

## **IAASB CAG PAPER**

**IAASB CAG Agenda (September 2006)**

**Agenda Item I.3**

**SME / SMP / DN Audit Considerations—Tizzano**

**ROBERTO TIZZANO**

*Professore Associato di Economia Aziendale*

*nell'Università degli Studi di Napoli Federico II*

**DOTTORE COMMERCIALISTA — REVISORE CONTABILE**

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Mr.

**David Damant**

*Chairman of the*

**IAASB Consultative Advisory Group**

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Napoli, May 31<sup>st</sup> 2006

**Obj: Comments about ISQC 1**

*Dear David,*

following the discussion that we had in Hong Kong and in New York (March and May 2006), I briefly summarize, for you, my point of view in relation to possibile implementation difficulties of ISQC n. 1 by Small Practitioners (SMPs) around the World. Such a view, as had a chance to tell you, was expressed by me to the IAASB at the time of voting out the document in February 2004: "Subject to certain editorial changes, the IAASB approved the issuance of ISQC 1 and ISA 220. Mr Tizzano dissented to the issuance of ISQC 1 since, in his view, the standard has been written in relation to the organizational structure of large firms and for the audit of financial statements conducted by them and consequently, the nature and extent of obligations may result in compliance and implementation difficulties for small-and medium-sized practices (SMPs). In addition, he believed that the approach taken in the standard conveys the message that the IAASB is not appropriately taking into consideration the needs of SMPs. Mr Tizzano abstained from voting on ISA 220" (IAASB Minute, February 2004).

ISQC 1 has in fact been written from the perspective of large (if not huge) audit firms. This becomes evident by starting the reading of the introductory part of the document, for example definitions, that clearly applies to a well structured and organized firm. Same problem is with the section titled "Elements of a System of Quality Control", that has been written in a way that clearly suggests a formal process for defining the procedures and the policies for addressing the elements of the Q.C. system. "Leadership and responsibilities for quality within the firm": again address problems that are typical of larger organisations.

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“Independence”: 3 long bold letter paragraphs defining procedures for dealing with independence problems that may arise especially in larger organisations, where it is not easy to keep under control independence threats relating to big audit teams. “Human Resources”: most of those that are identified in this section, are typical of large firms. Here we also find the *first* paragraph (41) dealing with SMPs: but only for suggesting that “smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel”.

A particularly critical section is the one dealing with “Engagement quality control review”. As you read carefully you recognize that the subject is not restricted to listed entities. And it would be very difficult for an SMP to comply with such regulation. A major problem is the availability, for an SMP of a “qualified person” for doing the review; and the document suggests (paragraph 72) that a small firm “may wish to use other firms to facilitate engagement quality control reviews”. Along the same line are paragraphs 80, dealing with “Monitoring”, and 92, dealing with “Complaints and allegations”. It easy to realize that SMPs are put into a position of significant competitive disadvantage in relation to greater firms, that may resolve the problems within the boundary of their organisations, and pose also other problems such as those relating to opening the business to potential competitors.

I think it is quite intuitive that ISQC 1 poses an heavy burden on the fragile shoulders of SMPs, that hardly ever can be in a position to comply with all of its requirements. And this may turn out to be a problem even greater that expected, since, as you heard at the New York meeting, convergence with the ISAs *imply* adoption of ISQC 1. As a few others, I think this would be unrealistic if we take (as we should) an international perspective: at the moment, there are maybe two countries in the World that are in position to verify whether or not ISQC 1 will be applied in practice, that is USA and UK: apart from the matter of the difficulties of application, that may be major ones even for an UK or USA SMP!

In point of fact, maybe, an attempt to verify the applicability of ISQC 1 around the World might be done with the cooperation of Standard Setter and other representatives of the accounting and auditing profession. This could turn out to be an opportunity to attract attention on the matter, that has not received, in my view, the consideration it deserves in relation to its practical implication (it is not easy, you know, to take a critical position against a document that, in these times, aims to improve the *quality* of the auditing profession).

In any case, I do not want to give the impression that I do not think that quality relates only to greater firms. ISQC 1 is the way to go for audit firms that audit listed or public interest entities (even if I would have some doubts in identifying public interest entities). And I also welcome, in general, the attempt to push SMPs towards an improvement of their organisational and control activities, in the light of an improvement of the quality of their services. But maybe a lower, less rigorous and less expensive approach is to be adopted for smaller organizations, an approach that be manageable for the accounting and auditing profession also in not leading countries; an approach that is likely to find more consensus that refusal around the World, with the greater part of the accounting and auditing profession.

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I hope the above may be useful to you.

Very kind regards

Roberto Tizzano