Initial Discussion on the IAASB’s Future Project Addressing Quality Control

Background

1. ISQC 1 applies to all firms of professional accountants in respect of audits and reviews of financial statements, and other assurance and related service engagements. It was originally issued in 2004, and the IAASB’s main goals in developing the standard were to:
   - Promote, at the firm level, the establishment and maintenance of a system of quality control that provides reasonable assurance that the firm and its personnel comply with professional standards and applicable legal and regulatory requirements, and that engagement reports issued are appropriate in the circumstances.
   - Require that this system has an appropriate emphasis on the role of leadership and the promotion of an internal culture that recognizes that quality is essential in performing engagements.
   - Require firms to have appropriate policies and procedures that address engagement quality control review and monitoring.

2. Over the last decade, there have been significant changes in the environment in which the standard operates. Among others:
   - Users of auditor’s reports on financial statements and other engagement reports are placing greater importance on, and have increasingly higher expectations for, quality control by firms.
   - Audit regulators and audit inspection bodies globally are also placing similar importance on quality control, and critical audit inspection findings are generally increasing. It has been noted that deficiencies in some matters continue to persist over time without timely or adequate resolution.
   - Firm practices continue to evolve, particularly in light of technological developments and the globalization of business practices.
   - There has been an increase in the demand for other types of assurance and related services engagements. Some relate to services that are primarily (but not exclusively) focused on addressing the needs of small- and medium-sized entities (SMEs) and their users, such as review and compilation engagements. Others relate to assurance on a variety of technically diverse subject matters, such as assurance on Greenhouse Gas Statements.

3. Developments such as these reinforce the relevance and importance of the IAASB’s main goals when it developed ISQC 1. They also stimulate the need to consider whether enhancements to the standard are

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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 In 2004, the IAASB released the clarified version of ISQC 1. The standard was redrafted to improve its overall readability and understandability through structural and drafting improvements, but was not substantively revised.
necessary to appropriately further strengthen quality control at the firm level, and whether additional
guidance may be needed to ensure it can be applied as intended to a wide range of services performed
by practitioners, on a proportionate basis as necessary.

4. The findings from the ISA Implementation Monitoring project, and other discussions with stakeholders,
including at the recent IAASB-National Standard Setters (NSS) Liaison Group meeting, have indicated
that the issues fall into the following:

I. Engagement quality control reviews (EQCRs).

II. Aspects of quality control highlighted during the IAASB’s development of its Framework for Audit Quality and other outreach.

III. Proportionality of ISQC 1 for small and medium practices (SMPs) and applicability to reviews, other assurance and related services engagements.

These issues are further discussed below.

I. EQCRs

Appointment of Engagement Quality Control Reviewers

Competence

5. ISQC 1 requires that firms establish policies and procedures to address the appointment of engagement quality control reviewers (engagement reviewers) and eligibility to perform such a role. These policies require that the engagement reviewer has the appropriate technical qualifications, which includes the necessary experience and authority; and that the engagement reviewer is sufficiently objective from the engagement. Further, the policies and procedures should be designed to maintain the objectivity of the engagement reviewer and provide for the engagement reviewer’s replacement should that objectivity become impaired. ISA 220 sets specific requirements for the engagement partner and the engagement reviewer for an EQCR.

6. ISA Implementation Monitoring project findings include concerns, particularly from regulators and audit oversight bodies, about the selection of engagement reviewers. In this regard, it was suggested that more specific criteria be established to determine who should perform EQCRs, including consideration of the results of internal or external quality monitoring reviews of that individual’s work.

7. In principle, the findings suggest greater emphasis is needed by firms to carefully consider “the best person for the job.” This point is consistent with the focus of the existing requirement. Nonetheless, the question for consideration is whether greater specificity within ISQC 1 would enhance the degree to which attention is given to the appointment decision, and achieve greater consistency in how the requirement is applied.

