Agenda Item

Committee: IAASB
Meeting Location: Sydney, Australia
Meeting Date: April 16-20, 2007

Quality Control

Objectives of Agenda Item

The objectives of this Agenda Item are to:

- Review, for approval and issue as an Exposure Draft, the proposed redrafted ISA 220, “Quality Control for Audits of Historical Financial Information,” based on the clarity drafting conventions adopted by the IAASB.
- Review, and decide upon action to take with, the proposed redrafted ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance Engagements and Related Services Engagements.”

Task Force Members

The members of the Task Force are:

- Phil Cowperthwaite, Chair
- Will Rainey
- David Swanney
- John Fogarty (as an advisor)

Further assistance was provided to the Task Force by Jon Grant, IAASB Technical Advisor. The redrafting support was provided by Jacqui Bridel, a principal with the Canadian Institute of Chartered Accountants (CICA) Auditing and Assurance Standards Department.

Activities since Last IAASB discussions

The Task Force met in February and held two conference calls (in January and March) to discuss the comments received from the IAASB at the December 2006 meeting on the first read of the proposed redrafted ISA 220. A revised redrafted ISA 220 was distributed to the Clarity Task Force, INTOSAI and the Small and Medium Practices Committee for their comment. The Task Force held a subsequent conference call to finalize the wording of the draft now being presented.

Matters for IAASB Consideration

The Task Force is presenting a revised draft of ISA 220 for approval as an Exposure Draft, taking into consideration the comments made by the IAASB at its December 2006 meeting. The Task Force is also presenting to the IAASB a first clarity redraft of ISQC 1.
Material Presented
(Note: Agenda Items 7-A and 7-E will be used for the purpose of the discussion at the meeting.)

Agenda Item 7-A  Proposed ISA 220 (Redrafted) (Clean)
(Pages 1073 -1086)

Agenda Item 7-B  Proposed ISA 220 (Redrafted) – mark up to reflect revisions made
(Pages 1087-1108) following the London IAASB meeting

Agenda Item 7-C  Disposition of present tense paragraphs in extant ISA 220
(Pages 1109-1118)

Agenda Item 7-D  ISA 220 Mapping Document
(Pages 1119-1134)

Agenda Item 7-E  Proposed ISQC 1 (Redrafted) (Clean)
(Pages 1135-1164)

Agenda Item 7-F  Proposed ISQC 1 (Redrafted) – mark up from extant
(Pages 1165-1208)

Agenda Item 7-G  Disposition of present tense paragraphs in extant ISQC 1
(Pages 1209-1226)

Agenda Item 7-H  ISQC 1 Mapping Document
(Pages 1227-1262)

Action Requested
The IAASB is asked to consider the accompanying material and approve ISA 220 (Redrafted) for
issue as an Exposure Draft.
Issues for the IAASB’s Consideration

ISSUES RELATED TO BOTH ISA 220 AND ISQC 1

A. PRESENT TENSE USED IN APPLICATION MATERIAL

A1. The application material contains a number of present tense paragraphs. The Task Force has not elevated these paragraphs to requirements because:

1) In (almost) all cases the application material comprises lists of procedures that would be carried out or conditions an auditor would consider in order to fulfill a principles-based requirement. The specific items provide guidance as to how an auditor would satisfy a principles-based requirement and are not the core requirements themselves. As a result, they are classified as application material and have not been elevated from the extant to requirements.

2) Elevation of all these present tense items would result in a significant increase in the number of requirements over those in the extant standard. The standard would have a more rules-based feel than is presently the case.

A2. Following is an example of the issue:

ISQC 1 contains the following requirement:

22. The firm shall also establish policies and procedures to:

   (a) Assign appropriate staff with the necessary capabilities, competence and time to perform engagements in accordance with professional standards and regulatory and legal requirements; and ...

The related application material is:

A32. When assigning engagement teams, and in determining the level of supervision required, the firm considers factors such as the engagement team's:

   • Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
   • Understanding of professional standards and regulatory and legal requirements.
   • Technical knowledge, including knowledge of relevant information technology.
   • Knowledge of relevant industries in which the clients operate.
   • Ability to apply professional judgment.
   • Understanding of the firm’s quality control policies and procedures.

In this case, the present tense “the firm considers” in the application material refers to a list of factors for a firm to consider in meeting the principle of establishing policies and procedures to assign appropriate staff, etc. The alternative is to elevate the application material to requirement status, which would be a change from extant ISQC 1.
Matters for IAASB Consideration
Q1. Does the IAASB agree with this approach in general?
Q2. Are there certain lists or type of lists that should be elevated?

