partner still has overall responsibility for the quality of the 	<ul style="list-style-type: none"> Consider limited changes to the application material in ISQC 1 to explicitly reference shared service centers and to explain that existing ISQC 1 quality control procedures apply to them. Provide guidance on best practices on developing policies and procedures for shared service centers. 	<ul style="list-style-type: none"> Develop specific requirements and application material in ISQC 1 recognizing the structure of the shared service center and outsourcing arrangements (including those outside of a firm’s network) and the nature of the procedures performed. Monitor the developing practice of shared

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			<p>documentation retention, and competencies at the outsourced location) may not be adequate.</p> <ul style="list-style-type: none">• Matters involving greater professional judgment (customized activities) should not be performed outside of the traditional engagement team or more effective quality control policies and procedures may be required.• Auditors do not always have access to the tools and documentation	<p>engagement through direction, supervision and review (ISA 220).</p> <ul style="list-style-type: none">• Policies and procedures relating to the operation of the shared service center are required by ISQC 1 and need to be monitored, but this is not explicitly stated in ISQC 1.• Analyze feedback from firms received in the recent staff survey on outsourcing practices.• Clarify the application of ISQC 1 to shared service centers and outsourcing.• Clarify the responsibilities of the engagement partner's for the direction, supervision and review of activities at the shared service center and outsourcing location.		<p>service centers and outsourcing activities in the audit profession.</p>

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			they need to perform their supervision and review.	<ul style="list-style-type: none">Co-ordination with Group Audits WG in case the shared service center activities involve using the work of other auditors.		
Remediation	<ul style="list-style-type: none">The ISA Implementation Monitoring Project identified concerns that when inspections indicate that an audit was seriously flawed:<ul style="list-style-type: none">The assessment of whether a report should be withdrawn was not sufficiently considered.The assessment of the need to issue a different opinion was not sufficiently considered.Feedback from other outreach suggests that ISQC 1 does not provide much guidance on	<ul style="list-style-type: none">Should form part of the project.Results of external inspections should be incorporated into remediation plansRoot cause analysis should form part of a firm’s remediation process	<ul style="list-style-type: none">Regulators believe that firms are not appropriately following up on inspection findings because ISQC 1 does not appropriately address the issue.	<ul style="list-style-type: none">ISQC 1 covers remediation of identified inspection findings through reference to complaints and allegations but this is not sufficiently explicit.ISQC 1 does not include a direct reference to root cause analysis but identifying the causes of deficiencies is necessary for taking appropriate remedial actions.Determine impact on individual engagement (ISA 560⁸) and on quality control policies and	<ul style="list-style-type: none">Make limited changes to ISQC 1 and/or ISA 220 to:<ul style="list-style-type: none">Explicitly incorporate external inspection results as part of the remediation considerations.Develop requirements, application material or both, to incorporate the consideration	<ul style="list-style-type: none">As part of a risk based approach to quality management, develop additional requirements, application material or both in the remediation section of ISQC 1 focused on continual improvement, including root cause analyses.Provide guidance outside of the standard to

⁸ ISA 560, *Subsequent Events*

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	<p>the application of systems of continuous improvement.</p> <ul style="list-style-type: none"> Regulators identified that ISQC 1 only considers the remediation of deficiencies noted as a result of the internal monitoring process. Regulators identified that the requirement to perform internal monitoring procedures on network firms was not embedded into ISQC 1. 			<p>procedures, including the impact on SMPs in respect of proportionate application (ISQC 1 / ISA 220).</p>	<p>and performance of “pre-issuance” reviews</p> <ul style="list-style-type: none"> Make limited changes to requirements, application material, or both in ISQC 1 focused on determining if an issue identified in an internal or external inspection applies to other engagements, and including appropriate remediation. 	<p>identify best practices for continual improvement.</p>
Engagement Quality Control Reviews (EQCR)	<ul style="list-style-type: none"> Concerns were identified in the ISA Implementation Monitoring Project in respect of: <ul style="list-style-type: none"> The selection of engagement quality control reviewers. 	<ul style="list-style-type: none"> Further clarity needed on the specific issue the IAASB is trying to fix. Expansion of requirements should only be made if corresponding changes are made to 	<ul style="list-style-type: none"> Regulators believe that EQCR is not being appropriately implemented and that more prescriptive requirements are needed specifically in respect of: 	<ul style="list-style-type: none"> Determine if the issues identified are execution or standards issues. If there are standards issues, determine if they relate to ISQC 1, ISA 220 or both; Clarify the role and responsibilities of the 	<ul style="list-style-type: none"> Use the responses from the discussion paper to determine if this is an execution issue or a standards issue, and also to determine if the issue should be addressed in the short-term, the long-term, or both. This could include: <ul style="list-style-type: none"> Making changes to ISA 220 to deal with issues identified including the application of judgment in performance of EQCR. 	