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3 ISQC 1 paragraph 39(a)
4 ISQC 1, paragraphs 40 and A49–A51
5 ISA 220, Quality Control for an Audit of Financial Statements, paragraphs 19–22
8. A challenge, however, is defining further specific criteria, in particular whether doing so would be appropriate for a principle-based standard, and how such criteria are to be applied. For example, if one of the specific criterion was the results of the internal or external quality reviews of that individual's engagements, what might be the factors for consideration in determining non-eligibility of that individual to perform the duties of an engagement reviewer?

9. For example, in considering whether an individual could be appointed as an engagement reviewer, it may be appropriate to take into account:

- **The number of engagement deficiencies**—If so, would one engagement deficiency be sufficient to disqualify an individual from being an engagement reviewer, or would multiple engagement deficiencies be needed?

- **The severity of the deficiency**—If so, what might be considered minor engagement deficiencies versus more severe engagement deficiencies? Or would the engagement need to be considered non-compliant in order to disqualify the individual from being an engagement reviewer?

10. Further, in selecting the results of previous internal or external reviews as a criterion to determine eligibility to act as an engagement reviewer, there would likely need to be consideration of whether focus on specific results of such reviews is inconsistent with the principle that findings from EQCRs are meant to improve quality over time rather than be punitive.

11. The selection of the appropriate engagement reviewer is clearly an important matter but may ultimately be a matter of judgment by a firm taking into account a number of factors. As such, it may be more useful to consider the potential for additional application material rather than greater specificity of the requirements on this matter.

Objectivity

12. Concerns were also noted with respect to the objectivity of the engagement reviewer. By definition, the engagement reviewer cannot be a member of the engagement team, and ISQC 1 establishes a requirement and provides guidance for the firm to establish policies and procedures required in respect of objectivity of the engagement reviewer. This includes:

- The extent of consultation on issues allowed with the engagement team; and
- That the engagement reviewer:
  - Where practicable, is not selected by the engagement partner;
  - Does not otherwise participate in the engagement during the period of the review;
  - Does not make decisions for the engagement team; and

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6 Paragraph 12(e) of ISQC 1 defines the engagement quality control reviewer as “a partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the report.”

7 ISQC 1, paragraphs 40 and A49
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- Is not subject to other considerations that would threaten the engagement reviewer’s objectivity.

ISQC 1 does not provide any further specificity on maintaining objectivity of the engagement reviewer.

13. The US Public Company Accounting Oversight Board’s (PCAOB) Auditing Standard No. 7 (AS 7), Engagement Quality Review (EQR), which was issued in 2009, includes similar considerations with respect to objectivity to those included in ISQC 1.

14. However AS 7 also contains other specific provisions that provide further guidance around the objectivity of the engagement reviewer. For example, AS 7 specifically requires that the engagement reviewer cannot be the individual that served as the engagement partner during either of the two audits preceding the audit subject to review, essentially establishing a “cooling off” period. The cooling off period was introduced to address the view that it would be more difficult for an engagement partner who had had overall responsibility for an engagement for at least a year to perform the role of engagement reviewer with the necessary level of objectivity.

**Timing of EQCRs**

15. ISQC 1 requires the firm to have policies and procedures about nature, timing and extent of the EQCR. The application material indicates that the engagement report may not be dated until the completion of the quality review, that the quality review should be conducted in a timely manner at the appropriate stages of the audit, and that the extent of quality review should be considered in light of the complexity of the engagement.

16. ISA Implementation Monitoring project findings include concerns about the timing of the performance of EQCRs—specifically with respect to when the engagement reviewer becomes involved in the EQCR. In this regard, anecdotal evidence suggests this is something that is understood but that there is still difficulty in getting to a consistent treatment. For example, it has been observed that the EQCR can happen in the latter stages of the engagement, which may make it difficult for the engagement team to react to any issues identified by the engagement reviewer.

