INTERNATIONAL STANDARD ON QUALITY CONTROL 1 (REVISED) – QUALITY MANAGEMENT FOR FIRMS THAT PERFORM AUDITS OR REVIEWS OF FINANCIAL STATEMENTS, OR OTHER ASSURANCE OR RELATED SERVICES ENGAGEMENTS

EXTRACTS OF THE SECTION ADDRESSING ENGAGEMENT QUALITY REVIEWS – CLEAN

Requirements

Engagement Performance

42. The firm shall establish the following quality objectives that address the performance of quality engagements in accordance with professional standards and legal and regulatory requirements:

    (a) Personnel understand and fulfill their responsibilities in connection with the engagement, including, as applicable: (Ref: Para. A92–A93)

        (i) The engagement partner's overall responsibility for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement; and

        (ii) The appropriate direction and supervision of the engagement team and review of the work performed.

    (b) Engagement teams make appropriate judgments and reach appropriate conclusions in accordance with professional standards and applicable legal and regulatory requirements, and exercise professional skepticism in performing engagements. (Ref: Para: A95)

    (c) The engagement documentation is appropriately assembled and retained.

43. In designing and implementing responses to address the quality risks identified by the firm, the firm shall include the following responses that relate to engagement performance:

    (a) Establishing policies or procedures addressing the nature, timing and extent of the direction and supervision of engagement teams and review of their work, including the direction and supervision of the engagement team by more experienced engagement team members and the review by more experienced engagement team members of the work performed by less experienced team members. (Ref: Para. A92–A93)

    (b) Communicating the engagement team's responsibility for:

        (i) Implementing the firm's responses that are applicable at the engagement level; and

        (ii) Planning and performing the engagement in accordance with professional standards and applicable legal and regulatory requirements.

    (c) Establishing policies or procedures addressing consultation, including the engagement team's responsibilities for consultation, the matters on which consultation is required and how the conclusions should be agreed and implemented. (Ref: Para. A96–A97)

(d) Establishing policies or procedures addressing differences of opinion that arise within the engagement team, or between the engagement team and the engagement quality control reviewer or personnel performing duties within the firm's system of quality management, including those who provide consultation. (Ref: Para. A98)

(e) Establishing policies or procedures addressing engagement quality reviews regarding:

(i) The scope of engagements subject to an engagement quality review, including requiring an engagement quality review to be performed for: (Ref: Para. A100–A102)

a. All audits of financial statements of listed entities and of other entities that are of significant public interest;

b. Engagements for which an engagement quality review is required by law or regulation; and

c. Other engagements or classes of engagements for which the firm has determined that an engagement quality review is an appropriate response to a quality risk identified by the firm because of the reasons for the assessment given to the quality risk or for other reason(s).

(ii) The appointment of engagement quality reviewers to perform engagement quality reviews, including:

a. The assignment of responsibility for the appointment of engagement quality reviewers to an individual with the competence, capabilities, appropriate authority within the firm and objectivity, needed to assume the responsibility; (Ref: Para. A104)

b. The criteria for eligibility to perform, or participate as an assistant in, the engagement quality review that fulfill the requirements in ISQC 2,[1] including limitations on the eligibility of individuals to be engagement quality reviewers who previously served as engagement partner on the engagement subject to the review; and (Ref: Para. A105–A106C)

c. The replacement of the engagement quality reviewer when the reviewer's ability to perform the engagement quality review is impaired. (Ref: Para. A106D)

(iii) The responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review that fulfill the requirements of ISQC 2.[2]

(iv) The responsibilities of the engagement partner in relation to the engagement quality review, including prohibiting the engagement partner from dating the engagement report until the completion of the review. (Ref: Para. A108–A108A)

(v) Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer. (Ref: Para. A109)

(vi) Communication of responsibilities for engagement quality reviews to, as applicable:

[1] Proposed ISQC 2, paragraphs 20 and 22

[2] Proposed ISQC 2, paragraphs 23–26

a. Individuals involved in appointing engagement quality reviewers;

b. Engagement quality reviewers and individuals who assist engagement quality reviewers in performing such reviews; and

c. Engagement partners and members of engagement teams on engagements subject to engagement quality review.

(f) Establishing policies or procedures addressing assembly and retention of documentation that require:

(i) The engagement files to be assembled within an appropriate period of time after the engagement reports have been finalized; and (Ref: Para. A110)

(ii) The engagement documentation to be retained and maintained to meet the needs of the firm and to comply with law, regulation, relevant ethical requirements, or other professional standards. (Ref: Para. A111–A114)

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Application Material

Engagement Performance

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Engagement Quality Review (Ref. Para. 43(e))

A99. The effectiveness of the engagement quality review in addressing quality risks is enhanced in circumstances when the firm has a culture that promotes a commitment to quality in the conduct of engagements. Such a culture may be created by:

- Assigning responsibility for the oversight of the engagement quality review process to a senior individual within the firm;
- Allocating appropriate resources for the performance of engagement quality reviews;
- Emphasizing the importance of the engagement quality review;
- Promoting personal characteristics essential to quality that include respect for the engagement quality reviewer and a responsive attitude to matters raised by the engagement quality reviewer; and
- Establishing policies or procedures addressing differences of opinion and encouraging appropriate discussion between the engagement quality reviewer and the engagement partner or the engagement team throughout the engagement.

