

**Meeting:** IAASB-Consultative Advisory Group  
**Meeting Location:** New York  
**Meeting Dates:** March 9–10, 2015

## Agenda Item C

### Quality Control

#### Objective of Agenda Item

1. To inform Representatives and Observers of the research performed by the Quality Control Working Group (the Working Group) and IAASB Board discussions to date.
2. To obtain Representatives' and Observers' views and further direction to assist the IAASB in moving forward with scoping the quality control project.

#### Background

3. The IAASB's *Strategy for 2015–2019*<sup>1</sup> and *Work Plan for 2015–2016*<sup>2</sup> (the Work Plan) was published in December 2014. Included in the Work Plan as one of the priority new initiatives was consideration of the issues relating to Quality Control. A Working Group was established subsequent to the June 2014 Board meeting to perform research on the issues identified and to make recommendations on the nature and scope of a future proposed project.
4. Issues identified and incorporated into the Work Plan as a result of the ISA Implementation Monitoring project and through outreach with others, include:
  - a) Engagement Quality Control Reviews
    - i. Selection of the engagement quality control reviewer;
    - ii. Independence of the engagement quality control reviewer from the engagement team;
    - iii. Professional skepticism exercised by the engagement quality control reviewer;
    - iv. Other matters relating to the objective, extent, timing and documentation of the engagement quality control review.
  - b) Consideration of whether aspects of the Framework for Audit Quality (the Framework) need to be addressed either within the requirements or guidance in ISQC 1<sup>3</sup> and ISA 220,<sup>4</sup> for example:
    - i. Engagement performance - including consultations, technical reviews of financial statements, engagement acceptance, appointment of engagement team members, independence and ethics, changing resource models;

<sup>1</sup> <http://www.ifac.org/publications-resources/iaasb-strategy-2015-2019>

<sup>2</sup> <http://www.ifac.org/publications-resources/iaasb-work-plan-2015-2016>

<sup>3</sup> International Standard on Quality Control (ISQC 1), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Service Engagements*

<sup>4</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

- ii. Human resources - including technical competence, expertise of the engagement team, recruitment and training, remuneration based on audit quality;
  - iii. Internal monitoring reviews - including scope and extent;
  - iv. Using the work of a specialist and auditor's expert, and the difference between the two;
  - v. Clarification of definitions and further guidance on the applicability to public sector audits; and
  - vi. Governance structures of firms and networks.
- c) Remediation, in particular the acknowledgement of the importance of addressing root cause analysis of significant deficiencies identified by inspections.
- d) Proportionate application of ISQC 1 for small- and medium-sized practices (SMPs) and its applicability to reviews, other assurance and related services engagements, in particular whether ISQC 1 can be proportionately applied by SMPs performing audits and how it can be applied to reviews, other assurance and related services engagements.
5. In June 2014, a Staff prepared paper<sup>5</sup> was presented to the IAASB exploring issues identified in respect of engagement quality control reviews, consistency of the Framework with ISQC 1 and other International Auditing Standards (ISAs), outsourcing arrangements<sup>6</sup> and the application of ISQC 1 to SMPs, including its application to review engagements, other assurance and related services engagements (proportionate application).

#### *IAASB Discussions*

6. Subsequent to its formation, the Working Group presented its initial thinking to the IAASB at its December 2014 meeting, recommending that:<sup>7</sup>

##### *Immediate-term Updates*

- Updates to ISQC 1 and the ISAs based on a comparison of the standards to the Framework form part of more immediate-term updates;
- Engagement Quality Control Review, remediation and outsourcing form the priority topics for the quality control project proposal;
- Awareness of existing guidance on the proportionate application of ISQC 1 developed by many national bodies and others throughout the jurisdictions in which the International Standards have been adopted as the appropriate course of action in the short term; and

##### *Longer-term Updates*

- A more extensive modernization of ISQC 1 into a risk based standard, also incorporating other aspects of corporate governance and conditional requirements form a longer term project that could be incorporated into the subsequent IAASB work plan.

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<sup>5</sup> See Agenda Item 6 – Quality Control <https://www.iaasb.org/auditing-assurance/meetings/new-york-usa-6>

<sup>6</sup> The term outsourcing is being used to describe the centralized locations performing audit procedures on behalf of engagement teams. These locations may be in the same jurisdiction or at an off-shore location.

<sup>7</sup> See Agenda Item 4 – Quality Control <https://www.iaasb.org/auditing-assurance/meetings/new-york-usa-8>

7. The views expressed by the IAASB from both of these meetings included:
- a) The need for a definitive objective for the project which could address the issue of whether the IAASB should take a holistic approach to the project of quality control or whether it was more appropriate to address topics identified on a piece-meal basis, and if so, determine the relative importance of those topics.
  - b) Consideration of whether the issues identified need to be addressed through amendments to the ISAs, including incremental changes to the structure of ISQC 1, or if other methods such as an International Practice Note (IPN) or Staff guidance may be more appropriate.
  - c) Consideration of providing any practical help to SMPs on the proportionate application of ISQC 1. Given that much concern had been expressed and continues to be expressed by the SMPs regarding the ability to apply ISQC 1 on a proportionate basis, only promoting awareness of the existing guidance on the proportionate application of ISQC 1 may not be sufficient.
  - d) The incorporation of governance issues into the project scoping, given its relative importance. Specifically, how a firm compensates and rewards its personnel is a key aspect of the “tone at the top” and the attitude to audit quality through-out the firm.
  - e) The need to ensure that issues were further considered and understood before commencing with a project proposal including:
    - i. The root cause of engagement quality control review issues;
    - ii. The balance of emphasis within both ISQC 1 and ISA 220 between the roles and responsibilities of the engagement partner, the engagement team and the engagement quality control reviewer; and
    - iii. Quality control issues, if any, with firm’s outsourcing audit-related activities.