17. A possible approach is to consider whether specificity should be included in the requirements about the timing of the EQCR. For example, consideration could be given to a milestone approach providing guidance on when the review of certain aspects of the engagement should be completed (similar to the approach taken in ISA 260 in relation to communications with those charged with governance (TCWG)), with the assumption that such matters would be documented as they are completed as evidence of the performance of the review.

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8 AS 7, paragraph 8
9 ISQC 1, paragraph 36
10 ISQC 1, paragraph A42
11 ISQC 1, paragraph A43
12 ISQC 1, paragraph A44
13 ISA 260, Communication with Those Charged With Governance
18. However, given the wide variety of engagement circumstances such that compliance with arbitrary milestones may be difficult to apply, a question exists as to what extent it would be practicable to establish such requirements. Further, there may be appropriate interaction between the engagement team and the engagement reviewer happening throughout the engagement, but this may be in an informal manner and, as such, documentation of the nature, timing and extent of these interactions may be inconsistent or it may not be apparent within this documentation that the EQCR was performed throughout the engagement. If so, does the merit of additional documentation requirements outweigh the potential disadvantage of a focus on compliance and documentation rather than effective performance?

Objective and Documentation of the EQCR

19. In respect of the nature and extent of the work undertaken by the engagement reviewer, ISQC 1 requires that the firm establish policies and procedures for the engagement reviewer that includes: the discussion of significant matters with the engagement partner; review of the financial statements or other subject matter information and the related report; review of selected engagement documentation relating to significant judgments and conclusions reached; and the evaluation of the conclusions reached in forming the report and the appropriateness of the subsequent report. Further, application material provides guidance around matters relevant to evaluating significant judgments in the context of the audit of financial statements of listed entities. These matters include significant risks; related responses and judgments made; and matters communicated with TCWG.

20. Further, ISQC 1 requires documentation that:

(a) The procedures required by the firm’s policies on EQCR have been performed;

(b) The EQCR has been completed on or before the date of the auditor’s report; 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 reached, were not appropriate.

21. In comparison, AS 7 specifically requires the engagement reviewer to evaluate the significant judgments that relate to engagement planning; the engagement team’s assessment of, and audit responses to, significant risks, including fraud risks; and the significant judgments made about identified misstatements and control deficiencies. It further requires the evaluation of whether appropriate matters have been identified for or communicated with TCWG.

22. AS 7 also requires that the documentation of an EQR should contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the engagement reviewer, and others who assisted the engagement reviewer, to comply with the provisions of the standard.
23. ISA Implementation Monitoring findings indicated concerns around the depth of EQCRs, specifically with respect to the focus of the review being in compliance with the firm’s EQCR policies instead of a focus on the significant areas of the specific engagement. Further, in respect to the documentation of EQCRs, in addition to questions about its timeliness, concern was expressed around whether the documentation was sufficiently robust in detailing the documents reviewed, the issues raised, differences of opinion and their disposition and resolution.

24. These findings may indicate that further guidance and specificity is needed to facilitate the implementation of policies and procedures that change the mindset from regarding EQCR as a compliance exercise to one of a focus on the significant issues and judgments made during the course of the engagement, and robust documentation of these considerations. As the IAASB further discusses these matters, consideration will need to be given as to how the ISAs and ISQC 1 specify responsibilities for both the engagement partner and the engagement reviewer, so as to not hold the engagement reviewer to more onerous requirements than those of an engagement partner.

Development of a Separate EQCR Standard

25. As part of a review of the provisions on EQCRs, one consideration is whether to retain the EQCR section within ISQC 1 and to develop further guidance in the related application material. On the other hand, it may be worth considering whether to remove the EQCR section of ISQC 1 into a separate standard that would apply when an EQCR was required either by the ISAs (i.e., for audits of financial statements of listed entities) or as determined by the firm.