Scope of Engagements Subject to an Engagement Quality Review (Ref: Para. 43(e)(i))

A100. Other than listed entities, entities that are of significant public interest may include entities that have a large number and wide range of stakeholders or are significant due to their nature and size of the business (e.g., financial institutions such as banks, insurance companies, and pension funds).

A100A. Law or regulation may require an engagement quality review for engagements other than audits of listed entities, for example, audits of financial statements of entities that:

- Are characterized in law or regulation as public interest entities;
- Operate in the public sector or which are recipients of government funding;
- Operate in certain industries (e.g., financial institutions such as banks, insurance companies and pension funds);
- Meet an asset threshold determined by law or regulation; or
- Are under judicial management.

A101. The firm may determine that an engagement quality review is an appropriate response to an identified and assessed quality risk for other engagements because of the significance of the effect of the quality risk related to inappropriate judgments being made or inappropriate conclusions being reached on the achievement of the quality objectives. Examples of such engagements or classes of engagements include those:

- That involve a high level of complexity or judgment or where previous issues have been encountered on the engagement, for example audits:
  - For entities operating in industries that involve making accounting estimates with a high degree of estimation uncertainty (e.g., financial institutions, extractive industries).
  - With a history of misstatements or deficiencies in internal controls, significant internal or external inspection findings, a material restatement of comparative information in the financial statements or an auditor's report that required reissuance.
  - For entities in which there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
- In which there are unusual circumstances, which may be identified as part of the firm's acceptance and continuance of client relationships process or through the firm's monitoring of its system of quality management.

A102. The firm's responses to a quality risk may include forms of engagement reviews that are not engagement quality reviews, for example, reviews of the engagement team's procedures on significant risks or reviews of certain matters by individuals within the firm who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review to appropriately address the quality risks. However, there may also be circumstances where, due to the nature and circumstances of the engagements performed by the firm, there are no engagements for which an engagement quality review is an appropriate response, such as may be the case when a firm performs only related services engagements.

Considerations Specific to Public Sector Audit Organizations

A103. Engagements for public sector entities may also have significant public interest due to the range of such entities' stakeholders (e.g., state-owned corporations or those in which the state has a controlling stake or a stake with significant influence, beneficiaries of public funding and public

utilities) or the size or complexity of the entity. Ongoing transformations within the public sector may also give rise to new types of entities that have significant public interest.

Appointment of the Engagement Quality Reviewer (Ref: Para. 43(e)(ii))

A104. Competence and capabilities that enable an individual to assume responsibility for the appointment of the engagement quality reviewer may include appropriate knowledge about:

- The responsibilities of an engagement quality reviewer;
- The criteria in paragraph 20 of ISQC 2 regarding the eligibility of engagement quality reviewers, including those regarding the competence, capabilities, appropriate authority and objectivity of the engagement quality reviewer; and
- The nature and circumstances of the engagement subject to engagement quality review (e.g., the nature of the entity and the composition of the engagement team).

A105. ISQC 2[3] includes criteria on the eligibility of the engagement quality reviewer. When an external person is to be appointed to perform the engagement quality review, making relevant inquiries about the external person before making the appointment may assist the firm in obtaining the necessary information about whether the person meets the eligibility criteria to be an engagement quality reviewer. An external person may be a partner or an employee of:

- A firm within the firm's network, which is subject to the requirements for networks or services in accordance with paragraphs 60–65 of ISQC 1 (Revised);
- A service provider, which is subject to the requirements for service providers in paragraphs 66–67 of ISQC 1 (Revised). For example, a service provider may be:
  - A firm outside of the firm's network;
  - A professional accountancy body whose members may perform audits or reviews of historical financial information, or other assurance or related services engagements; or
  - An organization that provides relevant quality management.

A105A. In some cases, such as sole practitioners, small firms, or network firms, suitably qualified external persons may be contracted to perform the engagement quality review. When the firm contracts suitably qualified external persons, the requirements in paragraph 43(e)(ii)(b) apply.

A106. A threat to the objectivity of the individual responsible for the appointment of the engagement quality reviewer may arise in circumstances when the individual is a member of the engagement team. In such circumstances, a threat to the objectivity of the engagement quality reviewer is also created. In exceptional circumstances it may not be practicable for an individual, other than a member of the engagement team, to appoint the engagement quality reviewer, for example, in the case of a smaller firm or a sole practitioner.