The IAASB also counseled the Working Group to ensure it had captured and considered the full range of issues relevant to this project.

### Discussion of Approach

8. The Working Group considered each of the Board’s recommendations<sup>8</sup> in its subsequent deliberations of how to progress the quality control project.
9. To identify issues with respect to quality control, the Working Group revisited findings and comments received from the ISA Implementation Monitoring Project and the Framework for Audit Quality. The Working Group also considered issues identified through other outreach, including a teleconference with the International Forum of Independent Audit Regulators (IFIAR), other offline discussions with regulators, feedback from firms (with respect to outsourcing) and feedback from small-and medium-sized practices.

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<sup>8</sup> The full text of the Decision Summaries for the June 2014 and December 2014 IAASB meetings is available on the IAASB website.

10. Based on this research, the Working Group's overall interpretation of the issues with ISQC1 include that:
- Due to significant changes in the environment in which the standard operates, it needs to be updated to reflect the current audit environment.
  - Different to the ISAs, it is not a risk based standard and that not all users, believe that it is scalable.
  - Different stakeholder groups attach a different level of priority to each of the identified issues.
- The Working Group did not identify any additional topics within the project other than those previously identified and discussed with the IAASB.<sup>9</sup>
11. The Working Group has compiled the issues, identified through the outreach discussed above, into the table, presented in **Agenda Item C-1**. This table consolidates the issues identified, the views expressed by the IAASB up to December 2014, the Working Group's interpretation of the views of some regulators, the Working Group's interpretation of the issues and suggested approach, and the potential actions to address the issues.
12. However, the Working Group believes that it needs to gather more information to better inform the project scoping, including whether there are issues relevant to the quality control project that have not yet been identified by the Working Group and also to obtain more detail and different perspectives on the issues that have already been identified.

### Way Forward

13. The Working Group determined that to obtain a more broad range of views on the issues with, and the application of, ISQC 1, a two-pronged approach would be appropriate. The first being to solicit views through a Discussion Paper from a broad range of stakeholders and the second being a survey targeting the SMPs to better understand their specific issues.
14. The Working Group will therefore recommend to the IAASB at its March 2015 meeting that the Discussion Paper be issued to fulfill the need for further research and to solicit views from the different stakeholder groups. The Discussion Paper will be based on the table presented in Agenda Item C-1 and will further explore the cause of the quality control issues, their relative importance and the most effective way to address them, i.e., through updates to requirements and application material in ISQC 1 and the ISAs, through Staff prepared implementation guidance or through other means. The Working Group is of the view that this is the most efficient and effective way to reach and obtain the views of the different stakeholders. Feedback from the CAG at this meeting will be incorporated into the Discussion Paper as appropriate.
15. As noted in paragraph 13, the Working Group determined that it was appropriate to target SMPs through a survey and has distributed this survey through the IFAC SMP Committee. The Working Group believes that this approach may solicit a higher rate of response from this group than that

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<sup>9</sup> For detail of previous Board agenda items discussing these issues, see June 2014 Board Meeting Agenda Item 6 <http://www.ifac.org/auditing-assurance/meetings/new-york-usa-6> and December 2014 Board Meeting Agenda Item 4 <http://www.ifac.org/auditing-assurance/meetings/new-york-usa-8>

previously received on discussion papers. Responses to the survey have been requested by the end of March.

16. The responses from the Discussion Paper, the survey and the detailed comments received from the ISA Implementation Monitoring project will then be used to form the basis for the project proposal.

#### **Proposed Timing of the Discussion Paper**

17. Subject to the Board's approval of the proposed approach, the Working Group believes that it is important to move forward on a timely basis with the Discussion Paper and therefore intends to table a draft Discussion Paper at the June 2015 Board meeting. The Working Group will incorporate comments and edits provided by the Board into an updated version of the Discussion Paper to be issued in the second half of July, with a 90 day comment period ending in the second half of October.

#### **Matters for CAG Consideration**

1. Representatives and Observers are asked for their views on:
  - (a) The Working Group's proposed approach to the Quality Control project to obtain further views through the issuance of a Discussion Paper.
  - (b) The appropriateness of the topics to be included in Discussion Paper (see Agenda Item C-1).
  - (c) The relative importance of the topics presented in Agenda Item C-1.
2. Representatives and Observers are asked to provide views on any other issues pertaining to quality control that they believe should be considered in scoping an international standard-setting project on quality control.

#### **Material Presented – IAASB CAG PAPERS**

Agenda Item C-1                      Quality Control – Table of Issues