26. Development of a separate EQCR standard could have the following advantages and disadvantages:

Advantages

- Greater prominence to audit quality through an increased focus on EQCR.
- Facilitation of more timely completion of changes to this particular aspect of ISQC 1.
- Allowance for greater elaboration of requirements and application material for an EQCR (including in relation to proportionate application or application to other types of assurance or related services engagements), without distorting the balance of EQCR relative to other aspects of ISQC 1.
- May help alleviate concerns about the burden and applicability of ISQC 1 to smaller practices or other engagements.

Disadvantages

- Linkages to and with the overall framework of ISQC 1 may be missed.
- Increased potential for duplication.
- Undue prominence on an EQCR in light of other important factors in quality control, in particular the role of the engagement partner.

27. Initial reactions from NSS at the recent IAASB-NSS Liaison Group meeting indicated a preference for maintaining the requirements and application material relating to EQCRs in ISQC 1.
Matters for IAASB Consideration

1. The IAASB is asked for views on the matters relating to EQCRs noted above, in particular in relation to:
   
   • The appropriateness and practicality of developing specific criteria for purposes of a firm’s appointment of an engagement reviewer, the timing of the EQCR, and views on further enhancing the focus of such EQCRs.
   
   • The merits or drawbacks of developing a separate standard for EQCRs rather than making revisions, as appropriate, to the extant material in ISQC 1.
   
   • Any other considerations or aspects relating to requirements and guidance for EQCRs, that should be taken into account in revising ISQC 1.

II. Aspects of Quality Control Arising from the IAASB’s Development of the Framework for Audit Quality and Other Outreach

28. The IAASB’s recently released publication, A Framework for Audit Quality (the Framework), describes key elements that create an environment for audit quality. One of the important factors to audit quality considered in the Framework relates to values, ethics and attitudes at the firm level. As noted in Agenda Item 5-A, work on the Framework has identified issues that need to be further addressed, either within the requirements in ISQC 1 or, as appropriate, within the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA Code) in relation to a number of important areas, including:

   • Engagement performance (matters relating to consultations, technical reviews of financial statements, engagement acceptance, appointment of engagement team members, independence and ethics)
   
   • Human resources (technical competence / capabilities and expertise of the engagement team, including the engagement partner, recruitment and training, remuneration based on audit quality)
   
   • Internal monitoring reviews, including scope and extent
   
   • Using the work of a specialist and auditor’s expert, and the differences between the two
   
   • Clarification of definitions, such as “professionals”, and further guidance on the applicability to public sector audits

29. On a preliminary basis, Staff has prepared, in the table below, a broad comparison of those factors considered in the Framework dealing with values, ethics and attitudes at the firm level to the requirements within ISQC 1. The comparison also highlights a preliminary consideration of the degree to which the factor is addressed by ISQC 1.

Legend

- Factor appears to be fully addressed by ISQC 1
- Factor appears to be only partially addressed by ISQC 1
- Factor does not appear to be addressed by ISQC 1
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<th>Framework Factor</th>
<th>Relevant ISQC 1 Requirement</th>
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| Governance arrangements are in place that establish the appropriate “tone at the “top” and which aim to safeguard the firm's independence. | 18. The firm shall establish policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements.  
19. The firm shall establish policies and procedures such that any person...assigned operational responsibility for the firm’s system of quality control...has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility.  
20. The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm…maintain independence where required by the relevant ethical requirements.                                                                                     |
| Necessary personal characteristics are promoted through appraisal and reward systems supporting audit quality. | 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:  
(a) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and  
(b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances.                                                                                           |
| Financial considerations do not drive actions and decisions that impair audit quality. | No requirement identified                                                                                                                                                                                                                                                                                                                                   |
| The firm emphasizes the importance of providing partners and staff with continuing professional development opportunities and access to high-quality technical support. | 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:  
(a) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and  
(b) Enable the firm or engagement partners to issue reports that are appropriate in the circumstances.                                                                                           |
The firm promotes a culture of consultation on difficult issues. | 34. The firm shall establish policies and procedures designed to provide it with reasonable assurance that:
   (a) Appropriate consultation takes place on difficult or contentious matters;
   (b) Sufficient resources are available to enable appropriate consultation to take place;
   (c) The nature and scope of, and conclusions resulting from; consultations are documented and are agreed by both the individual seeking consultation and the individual consulted; and
   (d) Conclusions resulting from consultations are implemented.