A106A. In evaluating the competence and capabilities of the individual(s) who may be appointed as an engagement quality reviewer, the individual responsible for the appointment of the engagement quality reviewer(s) may consider the results of the firm's monitoring activities, including the inspection of completed engagements, and performance evaluations and the results of external inspections.

[3] Proposed ISQC 2, paragraphs 19–21

Limitations on the Eligibility of Individuals to Serve as Engagement Quality Reviewers

A106B. Relevant ethical requirements or law or regulation may establish requirements for a cooling-off period during which individuals are prohibited from serving as the engagement quality reviewer for engagements for which they previously served in another role(s). For example, the IESBA Code contains prohibitions, for audits of public interest entities, on individuals acting in any of the following roles, or combination of such roles, for a period of more than seven cumulative years, with a minimum cooling-off period of two years:

- The engagement partner;
- The individual appointed as the engagement quality reviewer; or
- Any key audit partner role.

A106C. An individual who has served as the engagement partner is not likely to be able to perform the role of the engagement quality reviewer immediately after ceasing to be the engagement partner because it is not likely that the threats to the individual's objectivity with regard to the engagement and the engagement team can be reduced to an acceptable level. In recurring engagements, the matters on which significant judgments are made and the facts and circumstances around those significant judgments are not likely to vary to a degree such that an objective evaluation of those judgments can be made by the individual who served as the engagement partner in the immediate previous period. Accordingly, this ISQC requires the firm to establish policies or procedures that limit the eligibility of individuals as engagement quality reviewers who previously served as engagement partner. Determining a suitable cooling-off period depends upon the facts and circumstances of the engagement and may include consideration of:

- Whether the engagement quality review is for an audit of a listed entity or an entity with significant public interest, or is otherwise required by law or regulation; and
- For engagements or classes of engagements for which the firm has determined that an engagement quality review is an appropriate response because of the reasons for the assessment given to the quality risk.

In the case of an audit of the financial statements of a listed entity, it is unlikely that an engagement partner would be able to act as the engagement quality reviewer until two subsequent audits have been conducted.

Replacement of Engagement Quality Reviewer when Ability to Perform is Impaired (Ref: Para. 43(e)(ii)(c)

A106D. ISQC 2[4] requires the engagement quality reviewer to notify the firm when the engagement quality reviewer is, or becomes aware of, circumstances that impair the engagement quality reviewer's eligibility to be the engagement quality reviewer. The firm's policies or procedures that address providing a replacement for the engagement quality reviewer in these circumstances may set forth a process by which alternative eligible individuals are identified or the period of time after notification within which the firm is required to appoint a replacement.

[4] Proposed ISQC 2, paragraph 20

Responsibilities of the Engagement Partner in Relation to the Engagement Quality Review (Ref: Para. 43(e)(iv))

A108. ISA 220[5] establishes the requirements for the engagement partner in audit engagements for which an engagement quality review is required, including:

- Determining that an engagement quality reviewer has been appointed;
- Cooperating with the engagement quality reviewer and informing members of the engagement team of their responsibility to do so;
- Discussing significant matters arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
- Not dating the auditor's report until the completion of the engagement quality review.

A108A. Although the engagement partner does not date the auditor's report until the completion of the engagement quality review,[6] which includes resolving matters raised by the engagement quality reviewer before the report is issued, the documentation of the engagement quality review may be completed after the date of the report.[7] ISA 700 (Revised) requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements.[8,9] When the engagement quality review is performed for an audit of financial statements, such a review assists the auditor in determining whether sufficient appropriate audit evidence has been obtained.

Discussion between the Engagement Quality Reviewer and the Engagement Team (Ref**:** Para**.** 43(e)(v))

A109. During the engagement, there may be circumstances when the discussions between the engagement team and the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer. Such circumstances include when the nature and extent of discussions are such that the engagement quality reviewer becomes involved in making the significant judgments in the engagement, including when the engagement team seeks consultation on a matter with the engagement quality reviewer. When there is a threat to the engagement quality reviewer's objectivity, the firm's policies or procedures may establish the actions to be taken to maintain the objectivity of the engagement quality reviewer, such as requiring the engagement team to consult on the matter with other personnel or requiring the involvement of other personnel in the consultation or to oversee the consultation. In some cases, the firm's policies or procedures may include appointing another individual to perform the engagement quality review for the significant judgment.

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5 Proposed ISA 220, (Revised), *Quality Control for an Audit of Financial Statements*, paragraph 19

6 Proposed ISA 220, (Revised), paragraph 19(c)

7 ISA 230, *Audit Documentation*, paragraph 14

8 ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 49

9 Similar requirements exist in paragraph 92 of ISRE 2400 (Revised), *Engagements to Review Financial Statements* and in paragraph 41 of ISRS 4410 (Revised), *Compilation Engagements*