

## Quality Management: Relationship between Proposed ISQC 1 (Revised)<sup>1</sup> and Proposed ISA 220 (Revised)<sup>2</sup>

### Objective of the IAASB discussion

The objective of this Agenda Item is to explain the relationship between the draft Exposure Draft (ED) of Proposed ISQC 1 (Revised), set out in **Agenda Item 6–A**, and the working draft of Proposed ISA 220 (Revised), set out in **Agenda Item 5–A**.

### Introduction

1. This paper should be read in conjunction with **Agenda Item 5–A** and **Agenda Item 6–A**.
2. On the August 2017 IAASB teleconference, the Quality Control Task Force (QCTF) and ISA 220 Task Force (ISA 220 TF) presented recommendations on the relationship between Proposed ISQC 1 (Revised) and Proposed ISA 220 (Revised). The IAASB supported the Task Forces' proposals, including:
  - Incorporating a more proactive approach to management of quality at the engagement level, without replicating the Quality Management Process at the engagement level, and remaining focused on reinforcing the responsibilities of the engagement partner.
  - Retaining the elements in extant ISA 220 and reflecting those elements in Proposed ISQC 1 (Revised) by including them in the prescribed quality objectives and establishing prescribed quality risks that align to the prescribed quality objectives.
  - Clarifying that engagement team resources include technological and intellectual resources as well as human resources.
  - Continuing efforts to achieve necessary alignment between Proposed ISQC 1 (Revised) and Proposed ISA 220 (Revised), including aligning the wording of the requirements and related application guidance between the two standards where appropriate (with a caution about using exactly the same phrases in all cases because quality management at the engagement level is not necessarily the same as quality management at the firm level).

The discussion also included an explanation of how Proposed ISA 220 (Revised) would address the management of quality at the engagement level, including that the engagement team implements the responses designed at the firm level and supplements such responses, as appropriate, according to the engagement circumstances.
3. In developing their respective agenda items, the QCTF and ISA 220 TF have coordinated through staff liaison, overlap of Task Force members and various teleconferences and meetings of the Task Force chairs and IAASB staff.

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

<sup>2</sup> International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*  
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## The Structure of the Standards

4. As reflected in **Agenda Item 6–A**, and explained in **Agenda Item 6**, Proposed ISQC 1 (Revised) has been restructured. As a result of the restructuring, the elements of extant ISQC 1 have been established as discrete components of Proposed ISQC 1 (Revised). As previously proposed to the IAASB, Proposed ISA 220 (Revised) has retained the elements of extant ISA 220. Accordingly, the components of Proposed ISQC 1 (Revised) and the sections of Proposed ISA 220 (Revised) are as follows:

<b>Proposed ISQC 1 (Revised)</b>	<b>Proposed ISA 220 (Revised)</b>
The quality management process	*1
Governance and leadership	Leadership Responsibilities for Managing and Achieving Quality on Audits
Information and communication	*2
Relevant ethical requirements	Relevant ethical requirements
Acceptance and continuance of client relationships and specific engagements	Acceptance and continuance of client relationships and audit engagements
Resources	Engagement resources
Engagement performance	Engagement performance
The monitoring and remediation process	Monitoring and remediation
Notes: *1. Paragraphs 2–4 of Proposed ISA 220 (Revised) describe at a high-level how the quality management process is operationalized at the engagement level, see additional explanation below within paragraph 5. *2. Communication has been built into each of the discrete sections of Proposed ISA 220 (Revised), see additional explanation below within paragraph 5.	

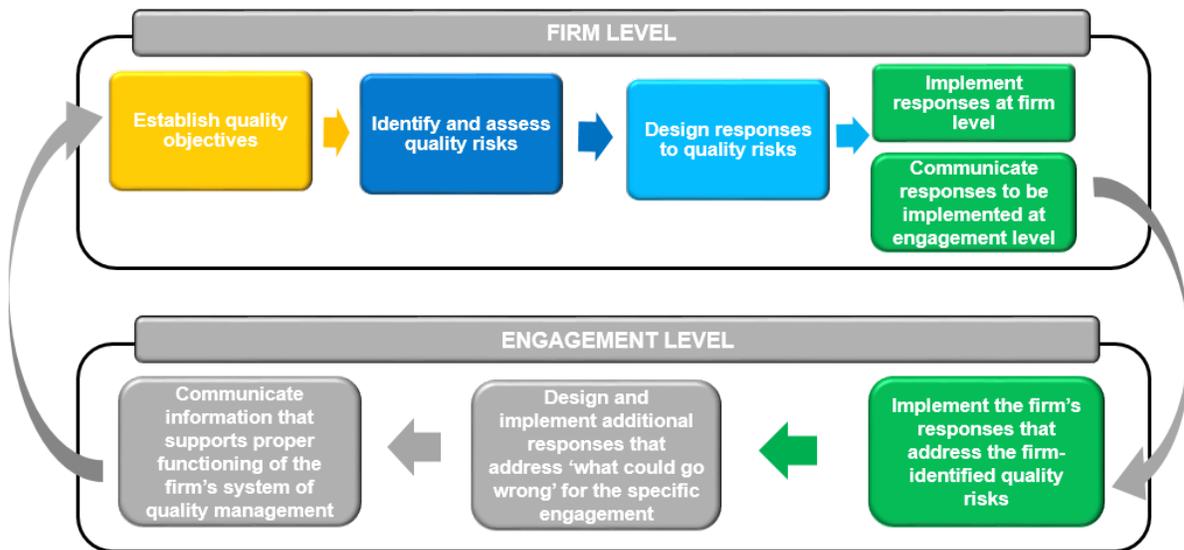
5. As is evident from the above, the components of Proposed ISQC 1 (Revised) and sections of Proposed ISA 220 (Revised) are substantially similar, with the exception of the quality management process and information and communication as follows:

