

July 1, 2019

## **IFAC Small and Medium Practices Committee Response to the IAASB's Exposure Draft for International Standard on Auditing – Proposed ISA 220 (Revised): Quality Management for an Audit of Financial Statements**

### **INTRODUCTION**

The SMP Committee (SMPC) is pleased to respond to the IAASB (the Board) Exposure Draft (the ED), for *ISA 220 (Revised): Quality Management for an Audit of Financial Statements*. The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMPC are small- and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members and Technical Advisers serving the SMPC are drawn from IFAC member bodies representing 22 countries from all regions of the world.

### **GENERAL COMMENTS**

The proposed ISQM standards and ISA 220 (Revised) are two sets of very important standards that will shape the foundation of quality management (QM) of SMPs going forward. It is therefore critical that it can be operationalized for firms of all sizes and applicable to all types and nature of engagements in all situation. We commend the significant amount of works that has been undertaken by the Board in progressing these projects and we continue to support the objective of enhancing QM within the industry.

The SMPC is pleased to have had the various opportunities to contribute to this project as it has progressed over the last three years. We continue to believe that an appropriate overall quality objective ought to be about establishing and maintaining the firm capabilities to perform quality engagements on a consistent basis but being scalable enough to accommodate firms of all sizes. We believe that more direction is needed in ISA 220 (Revised) and provide suggestions to enhance the clarity below.

**We question whether the three EDs as a whole will really increase audit quality from an SMP perspective.** We are also concerned that the complexity of the QM Standards taken together may drive a compliance mindset, especially amongst smaller firms who become subject to proportionately greater documentation burdens to “explain/ prove” their compliance. In our view, it is important that IAASB ensure the final suite of QM Standards addresses this issue in order to foster an effective focus on the quality of the services each individual firm delivers, as opposed to compliance with complex standards.

The SMPC notes that a perceived need for support material indicates that the EDs' requirements may not be sufficiently clear. Hence, a more practical approach is to have, in place, very clear requirements with relevant application material where possible.

The IAASB has proposed a change to the definition of engagement team from “all partners and staff performing the audit engagement, and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement” in extant ISA 220 to “all partners and staff performing the audit



engagement, and any other individuals who perform audit procedures on the engagement, including individuals engaged by the firm or network firm”. We do not believe this proposed change is appropriate, as it would mean that all component auditors were included in the engagement team definition, since individuals engaged by components to perform audit procedures for the purposes of a group audit will be included irrespective of whether they are a part of the firm, network firm or another firm or network. This change has far-reaching consequences in terms of the independence requirements applicable to component auditors, who may be subject to conflicts of laws between jurisdictions. In addition, since all of the members of a component auditor would be subject to the same quality management policies and procedures applicable to the group engagement team, this potentially poses significant practical difficulties when the component auditors are not from the same firm, or even the same network, as the group engagement team.

We also see a need for a closer coordination by the IAASB and IESBA Board on this definition to avoid inconsistency in application and unnecessary market confusion – among the audit professionals as well as the more general business community.

#### **DETAILED COMMENTS**

We have outlined our responses to the questions (in bold) in the ED below.

#### **Overall Questions**

- 1) Do you support the focus on the sufficient and appropriate involvement of the engagement partner (see particularly paragraphs 11–13 and 37 of ED-220), as part of taking overall responsibility for managing quality on the engagement? Does the proposed ISA appropriately reflect the role of other senior members of the engagement team, including other partners?**

We support the engagement partner taking overall responsibility for the engagement through focusing on his or her sufficient and appropriate involvement throughout the entire engagement.

We noted that the responsibilities of the engagement partner now exceed those of extant ISA 220. Under extant ISA 220, the engagement team can rely on the firm’s quality control unless there are indications to the contrary. In our view, this remains a pragmatic approach. We believe it is appropriate for the engagement partner and the engagement team to be required to go through an exercise of evaluation on a case-by-case basis as to whether the firm has implemented sufficient QM responses to quality risks and, if so, whether additional measures need to be taken to address any ‘gaps’ so identified. This should be confined to certain areas only at the engagement level.

However, the engagement partner and the engagement team should be required to remain alert for such indications of gaps. For example, we agree that it is essential that the engagement team has sufficient resources and the necessary capabilities to carry out the engagement in accordance with legal requirements, professional standards and the expectations of stakeholders and so cannot disclaim responsibility e.g., being “allocated” inappropriate or insufficient staff.