Robust systems exist for making client acceptance and continuance decisions. | 26. The firm shall establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm:
   (a) Is competent to perform the engagement and has the capabilities including time and resources, to do so;
   (b) Can comply with relevant ethical requirements; and
   (c) Has considered the integrity of the client, and does not have information that would lead it to conclude that the client lacks integrity.

30. For noting, the International Association for Accounting Education and Research (IAAER) and the IAASB have commissioned a research study that explores how the evaluation and rewards systems in accounting firms promote and reward skeptical behavior. Initial results of this study indicate that, where auditors investigate inconsistencies, the evaluations reward the auditor if misstatements are found, but result in negative evaluations if no misstatements are found. This creates an environment where the costs of skepticism are only “worth it” if a misstatement is found.

Assignment of Engagement Teams

31. Also potentially warranting further consideration in revising ISQC 1 is the need to ensure that emphasis and focus given in ISQC 1 is not to just one aspect of ensuring that a quality engagement is performed. In a system of quality control, the engagement quality review is only one part of a quality control management system. Further, it is essentially a detective control, which aims to fix issues with quality subsequent to those issues arising, but before issuance of the engagement report. As noted in paragraph 28, there may be opportunities to include additional emphasis within ISQC 1, amongst others, in relation to preventative controls, for example the need for the firm to ensure that there are appropriate policies and procedures with respect to the appropriate staffing of an engagement and the qualifications and performance of engagement team members, including the engagement partner.
32. ISQC 1 includes high-level requirements, such that the firm shall assign responsibility for each engagement to an engagement partner and shall establish policies and procedures requiring that, amongst other things, the engagement partner has the appropriate competence, capabilities and authority to perform the role; and the responsibilities of the engagement partner are clearly defined and communicated to that partner.\(^{19}\) However, as noted during the IAASB-NSS Liaison Group meeting, in looking at how ISQC 1 addresses the appointing of an engagement reviewer, it may be useful for the IAASB to also consider whether more is needed in ISQC 1 to describe the process by which an engagement partner is appointed and highlight the necessary characteristics thereof.

33. ISQC 1 also requires that firms establish policies and procedures to assign appropriate personnel with the necessary competence, and capabilities to perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and to enable the firm or the engagement partners to issue reports that are appropriate in the circumstances.\(^{20}\)

34. Application material to these requirements discusses that these 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; listing a number of considerations in the firm’s assignment of the engagement team.\(^{21}\) However, as noted in the table above, there may be opportunities to provide additional guidance explaining the role of all engagement team members in achieving audit quality and incorporate thinking from the Framework as to how firms might promote a culture of audit quality.

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**Matter for IAASB Consideration**

2. In light of the factors noted in the Framework, what are the IAASB’s views on whether the more is needed within ISQC 1 to place adequate emphasis on matters such as the tone at the top, appropriate training and remunerations systems, and engagement team performance, particularly with respect to rewarding professional skepticism?

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**Other Aspects of Quality Control Noted for Possible Consideration**

Remediation – Re-Issuing Engagement Reports in Light of External Inspection Findings

35. Regulators have also stressed the need for the IAASB to consider how best to address circumstances when significant audit deficiencies have been identified by external or internal inspections (i.e., remediation), as this topic is not explicitly addressed in the ISAs and consistency in practice (e.g., through requirements and guidance explicitly addressing this issue) is seen as a means to improve audit quality.

36. The ISA Implementation Monitoring project findings include concerns, in particular from regulatory bodies, that firms do not always properly assess whether the audit report should be withdrawn or if there is a need for the firm to consider issuing a different audit opinion when subsequent external inspections indicate the audit was seriously flawed.