- **Quality management process**—Consistent with the structure of extant ISA 220, the section titled “System of Quality Management and Role of Engagement Teams” in Proposed ISA 220 (Revised), and the related application material, explains the relationship between the firm’s system of quality management and what is relevant to managing quality at the engagement level. Taking into account previous discussions with the IAASB, Proposed ISA 220 (Revised) does not seek to duplicate the quality management process at the engagement level, but rather it clarifies that management of quality at the engagement level is demonstrated through addressing the requirements of the ISA.
- **Information and communication**—The ISA 220 TF has taken into account previous discussions with the IAASB, which highlighted concerns that overarching requirements for two-way communication is not likely to be effective, may be difficult to implement and therefore may not

necessarily promote the required behavioral change. The ISA 220 TF also notes that some ISAs already include required communications with external parties, such as management or those charged with governance.<sup>3</sup> As such, the ISA 220 TF has included additional application material around communication that reinforces the importance of communication in managing quality at the engagement level, identifies the parties that might be involved in communication and explains how the nature and circumstances of the engagement may affect the engagement partner’s decisions regarding the most appropriate means of communication with engagement team members (see paragraphs A3H–A3J of **Agenda Item 5–A**). Additionally, various other requirements address the necessary communication between the engagement partner or engagement team and the firm. The ISA 220 TF plans to further develop the requirements and application guidance relating to direction and supervision of engagement team members and review of their work and in doing so, will further emphasize the importance of communication.

6. With respect to resources, the titles of the component in Proposed ISQC 1 (Revised) (“Resources”) and the section in Proposed ISA 220 (Revised) (“Engagement Resources”) are intentionally different. At the firm level, resources are needed to support a range of activities relating to the firm’s system of quality management, and therefore encompass a broader range of resources, including financial resources. At the engagement level, the resources are those that are necessary to perform the audit engagement, and therefore comprise a more narrow range of resources. However, this section in Proposed ISA 220 (Revised) has been broadened from extant to encompass not only human resources, but also technological and intellectual resources that are necessary in performing an audit engagement.

## The Relationship between the Management of Quality at the Firm Level and the Engagement Level



<sup>3</sup> See, for example, ISA 210, *Agreeing the Terms of Audit Engagements*, ISA 260 (Revised), *Communication with Those Charged with Governance*, ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, and ISA 450, *Evaluation of Misstatements Identified during the Audit*.

7. In accordance with Proposed ISQC 1 (Revised), the firm establishes quality objectives, identifies and assesses quality risks and designs responses to address the quality risks in relation to the various components of the firm's system of quality management (except for monitoring and remediation). As explained in paragraph A19 of **Agenda Item 6–A**, the level at which the responses are implemented may vary, for example:

- The firm may implement the response at the firm level. In these circumstances, there may be supplementary actions at the engagement level in order that the response operates as designed.
- The engagement partner or engagement team may implement the firm's response at the engagement level.

The firm's responses may include services provided by the network, which form part of the firm's system of quality management.

8. The engagement team is required to implement the firm's responses at the engagement level, as directed by the firm. Proposed ISQC 1 (Revised) requires the firm to communicate information related to the engagement team's responsibilities with respect to the firm responses that are required to be implemented at the engagement level, which is included in paragraph 33(b) of **Agenda Item 6–A**.

9. In addressing the relationship between Proposed ISQC 1 (Revised) and Proposed ISA 220 (Revised), the ISA 220 TF has given consideration to the fact that Proposed ISA 220 (Revised) needs to accommodate firms subject to national requirements (i.e., not all firms are subject to ISQC 1 and may instead be subject to national requirements that are at least as demanding as ISQC 1). At the engagement level, the engagement team's responsibility within the context of the firm's system of quality management is explained in paragraph 3 of **Agenda Item 5–A** and includes:

- (a) Implementing the firm's responses to quality risks that are applicable to the audit engagement, taking account information obtained from or provided by the firm; and
- (b) Communicating relevant information that supports the proper functioning of the firm's system of quality management to the firm.

10. In addition to implementing the firm's responses to quality risks that are applicable to the audit engagement described in paragraph 9 above, Proposed ISA 220 (Revised) requires the engagement team to determine whether responses in addition to the firm's responses are necessary in order to manage and achieve quality at the engagement level (see paragraph 3A of **Agenda Item 5–A**).

#### **Matter for IAASB Consideration**

1. Is the IAASB of the view that the relationship between Proposed ISQC 1 (Revised) and Proposed ISA 220 (Revised) is appropriate and is this evident?