B. REFERENCE TO THE IFAC CODE OF ETHICS, PART A AND B
B1. The extant ISQC 1 and ISA 220 refer to the IFAC Code of Ethics in the introduction and definitions. The Task Force understands that this may cause problems for jurisdictions with a Code of Ethics other than the IFAC code. To try to resolve this issue, references to the IFAC Code of Ethics in the introduction, definitions and requirements sections have been replaced with the more generic reference to relevant ethical requirements.

B2. The application material has been amended to incorporate reference to the IFAC Code (e.g. revised ISQC 1, paragraph A11 states: “Ethical requirements relating to audits and reviews of historical financial information, and other assurance and related services engagements ordinarily comprise Parts A and B of the IFAC Code together with national requirements that are more restrictive.”)

Matters for IAASB Consideration
Q3. Does the IAASB agree with this approach?

C. DEFINITIONS
C1. The definition of engagement team has been updated to reflect the wording in the recently issued IESBA ED regarding independence (Sections 290 and 291 of Code of Ethics). The proposed definition is as follows:

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.

C2. The Task Force found the phrase “might otherwise be provided by a partner or staff of the firm” confusing and thought it could be misinterpreted. The Task Force had differing views as to what types of services provided by a firm might be included.

C3. For the purposes of the proposed redrafted ISA 220 and ISQC 1, the Task Force considered the following:
- Whether the same definition should be used in ISQC 1 and ISA 220.
- The implications of removing experts from the definition, and therefore from the requirements of ISA 220 and ISQC 1.

C4. The Task Force concluded that there was no compelling reason why the definition in ISA 220 and ISQC 1 should differ from that used by the IESBA and therefore have proposed to
include their definition in the proposed redrafted material. However, the Task Force notes that if the IESBA makes changes to the definition as a result of its exposure process, similar changes would need to be made to ISA 220 and ISQC 1.

**Matters for IAASB Consideration**

Q4. Does the IAASB agree with this approach?

**ISSUE RELATED TO ISA 220**

D. **ISA 220 (REDAFTED) PARAGRAPH A19 (A24 IN THE LONDON DRAFT)**

D1. At the London IAASB meeting, the Task Force was asked to consider whether this paragraph should be elevated to a requirement. The Task Force does not believe that the entire paragraph needs to be elevated for the following reasons:

- Paragraph 19 of the redrafted ISA (extant ISA 220 paragraph 38) requires the engagement quality control review to include an objective evaluation of significant judgments made by the engagement team.
- Most of the items in the point list in A19 are significant judgments; therefore the Task Force believes that the requirement in paragraph 19 sets out the principle, while A19 is a list of items for the reviewer to think about.
- Inclusion of such a detailed list to a requirement makes it more rules-based, rather than principles based.

D2. However, the Task Force believes that certain of the bullet points were requirements, and accordingly, have elevated and included these points in paragraph 19.

**Matters for IAASB Consideration**

Q5. Does the IAASB agree with this approach?

**ISSUES RELATED TO ISQC 1**

E. **ISQC PREFACE MATERIAL**

E1. The revised Preface issued in December 2006 sets out the authority attaching to international standards issued by the IAASB. The authority of the ISAs is laid out in Preface paragraphs 10 to 22. The Preface refers readers to the ISQCs themselves, however, for the authority of ISQCs [Preface paragraph 23]. As the ISQC applies equally to audits, reviews and other assurance and related services engagements, and the authority of the ISQCs objectives, requirements etc. are not explicitly defined in the preface, they must be defined somewhere.

E2. The Task Force considered the following alternatives for setting out the authority of ISQC1:

1) Draft a separate ISQC preface document. This option has the advantage of taking preface-type material out of ISQC 1 resulting in a quality control standard that looks very similar
to a clarified ISA. This option also provides for issuance of other ISQCs in the future without the need to modify ISQC 1. The disadvantage is that a new document must be created for a single ISQC.

The Task Force has drafted, for the Board’s consideration, a separate ISQC preface document attached to this issues paper as Appendix 1.

2) Include ISQC preface material in ISQC 1 itself. The advantage of this approach is that the ISQC is a self-standing document. Readers can determine immediately the authority of the various sections of the document. The disadvantage is that the ISQC contains material not included in a clarified ISA. This may lead to confusion as to the structure and authority of the various sections.

The Task Force considered two options under alternative 2:

A. Include all the ISQC preface material in the introduction section of ISQC 1. Having all the material in one place may improve understandability of the authority of the ISQC. However, it could make the front end of the standard cumbersome.