\(^{19}\) ISQC 1, paragraphs 30(b) and 30(c)

\(^{20}\) ISQC 1, paragraph 31

\(^{21}\) ISQC 1, paragraph A31
37. ISQC 1 requires that firms establish policies and procedures to address cases where the results of the firm’s monitoring procedures indicate that the issued engagement report may be inappropriate. Further, it requires that those policies and procedures include the determination of what further action is appropriate to comply with the relevant professional standards and legal and regulatory requirements. However, ISQC 1 does not contemplate further firm actions when the findings from external inspections or monitoring reviews appear to indicate that the auditor’s opinion is flawed, either because there is insufficient appropriate audit evidence or the audit evidence would support a different opinion to that issued.

38. Further, as highlighted during the IAASB’s work on ISA 720\textsuperscript{23} and ISA 560,\textsuperscript{24} the ISAs are silent on the specific actions to be taken in relation to notifying people of a withdrawal given the variety of national circumstances. More broadly, it is a question of association, a topic touched on in the IESBA Code but not further addressed in either the IESBA Code or the ISAs in detail.

Monitoring, Evaluating and Remedying Identified Deficiencies in a Firm’s System of Quality Control

39. ISQC 1 requires that firms develop systems and process to evaluate, amongst other things, the effect of identified deficiencies to determine if they are systematic, repetitive or other significant deficiencies that require corrective action.\textsuperscript{25} It further requires that changes to quality control policies and procedures be made when appropriate.\textsuperscript{26}

40. Feedback has suggested that this is an essential aspect of continuous improvement in a firm’s system of QC, yet the standard does not provide much guidance in terms of application of the requirements.

41. In relation to this area, a broader consideration is whether it would be appropriate for the standard to emphasize the importance of a root cause analysis when evaluating the deficiencies and recommending corrective action, particularly in identifying and responding to systematic issues. This may also include consideration of how to further promote dialogue with regulators, as appropriate, as part of the firms’ overall monitoring and remediation program, in particular to respond to findings from external inspections especially those of a recurring nature.

Off-Shoring/Shared Service Centers

42. Some firms, especially the larger firms, are increasing efforts to realize engagement efficiencies by “outsourcing” certain routine audit and administrative procedures to either off-shore locations or to a domestic shared service center where such procedures are performed by more junior staff.

43. Regulators in particular have expressed concerns about the effect of off-shoring on the quality of the audit and have suggested that the IAASB may need to consider whether requirements or guidance in the ISAs addressing the practice are needed. For example, some have questioned

\textsuperscript{22} ISQC 1, paragraph 52
\textsuperscript{23} ISA 720, The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements
\textsuperscript{24} ISA 560, Subsequent Events
\textsuperscript{25} ISQC 1, paragraph 49(b)
\textsuperscript{26} ISQC 1, paragraph 51(c)
whether off-shore staff are sufficiently integrated into the audit team and possess sufficient knowledge to be able to identify matters that are significant in the context of a particular engagement. Others have noted that the assignment of procedures to such staff typically relate to areas of lower risk in the audit.

44. ISQC 1 includes the requirement for firms to establish policies and procedures that are designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements. It further explains that such policies and procedures shall include the promotion of consistency in the quality of engagement performance; supervision responsibilities; and review responsibilities. The related application material further explains these factors.

45. Taking supervision responsibilities as an example, ISQC 1 indicates that engagement supervision includes: tracking the progress of the engagement, assessing the competence and capabilities of individual team members, their workload, understanding of the instructions, and if work is being carried out in accordance with the planned approach; and addressing significant matters that arise during the engagement and matters for consultation with more experienced members of the engagement.

46. Consideration might be given as to whether application material should be further developed on how supervision is to be applied over staff performing audit procedures in a location that is remote from the core engagement team and whether, similar to the approach taken to direct assistance, it may be necessary to set out parameters about the use of off-shoring and shared service centers.

