

[DRAFT] IAASB STAFF QUESTIONS AND ANSWERS**APPLYING ISQC 1 PROPORTIONATELY WITH THE NATURE AND SIZE OF A FIRM**

This Questions & Answers (Q&A) publication is issued by staff of the International Auditing and Assurance Standards Board (IAASB) to highlight how the design of International Standard on Quality Control (ISQC) 1,¹ issued by the IAASB under the Clarity Project, enables it to be applied in a manner proportionate with the nature and size of a firm. Specifically, while ISQC 1 applies to all firms, this Q&A focuses on matters that are likely to be of particular relevance to the application of ISQC 1 in the context of smaller firms. Smaller firms may find this publication helpful in achieving an effective and efficient implementation of ISQC 1. Others (including, but not limited to, regulators and audit oversight bodies) with responsibilities for or relating to services provided by firms of professional accountants may also find this Q&A helpful.

This publication does not constitute an authoritative pronouncement of the IAASB nor does it amend or override ISQC 1.² Further, this publication is not meant to be exhaustive and reading this Q&A is not a substitute for reading ISQC 1.

BACKGROUND

Quality control is central in enhancing users' confidence in the services provided by a firm. A robust system of quality control addresses quality control with respect to engagement performance as well as leadership responsibilities for quality within the firm, compliance with relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, human resources and monitoring. ISQC 1 helps serve this important purpose.

ISQC 1 applies to firms of all sizes that provide services covered by the IAASB's International Standards. The term "firm" includes a sole practitioner, partnership or corporation or other entity of professional accountants.³ The IAASB's International Standards cover, but are not limited to, the following:

- Audits of historical financial statements (International Standards on Auditing)
- Reviews of historical financial statements (International Standards on Review Engagements)
- Assurance engagements other than audits or reviews of historical financial statements such as assurance engagements to report on controls at a service organization (International Standards on Assurance Engagements)
- Compilation engagements and agreed-upon-procedures engagements (International Standards on Related Services)

In developing ISQC 1, the IAASB was alert to the needs of smaller firms, a constituency that is particularly affected by standards-overload. Therefore, the IAASB was mindful of the importance of setting requirements that would be applicable on a proportionate basis relative to the nature and size of a firm.

¹ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

² All references to ISQC 1 in this publication are to the clarified ISQC 1 that became effective on December 15, 2009.

³ ISQC 1, paragraph 12(g)

An understanding of the design and intent of ISQC 1 will help smaller firms to apply ISQC 1 in a relevant and cost-effective way. Amongst other important features, there are a number of concepts embedded in ISQC 1 that are useful to achieving proportionate application, including that:

- Firms need only to comply with those requirements that are relevant to the services provided.
- Firms can exercise appropriate judgment in implementing a system of quality control, for example, in deciding how formal certain processes need to be to comply with requirements or in documentation of the system.
- Firms can draw on external resources to meet some of the requirements.

Smaller firms will find that effective and proportionate implementation may be best achieved by first studying the provisions of ISQC 1 and then, in light of the nature and size of a firm and the services the firm provides, developing policies and procedures tailored to the firm's circumstances.

In the context of audits of financial statements, ISQC 1 works in tandem with ISA 220⁴ to establish a framework for quality control in two specific dimensions: at the firm and engagement levels. Together, these two standards address a variety of areas where auditors and firms can take specific action to promote and safeguard audit quality.

Questions and Answers

Q1. How does ISQC 1 address the fact that the characteristics of a smaller firm are significantly different from those of a larger firm?

The objective of implementing a system of quality control is the same for all firms regardless of their nature or size. However, this does not mean that all firms have to design and implement exactly the same policies and procedures to achieve the objective of ISQC 1.

ISQC 1 recognizes that the nature and extent of the specific policies and procedures to be developed by a firm to comply with ISQC 1 will depend on various factors, such as the size and operating characteristics of the firm and whether or not it is part of a network.⁵ ISQC 1, therefore, does not suggest a specific approach to implementation.

A particularly important provision in ISQC 1 relative to its proportionate application is the requirement for the firm to comply with each requirement of the standard *unless, in the circumstances of the firm, the requirement is not relevant to the services provided* in respect of audits and reviews of financial statements, and other assurance and related services engagements.⁶ This means that, depending on the scope of services provided by a firm, some – or even many – of the requirements of ISQC 1 should not pose a challenge or have implication to the firm.

Consider the case a sole practitioner, with no staff, that performs only compilation engagements in accordance with ISRS 4410 (Revised)⁷ and does not perform audit, review or other assurance engagements. In this circumstance, assuming there are no local requirements regarding

⁴ ISA 220, *Quality Control for an Audit of Financial Statements*

⁵ ISQC 1, paragraph 4

⁶ ISQC 1, paragraph 14

⁷ International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*

independence for non-assurance services, the requirements in ISQC 1 for the establishment of policies and procedures regarding independence would not be relevant and, accordingly, need not be implemented.

ISQC 1 also acknowledges the importance of exercising appropriate judgment in implementing a system of quality control. For example, ISQC 1 indicates that the form and content of documentation of the system of quality control is a matter of judgment and will depend on a number of factors.⁸

Q2. How might the implementation of ISQC 1 in a smaller firm differ from that in a larger firm?

Generally, the organizational structure of a smaller firm will be simpler than that of a larger firm, for example:

- Smaller firms may use less structured means and simpler processes and procedures to achieve their objectives.
- Communications may more informal in smaller firms.

Consequently, implementation of ISQC 1 in a smaller firm will likely be simpler than in a larger firm.