B. Include the overall authority of the ISQC in the introductory material (see paragraph 3 of 7-E) and set out the rest in the application material section (see paragraphs A1 to A6 of 7-E). The draft clarified ISQC is drafted on this basis. The benefit to presenting the material in this manner is that the introductory material preceding the objective and requirements is shorter and possibly easier to read. The Application Material in paragraphs A1-A6 expands on the introductory material in paragraph 3. This is arguably closer to the clarity drafting conventions for ISAs. Splitting the material could cause confusion in situations where published requirements are without application material.

Matters for IAASB Consideration
Q6. Are there options not considered by the Task Force?
Q7. Which of the options above is preferable?

F. DOCUMENTATION REQUIREMENTS IN ISQC 1

F1. Documentation requirements are grouped together in a number of clarified ISAs. The Task Force has taken the approach of grouping firm-specific documentation requirements together in the documentation section. Documentation requirements remaining in the other requirements of ISQC 1 relate to documentation at the assurance engagement level.

Matters for IAASB Consideration
Q8. Does the IAASB agree with this approach?
G. Clarification of ISQC 1

G1. ISA 220, “Quality Control for Audits of Historical Financial Information,” differs from other ISAs in that it has a companion standard, ISQC 1, which applies at the firm level, rather than at the engagement level. ISQC 1 has a broader scope than the ISAs, as it applies to assurance and related service engagements as well as audits of financial statements.

G2. At the London IAASB meeting, a brief discussion was held regarding the redrafting of ISQC 1. The Task Force recommended that ISQC 1 be clarified at the same time as ISA 220, as the two standards are closely linked – many paragraphs deal with the same issues at the firm level and the engagement level, respectively. Further, ISA 220 states that the engagement team is entitled to rely on the firm’s policies and procedures established under ISQC 1. The Task Force believes that there should be consistency between the two standards. The IAASB concluded that, while it is unlikely the IAASB will be able to review and approve a clarified version of ISQC 1 given its current workload commitments, the Task Force should draw to the Board’s attention any significant matters that arise from its review of ISQC 1. The objective of this session ideally is to review and approve the clarified ISA220 exposure draft and provide the Task Force with direction sufficient to prepare a clarified ISQC1 exposure draft for approval at a subsequent date.

Matters for IAASB Consideration

Q9. At the end of the session, the Task Force will ask the IAASB whether they foresee significant obstacles to preparing for approval a clarified ISQC 1 exposure draft.
ISQC Preface

Introduction

1. ISQCs apply to all firms in respect of audits and reviews of historical financial information, and other assurance and related services engagements. The nature of the policies and procedures developed by individual firms to comply with ISQCs will depend on various factors such as the size and operating characteristics of the firm, and whether it is part of a network.

ISQC Objectives

2. ISQCs contain objectives and requirements, together with introductory material and definitions that provide context essential to a proper understanding of ISQCs, and related guidance in the form of application material.

3. ISQCs contain an objective for the firm in respect of its system of quality control. It represents the desired outcome of implementing the system, and accordingly, the firm shall aim to achieve the objective. The objective is intended to assist the firm in:
   - Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
   - Deciding what more, if anything, needs to be done to achieve the objectives.

Requirements

4. The firm complies with the requirements of ISQCs in all cases where the requirements are relevant in providing services in respect of audits and reviews of historical financial information, and other assurance and related services engagements. The requirements of ISQCs are contained in a separate section and expressed using the word “shall.” The firm applies the requirements in the context of the other material included in ISQCs. Proper application of requirements will ordinarily provide a sufficient basis for achievement of the objective of the ISQCs. Requirements cannot expect to anticipate all circumstances and consequently the firm may judge it necessary to establish further policies and procedures in pursuance of the objective.

Application and Other Explanatory Material

5. The application and other explanatory material contained in ISQCs is integral to the ISQC as it provides further explanation of, and guidance for carrying out, the requirements of ISQCs, along with background information on the matters addressed in the ISQC. The application material may include examples of policies and procedures, some of which the firm may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement. Where appropriate, additional considerations specific to the public sector or smaller practices are included within the application material.

Introductory Material and Definitions

6. The introduction includes such matters as explanation of:
   - the scope of the ISQC, including the subject matter of the ISQC;
7. ISQCs may include, in a separate section under the heading ‘Definitions,’ a description of the meanings attributed to certain terms for purposes of the ISQCs. These are provided to assist in the consistent application and interpretation of the ISQCs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout the ISQCs. The Glossary of Terms in the Handbook contains a complete listing of terms defined in the ISQCs. It also includes descriptions of other terms found in ISQCs to assist in common and consistent interpretation and translation.