47. However, the relevance of this issue is more likely to lie with larger firms and relate specifically to audits. To further understand the extent and nature of the issues, Staff would welcome IAASB experiences on these or other issues encountered in respect of off-shoring of parts of an engagement.

Matters for IAASB Consideration

3. The IAASB is invited to share views and experiences on the matters noted above (i.e., remediation of engagement reports and off-shoring of parts of an engagement), in particular:

(a) Whether firm policies and procedures cover further consideration of an engagement report where an external inspection indicates a serious flaw in the audit.

(b) The extent of off-shoring, and what types of activities are performed “off-shore.”

(c) Whether firms have policies and procedures in place to reduce the risks attached to the off-shore activities.

(d) Whether, on an initial basis, the IAASB believes it may be necessary to address these issues within ISQC 1 or in another manner to respond to the concerns that have been raised.

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27 ISQC 1, paragraphs 32(b) and A34
28 ISQC 1, paragraph A34
III. Proportionality of ISQC 1 for SMPs and Applicability to Other Assurance and Related Services Engagements

48. Respondents to the IAASB’s consultation on its Work Program for 2015–2016 urged the IAASB to further consider issues related to the proportionate application of ISQC 1 to all types of engagements, and the most appropriate actions to address the issues identified. As set out in Agenda 5-A, this has been identified as a separate workstream to commence as a matter of priority on the IAASB’s future agenda.

Proportionate Application of ISQC 1

49. ISQC 1 provides for a system of quality control that may be tailored to both the size of the firm, and to reflect the size of the entity for which the assurances services are being provided in relation to the public interest.

50. ISQC 1 includes guidance on exceptions for requirements that are not relevant to smaller firms, and other non-authoritative material has been developed to explain how the standard can be applied on a proportionate basis. However, consistent with the ISA Implementation Monitoring findings, the IAASB continues to hear concerns from NSS and SMPs that there remains insufficient guidance around the proportionate application of ISQC 1.

51. This feedback indicated that some users of ISQC 1 believe that proportionality was not contemplated within its basic design, such that considerations with respect to SMPs are viewed as more of an “add on” to amend requirements within the standard to allow for its proportionate application.

52. Reasons cited supporting that proportionality was not explicitly contemplated when ISQC 1 was written include that:

- The approach to quality control is not risk-based;
- The standard does not include sliding scale requirements, which some view as fundamental to the operation of quality control systems;
- The standard was written with audit engagements in mind and not for less-regulated types of engagements, such as review, compilation and agreed-upon-procedure engagements; and
- The standard includes more absolute requirements and fewer conditional requirements. Some are of the view that a greater use of conditional requirements could reduce the number of instances of requirements that are not relevant to the smaller firms.

53. SMPs and some NSS have suggested that a revision of ISQC 1 on a “think small first basis” could enable the IAASB to provide more guidance on the proportionate application of ISQC 1, and would

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29 IAASB Staff and IFAC have issued additional material to assist proportionate application of ISQC 1 to smaller practices. This material includes the IAASB Staff Questions & Answers, Applying ISQC 1 Proportionately with the Nature and Size of a Firm, the SMP Committee’s Guide to Quality Control for Small- and Medium-Sized Practices; and the IFAC SMP Committee’s Companion Manuals, Guide to Quality Control for SMPs, Guide to Using ISAs in the Audits of SMEs, and Guide to Review Engagements.
allow practitioners the opportunity to adopt a more tailored and proportionate approach in developing a system of quality control.

Applicability of ISQC 1 to Reviews, Other Assurance and Related Service Engagements

54. ISQC 1 applies to all firms of professional accountants in respect of audits and reviews of financial statements, and other assurance and related services engagements. Therefore, in addition to ISAs, ISQC 1 applies to engagements conducted in accordance with International Standards on Review Engagements (ISREs), International Standards on Assurance Engagements (ISAEs) and International Standards on Related Services (ISRSs).