- 2) **Does ED-220 have appropriate linkages with the ISQMs? Do you support the requirements to follow the firm’s policies and procedures and the material referring to when the engagement partner may depend on the firm’s policies or procedures?**

While the over-arching Explanatory Memorandum briefly covers the inter-relationship between ISQM 1 and ISA 220 (Revised), more detail could be included in the objective of the standard to better explain the dynamic between these two standards. This could include how some quality objective(s) and the corresponding response(s) to risks can/ should be established at the firm level, whereas others will be more appropriately dealt with at the engagement level, and in some cases, responses could be even at both levels. Para 9 as it is currently worded makes no such inference.

The SMPC generally supports the direction being taken vis-à-vis the requirements to follow the firm’s policies and procedures as described in para A8 and the drafting of the standard that refers to instances when the engagement partner can depend on the firm’s policies and procedures as per the proposed para A7.

- 3) **Do you support the material on the appropriate exercise of professional skepticism in managing quality at the engagement level? (See paragraph 7 and A27–A29 of ED-220)**

Yes, the SMPC is generally supportive of the materials that demonstrates the exercise of professional skepticism in managing quality at the engagement level – to an extent. As mentioned in our comment letter on ISQM 1, we are more convinced that a continuing educational strategy may be more effective in driving a change of behavior. Nevertheless, the current approach can still serve as a timely reminder for the firms, the engagement partners and the assurance teams.

- 4) **Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?**

Yes, in our mind, this has been sufficiently revised to reflect the current situation in practice. The principles-based approach should help ensure it remains relevant, going forward.

- 5) **Do you support the revised requirements and guidance on direction, supervision and review? (See paragraphs 27–31 and A68–A80 of ED-220)**

In our view, the SMP environment is generally conducive to engagement partner being closely involved in all key aspects of each engagement. Hence, we are generally supportive of the requirements and guidance under paras 27-31.

We also support the stand back required by para 37 in regard to sufficient and appropriate involvement in the audit engagement, as long as the term “throughout” is not intended to mean a continuum (we suspect this stand back provision will only be meaningful if conducted at the later part of an audit, closer to the dating of the auditor’s report). However, we believe that application material is necessary to explain what subsection (b) entails. It should not be a checklist of all of the firm’s policies and procedures having been adhered to.

- 6) **Does ED-220, together with the overarching documentation requirements in ISA 230, include sufficient requirements and guidance on documentation?**



Yes, the overarching documentation requirement is sufficiently principled-based and hence, appropriate for SMPs. However, this has to be read together with ISA 230 for a complete picture.

It can be unclear as to how IAASB determines what needs to be included in an individual standard rather than relying on the overall requirements in ISA 230. A more systematic approach may be warranted, going forward.

In addition, para A102 which provides a list of items the Engagement Partner (EP) should sign off to support taking overall responsibility for the engagement can be further enhanced, especially from the stand point of very small SMPs. As an example, in a very small engagement team, minutes of meeting or agenda of discussion may not be necessary if the work is documented. Again, communication in respect of culture and expected behavior may not always be obvious in a small SMP.

**7) Is ED-220 appropriately scalable to engagements of different sizes and complexity, including through the focus on the nature and circumstances of the engagement in the requirements?**

In the case of a sole practitioner or a very small audit team (e.g. the EP and one staff), the requirements with regard to direction, supervision and review are not, or are only partly relevant. We are concerned that certain SMPs may not be able to easily navigate the standard to ascertain which requirements are not relevant to their circumstances. It would be preferable if all such requirements [eg. para 15 (a) to (c) or para 32(a) and (b)] could be reworded in such a way that it is clear that they are conditional.

Another possible approach is to follow para 21 of ISQM 1 which was further supported by para A20 (of ISQM 1) in the application material section for added clarity on such conditionality.

ED-220 contains the section “Consideration Specific to Smaller Firms” whereas both ISQM 1 and 2 do not. We noted the Board’s rationale as mentioned in the Explanatory Memorandum. We do not think the purported integrative nature of both ISQMs is an impediment to do so. We suggest that consistency amongst the three standards on this matter will be highly responsive to the market demand for signposting, especially given the length of the revised standards.

**CONCLUDING COMMENTS**

We hope that the IAASB finds this letter useful. We are committed to helping the Board in whatever way we can to build upon the results of the ED.

Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

*Monica Foerster*

Monica Foerster

Chair, SMP Committee