Smaller firms will also find that proportionate implementation may be best achieved by first studying the provisions of ISQC 1 and then, in light of the nature and size of a firm and the services the firm provides, developing policies and procedures tailored to the firm's circumstances. While this is true for firms of all sizes, in the context of a smaller firm, it assists in determining which of the requirements of ISQC 1 are relevant in the circumstances of the firm. For example, for a sole practitioner with no staff, requirements to establish policies and procedures for the assignment of appropriate personnel to the engagement team,⁹ for review responsibilities,¹⁰ and for the annual communication of the results of monitoring to engagement partners within the firm¹¹ will not be relevant.¹²

Further, some requirements of ISQC 1 may be easier for smaller firms to implement. For example, in relation to the requirements that address the importance of promoting an internal culture recognizing that quality is essential, smaller firms may be able to achieve this simply through leading by example and various communications between staff and leadership as they occur on a regular basis. Likewise, in the case of a sole practitioner, a mission statement or other practice policies (e.g., in relation to fee quotes) may usefully be employed by the practitioner to reinforce quality over commercial interests.

Finally, the approach to establishing quality control policies and procedures in a smaller firm may be less formal and structured. For example, smaller firms may employ less formal methods in carrying out performance evaluations for their staff.

⁸ ISQC 1, paragraph A73

⁹ ISQC 1, paragraph 31

¹⁰ ISQC 1, paragraph 33

¹¹ ISQC 1, paragraph 53

¹² ISQC 1, paragraph A1

Q3. How does ISQC 1 help guide smaller firms in implementation of a system of quality control?

ISQC 1 includes numerous specific considerations, labeled *Considerations Specific to Smaller Firms*, to assist smaller firms in understanding or applying the requirements. For instance, ISQC 1 states that a firm needing to consult externally (for example, a firm without appropriate internal resources) may take advantage of advisory services provided by:

- Other firms;
- Professional and regulatory bodies; or
- Commercial organizations that provide relevant quality control services.

ISQC 1 states that before contracting for such services, consideration of the competence and capabilities of the external provider helps the firm to determine whether the external provider is suitably qualified for that purpose.¹³

ISQC 1 also provides other guidance that smaller firms may find helpful in implementing the requirements of the standard. For example, in relation to the requirements of ISQC 1 addressing the need for sufficient personnel with the competence and capabilities to perform engagements in accordance with professional standards,¹⁴ firms may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.¹⁵ Often, this will likely be an effective (and cost effective) way to achieve the aims of the requirements.

Q4. How do sole practitioners or firms with few partners comply with ISQC 1's requirements relating to engagement quality control review?

ISQC 1 requires an engagement quality control review for all audits of financial statements of listed entities.¹⁶ This requirement does not apply if the firm does not perform such engagements.

ISQC 1 also requires firms to set out criteria against which all other audits and reviews of historical financial information and other assurance and related services should be evaluated to determine whether an engagement quality control review should be performed.¹⁷ In this regard, ISQC 1 provides guidance on possible criteria that may be used for this purpose, such as the nature of the engagement, risks in an engagement, and whether laws or regulations require an engagement quality review.¹⁸ In some circumstances, none of the firm's engagements may meet the criteria that would subject the engagement to such a review.

ISQC 1 requires the firm to establish policies and procedures to maintain the objectivity of the engagement quality control reviewer. In the case of firms with few partners, ISQC 1 explains that suitably qualified external persons may need to be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. ISQC 1 indicates that some sole

¹³ ISQC 1, paragraph A40

¹⁴ ISQC 1, paragraph 29

¹⁵ ISQC 1, paragraph A27

¹⁶ ISQC 1, paragraph 35(a)

¹⁷ ISQC 1, paragraph 35(b)

¹⁸ ISQC 1, paragraph A41

practitioners or small firms may alternatively wish to use other firms to facilitate engagement quality control reviews.¹⁹

Q5. What are relevant considerations for smaller firms, including sole practitioners, as it relates to the “monitoring” element of ISQC 1?

Monitoring is an essential element of a robust system of quality control. ISQC 1 requires that the firm establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.²⁰

In the case of smaller firms, ISQC 1 explains that monitoring procedures may need to be performed by individuals who are responsible for the design and implementation of the firm’s quality control policies and procedures, or who may be involved in performing the engagement quality control review. It also explains that a firm with a limited number of persons may choose to use a suitably qualified external person or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, the firm may establish arrangements to share resources with other appropriate organizations to facilitate monitoring activities.²¹

Also, ISQC 1 requires the inspection of at least one completed engagement for each engagement partner on a cyclical (not necessarily annual) basis and specifically prohibits the use of personnel involved in performing an engagement from also performing an inspection of files for that engagement. In these circumstances, smaller firms may consider making arrangements with other smaller firms to perform inspections of each other’s files.

ISQC 1 also requires policies and procedures to be established for the investigation of complaints and allegations.²² ISQC 1 explains that it may not be practicable, in the case of firms with few partners, for the partner supervising the investigation not to be involved in the engagement. In these circumstances, firms may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.²³

Q6. How might the documentation considerations for a system of quality control for a smaller firm differ from those of a larger firm?

ISQC 1 requires a firm to establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.²⁴

Documentation of the system of quality control will assist firms in demonstrating compliance with ISQC 1 and facilitate improvements in the system of quality control in the future.

ISQC 1 indicates that the form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:

¹⁹ ISQC 1, paragraph A50
²⁰ ISQC 1, paragraph 48
²¹ ISQC 1, paragraph A68
²² ISQC 1, paragraph A71
²³ ISQC 1, paragraph A72
²⁴ ISQC 1, paragraph 57

- The size of the firm and the number of offices.
- The nature and complexity of the firm’s practice and organization.

Also, ISQC 1 explains that smaller firms may use more informal methods in the documentation of their systems of quality control such as manual notes, checklists and forms.²⁵

²⁵ ISQC 1, paragraph A75