55. Feedback has indicated that consideration of further guidance that demonstrates how ISQC 1 can be applied more effectively and efficiently in relation to reviews, other assurance and related services engagements would be helpful. In part, this reflects views that the required quality control policies and procedures may warrant greater or less attention to certain matters in light of the unique characteristics of such engagements.

56. For example, firm level policies and procedures may be less applicable to certain engagements that have fewer public interest implications, for example compilations or agreed-upon-procedure engagements.

57. On the other hand, in some instances there is need for more specialized skills to conduct these engagements, resulting in the need for both multi-disciplinary teams and increased consultations with experts. For example, the use of multi-disciplinary teams is becoming more and more important with the requests for services other than the audit or review of historical financial information.

58. Notwithstanding that ISQC 1 is a principles-based standard and, as such is broadly capable of being applied in all engagements irrespective of the subject matter, there may be merit in considering whether the standard provides sufficient guidance in relation to:

- **Acceptance and Continuance**—ISQC 1 and ISAE 3000 (Revised) require that a firm, amongst other things, only undertakes engagements where the firm is competent to perform the engagement and has the resources to do so; i.e. those persons performing the engagement collectively have the appropriate competence and capabilities.

  For assurance engagements, particularly where the subject matter is complex or concerns a new or emerging area of reporting, might further guidance be useful around the determination of the need for, and availability of, appropriate subject matter experts before an engagement is accepted?

- **Culture**—ISQC 1 requires that firms establish policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements to all members of the team, particularly those from other practice areas within the firm, or external experts that may be new to assurance engagements or only used infrequently by the assurance practice on

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30 ISAE 3000 (Revised), Assurance Engagements other than Audits or Reviews of Historical Financial Information
31 ISQC 1, paragraphs 26(a) and A18, and ISAE 3000 (Revised), paragraph 22(b)
32 ISQC 1, paragraphs 18 and A4–A5
an “as needed basis.” Should further guidance be provided to emphasize the importance of this area?

- **Review and Supervision**–ISQC 1 requires the firm’s review responsibilities to be determined on the basis that work of less experienced team members is reviewed by more experienced team members and that the engagement partner has the appropriate competence, capabilities and authority to perform the role.\(^{33}\) Further, ISAE 3000 (Revised) requires that a sufficient understanding of the field of expertise of the expert is obtained.\(^{34}\)

The aims of these requirements may become increasingly difficult to accomplish as assurance engagements become more complex and move into areas of new and emerging topics. Is further guidance needed to address situations where the knowledge of the subject matter expert is such that the reviewer may not be in a position to adequately supervise the expert’s work?

- **Monitoring**–The standards require that firms establish a monitoring process that is designed to provide it with reasonable assurance that the policies and procedures relating to quality control are relevant, adequate, and operating effectively. This includes, on a cyclical basis, inspection of at least one completed engagement for each partner.\(^{35}\) The application material provides further guidance on factors that may be considered in selecting the engagement, which includes the risk associated with the firm’s clients and specific engagements.\(^{36}\)

However, does such a requirement result in adequate attention being given to monitoring assurance engagements and, more specifically, assurance engagements that have a subject matter of significant complexity or in an emerging area where knowledge and experience may be limited?

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**Matter for IAASB Consideration**

4. The IAASB is asked for its initial views on what actions may be appropriate to further:

   (a) Address how ISQC 1 is capable of proportionate application;

   (b) Illustrate how ISQC 1 is to be applied to engagements other than audits of historical financial information.

   In particular, the IAASB is asked whether consideration should be given to revising the standard on a “think small first basis” or whether further guidance would be more helpful to address the concerns that have been raised.

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\(^{33}\) ISQC 1, paragraph 30(b)

\(^{34}\) ISAE 3000 (Revised), paragraph 52

\(^{35}\) ISQC 1, paragraph 48(a)

\(^{36}\) ISQC 1, paragraph A66