

IAASB CAG PAPER
IAASB CAG Agenda (September 2006)
Agenda Item I.4
SME / SMP / DN Audit Considerations—Professional Practices Board of the
New Zealand Institute of Chartered Accountants

IMPLEMENTATION ISSUES PERTAINING TO ISQC 1

COMMENTS FOR IAASB CAG CHAIRMAN

Prepared by the Professional Practices Board
of the New Zealand Institute of Chartered Accountants

30 June 2006

1. Introduction

The Professional Practices Board of NZICA currently has on issue an Exposure Draft for its proposed revised Professional Standard PS-1 *Quality Control*. Revised PS-1 incorporates ISQC 1 in total (together with consequential amendments from the recent revision of ISA 230 *Audit Documentation*). The exposure period for revised PS-1 has passed and the PPB has had opportunity to consider feedback on this proposed Quality Control Standard.

Responding to a request from David Damant, in this briefing the PPB provides feedback on its experience of the implementation of ISQC 1 in the New Zealand context to date, for information of the IAASB CAG.

2. Background

The existing quality control standard in New Zealand PS-1 Quality Control, addresses quality control at both the level of the firm and individual professional engagements.

The PPB wishes to preserve the current application of its quality control standard at the engagement level across all types of professional engagement. A New Zealand equivalent of ISA 220 is being proposed as a separate standard that specifically addresses engagements to audit historical financial statements. For all other types of engagements, proposed revised PS-1 incorporates engagement-level requirements and guidance modelled on those contained in ISA 220.

In incorporating ISQC 1 into revised PS-1 the PPB is mindful of the need to ensure the incorporation of ISQC 1 in total, to enable NZICA to achieve compliance with its membership obligations relating to Quality Assurance (SMO 1). The PPB has done this also in view of its intention to adopt the ISAs in a manner that will enable practitioners in New Zealand to state in their audit reports that they have performed the audit in accordance with ISAs.

Proposed revised PS-1 went through a first exposure period earlier this year, and is to be re-exposed for a further shorter exposure period later this year to expose further amendments made to this Standard.

3. Summary of Implementation Issues

3.1 General comments

• Clarity Issues in ISQC 1

ISQC 1 was issued in February 2004, ahead of the IAASB's work in relation to its Clarity of Standards project. Working to adopt ISQC 1 in its currently drafted form it is apparent to the PPB that this Standard could be significantly improved by being put through the IAASB's redrafting process currently being applied to ISAs, on a priority basis. From a New Zealand perspective it is considered that an early redrafting of ISQC 1 along similar lines by the IAASB would be of great assistance to national standard setters working to adopt this Standard.

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- Compliance with ISQC 1 requirements by SMP practitioners

In the context of compliance with ISQC 1 in the SMP setting, the PPB has received much feedback along the lines that the requirements in the Standard are considered onerous by small and medium practitioners.

While there is general acknowledgement of the upside of adopting ISQC 1 in the form of there being more explicit requirements and guidance on quality control for audit, assurance and related service engagements, in general respondents to the PPB's exposure draft expressed the view that the imposition of an obligation on New Zealand members in the SMP category to comply with all the Standard's requirements would have the effect of inducing many SMP audit practitioners to voluntarily withdraw provision of audit services.

As SMP practitioners mainly service the audit and review requirements of SMEs this would likely have an adverse effect on supply of audits to this class of entity. In New Zealand, many SMEs and not for profits voluntarily require financial statement audits or reviews, either for purposes of ensuring accountability to sponsors/funders or for securing credit facilities.

To attempt to ameliorate this position, the PPB has decided it will develop SMP implementation guidance for revised PS-1, as a number of national standard setters have done.

3.2 Specific comments

There are a couple of requirements in ISQC 1 that would appear to present some difficulties to implement in practice, particularly for SMPs.

In relation to engagement performance and engagement quality control reviews, **paragraph 72** states that a suitably qualified external person may be contracted to perform quality control reviews for sole practitioners or small firms. The difficulty with this scenario is that whereas other firms of practitioners may be willing to make such persons available to perform a review for a sole practitioner or small firms, for legal reasons persons performing such reviews tend to be less than willing to issue reports/statements concerning the quality control review and the results thereof. As a result, documentation of the engagement quality control review by persons external to the firm to comply with **paragraph 73** may be somewhat problematic.

A similar problem would appear to exist in relation to the requirement to carry out consultation (**paragraph 51 read with paragraph 56**), where the application guidance in par 56 states,

"The documentation of consultations with other professionals that involve difficult or contentious matters is agreed by both the individual seeking consultation and the individual consulted... and is sufficiently complete and detailed to enable an understanding of ... (b) the results of the consultation, including any decisions taken... and how they were implemented."

Where a firm relies on another practitioner to complete the required consultations, the practitioner being consulted may be reluctant to agree or "sign-off" the documentation of the consultations, and the documentation of decisions taken and how they were implemented, for various reasons including legal ones.

Notwithstanding paragraph 54, as there may potentially be scope for some 'moral hazard' on the part of the firm undertaking the consultation it is perhaps understandably more difficult than it would at first appear for a practitioner performing the consultant's role to agree the documentation of consultations performed and how the results of the consultation were implemented by the firm undertaking the consultation. This raises the prospect of the need for a legal review of the documentation of the consultation and its outcomes in order for anything to be 'agreed' by the parties to the consultation, and will likely add to practitioners' overall costs of compliance for this quality control requirement.

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Possibly the wording of this application guidance could be revisited to ensure compliance can be achieved by practitioners on a more reasonable/realistic basis.

4. Conclusion

Overall, compliance with the requirements of ISQC 1 is viewed by the practitioner community in New Zealand as being fairly onerous, especially by SMP practitioners.

It is hoped that most of the resistance to implementation of ISQC 1 among SMP practitioners can be resolved through the planned provision of implementation guidance. Also, as this type of practitioner becomes more familiar with the requirements of the Standard it can be expected that changes they make to their practice over time will lessen the number of impediments they experience for achieving full, proper compliance.

Larger firms, among them the Big 4 New Zealand firms, see far fewer problems and impediments to compliance and have stated that they are already in compliance with this Standard through the global approach these firms take to quality control and compliance with Standards.

There is probably scope to improve ISQC 1, both from a clarity perspective and to ensure the types of issues mentioned in our specific comments above are adequately addressed in the Standard in any future revisions the IAASB undertakes.

We hope the feedback provided will be helpful to the IAASB and the CAG.