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	<ul style="list-style-type: none">• The objectivity of the reviewer.• The timing of the performance of the EQCR, specifically with respect to when the reviewer becomes involved in the EQCR.• The depth and focus of the review, specifically with respect to a perceived focus on compliance with the firm’s EQCR policies.• The robustness of the documentation of the review, including, documents reviewed, issues raised and the disposition and resolution of issues	<p>engagement partner responsibilities.</p> <ul style="list-style-type: none">• A separate ISA for EQCR is not thought to be necessary.• The issues as presented, may not necessarily require an update to ISQC 1 or ISA 220.	<ul style="list-style-type: none">• Selection of and competence and experience of reviewers, including consideration of the reviewer’s own inspection results.• Selection of engagements• Timing of the performance of EQCR• Allocation of time to perform the EQCR• Focusing of the review on engagement risks• Depth of the review performed by the EQCR• Documentation of the EQCR	<p>engagement quality control reviewer including in relation to the roles and responsibilities of the engagement partner.</p>	<ul style="list-style-type: none">• Considering the impact, if any, on ISQC 1 including policies and procedures related to the selection of engagements subject to EQCR.• Developing a risk based approach to EQCR in ISQC 1.	

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	<ul style="list-style-type: none">• A comparison of ISQC 1 to AS 7⁹ and the European¹⁰ Regulation identified the following differences:<ul style="list-style-type: none">• The types of engagements for which an EQCR is required.• The inclusion of an objective of the EQCR.• The requirement for the reviewer to have integrity and independence and a “cooling off” period.• The requirement to review specific areas of the engagement.• The concept of a significant engagement deficiency.					

⁹ US Public Company Accounting Oversight Board Auditing Standard No. 7 (AS 7), *Engagement Quality Review*

¹⁰ Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC

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	<ul style="list-style-type: none"> Specific documentation requirements for the reviewer. Feedback from the National Standard Setters indicated a preference for EQCR to remain integrated with ISQC 1. Requirements and responsibilities of the engagement quality control reviewer should not exceed those of the engagement partner. 					
Proportionality and Application to other Assurance Engagements and Related Services	<ul style="list-style-type: none"> National Standard Setters and Small- and medium-sized practices (SMPs) expressed concern that ISQC 1 was not written with SMPs in mind and as such proportionality was not contemplated within its basic design. Other feedback suggested that additional guidance is needed on how to effectively and efficiently apply ISQC 1 	<ul style="list-style-type: none"> ISQC 1 is capable of being applied by both different types of firms and to different types of engagements. Revising the standard on a “think small first” basis or developing a separate standard would have a negative impact on quality. 		<ul style="list-style-type: none"> SMPs are not always aware of how ISQC 1 applies to them and believe that its requirements are excessive for the nature of their practices. For example, who can perform the monitoring procedures? There may be an issue about how external 	<ul style="list-style-type: none"> Engage in a dialogue with regulators, especially those who are inspectors of the auditors of non-listed companies and SMPs. Consider the feedback obtained through outreach to SMPs, in particular the survey of SMPs 	<ul style="list-style-type: none"> Consideration of more significant amendments to ISQC 1 and ISA 220 as part of an overall revision to apply more conditional requirements and a risk based approach.

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	to reviews, other assurance engagements and related services engagements.	<ul style="list-style-type: none">• Promoting awareness of guidance is not sufficient• Issue has been raised over a long period of time• Maybe not highest priority		<p>inspections apply ISQC 1 to SMPs in contrast to the flexibilities that ISQC 1 has already established.</p> <ul style="list-style-type: none">• Proportionality is inextricably linked to an overall modernization of ISQC 1 and the application of a risk based approach in which quality risks are identified and responded to.• The basis for such a modernization could be alternative risk and quality management frameworks.• Proportionality issues are not limited to SMPs but also apply to larger firms which may establish different quality control systems for different client segments.	<p>on issues relevant to them issued February 2015.</p> <ul style="list-style-type: none">• Liaison with the National Standard Setters (NSS) to determine how much of the issue relates to 1) execution and 2) practical implementation guidance.• Clarify and highlight existing material that allows for scalability and add more application material, as applicable based on the results of the survey, in the form of special considerations for the application of ISQC 1 for SMPs.	

Quality Control – Table of Issues
IAASB Main Agenda (March 2015)

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				<ul style="list-style-type: none"> Clarification that scalability is inherently embedded in ISQC 1. Sensitization of inspectors to the scalability of ISQC 1. Identify what part of the issue is an execution issue and not a standards issue. 		
Group Audits	<ul style="list-style-type: none"> Issues being considered as part of the scoping of the Group Audits Project and the Quality Control Project may cross over, and have implications for both projects. 	<ul style="list-style-type: none"> Aspects of Group Audits project may become part of quality control. 		<ul style="list-style-type: none"> Cross over issues identified to date include: <ul style="list-style-type: none"> Role of engagement partner in direction, supervision and review Use of a Shared Service Center or outsourcing arrangements by the audited entity. Understanding quality control 	<ul style="list-style-type: none"> Co-ordination with the Group Audits WG on the cross over issues and potential solutions will determine if the issue should be addressed in the short-term, the long-term, or both. This could include: <ul style="list-style-type: none"> Making changes to ISQC 1 and ISA 220 as determined appropriate based on further research of the issues. Incorporate changes into ISQC 1 as part of the development of a risk based approach. 	

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				<div>results at other network firms</div> <ul style="list-style-type: none">• Quality control procedures around joint audits• Co-ordination with the Group Audits WG to define the issue and determine the appropriate place for resolution.		