

Tips for Cost-Effective ISQC 1 Application



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INTRODUCTION

The Clarity Project of the International Auditing and Assurance Standards Board (IAASB) culminated in the issue in March 2009 of a suite of 36 newly updated and clarified International Standards on Auditing (ISAs) and a clarified International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*. ISQC 1 was first issued in 2004.

The IAASB Clarity Project resulted in a redrafting of ISQC 1 which, whilst not substantively changing the focus of the standard, did clarify its requirements. It is therefore important for firms to familiarize themselves with the clarified standard and, where necessary, take steps to ensure full compliance.

Effective as of December 15, 2009, clarified ISQC 1 deals with a firm's responsibilities for its quality control system for audits and reviews of financial statements, and other assurance and related services engagements (such as compilation engagements).

ISQC 1 states the firm's objective in following the standard and presents a set of requirements (supported by application and other explanatory material where appropriate) designed to enable the firm to meet that objective. Under ISQC 1, the objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that:

- the firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
- reports issued by the firm or engagement partners are appropriate in the circumstances.

ISQC 1 focuses on quality control at the firm level; other pronouncements issued by the IAASB may set out additional standards and guidance for quality control at the engagement level for specific types of engagements. For example, those that perform audits of financial statements need to comply with ISA 220, *Quality Control for an Audit of Financial Statements* in order to represent compliance with the ISAs in the auditor's report. ISA 220 deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements but is also premised on the firm being subject to ISQC 1 or national requirements that are at least as demanding.

While the principles of quality control at the firm level are universally applicable, 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. Applying/implementing ISQC 1 proportionately to the size and complexity of the firm is, therefore, one of the keys to complying efficiently with the standard. This article aims to help firms, especially small- and medium-sized practices (SMPs), by highlighting some key aspects of ISQC 1, as well as providing some tips and resources that may help them comply with the standard in an efficient, cost-effective manner.

TIP 1: TAKE TIME TO STUDY THE STANDARD AND REVIEW AVAILABLE SUPPORTING IMPLEMENTATION GUIDANCE

ISQC 1 requires those personnel within the firm who are responsible for establishing and maintaining the firm's system of quality control to have an understanding of the entire text of the standard, including its application and other explanatory material, in order to apply the requirements properly. First and foremost, therefore, those with such responsibilities should read ISQC 1. Without reading the full standard, there is a risk that some requirements will get missed, that the aim and scope of some of the requirements will not be fully understood, or that helpful application guidance will be overlooked. ISQC 1 is available in the IAASB Clarity Center.

Those responsible for the firm's system of quality control may also find it helpful to consider available supporting implementation guidance. In August 2011, the SMP Committee of the International Federation of Accountants (IFAC) published the third edition of the *Guide to Quality Control for Small- and Medium-Sized Practices*. The guide includes non-authoritative guidance, an illustrative case study, checklists, and two sample quality control manuals.

ISQC 1 requires that firms establish and maintain a system of quality control (QC system) that includes policies and procedures that address each of the six elements shown in Table 1.

Table 1: Elements of a Quality Control System

- | |
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| <ol style="list-style-type: none">1. Leadership responsibilities for quality within the firm2. Relevant ethical requirements3. Acceptance and continuance of client relationships and specific engagements4. Human resources5. Engagement performance6. Monitoring |
|---|

TIP 2: COMPARE CURRENT QC SYSTEM WITH ISQC 1

Does your firm's current QC system meet all the requirements of ISQC 1?

ISQC 1 requires firms to document their QC policies and procedures. These documented policies and procedures may help facilitate a gap analysis against the requirements of the standard by:

- a) comparing each requirement within the standard to the existing policies and procedures;
- b) highlighting those requirements not currently met; and
- c) determining what changes need to be made.

Consider also if your firm has had any significant changes in its operations in recent years—for example, it may have started providing a new service or accepting new types of clients—as this too may indicate that the current QC system is in need of updating.

The firm's QC policies and procedures can be usefully collated and recorded in a quality control manual. Such a manual could usefully act as a key communication tool between all partners and staff to set expectations and may, therefore, also serve as a framework within which to develop performance evaluation criteria. Revisions or additions of new policies or procedures that are necessary to close any gaps between the current QC system and the requirements of ISQC 1 can then simply be edited or inserted into the manual.

In order to be able to demonstrate how the QC policies and procedures meet the requirements of ISQC 1—whether for internal purposes or external inspection purposes—it may be useful to consider cross-

referencing directly between the quality control manual and ISQC 1 or preparing a mapping document that compares the two.

The *Guide to Quality Control for Small- and Medium-Sized Practices* includes two sample manuals, which firms may use as benchmarks and adapt to suit their practice.

TIP 3: TAILOR THE QC POLICIES AND PROCEDURES

While the elements of a QC system are common to all firms no matter their size, smaller and simpler practices will often have smaller and simpler QC systems. ISQC 1 includes considerations specific to smaller practices in the application and other explanatory material section. For example, smaller firms may employ less formal methods of evaluating the performance of their personnel (see ISQC 1, paragraph A29).

ISQC 1 also recognizes that some requirements are not always relevant. For example, sole practitioners with no staff would not require policies and procedures for the assignment of appropriate personnel to the engagement team, for certain review responsibilities, and for the annual communication of the results of monitoring to engagement partners within the firm (see ISQC 1, paragraph A1).

ISQC 1 requires firms to document their QC policies and procedures. The standard also acknowledges that, for smaller firms, such documentation may be less formal and less extensive than for larger firms (see ISQC 1, paragraph A3).

Firms may also consider adding to their QC policies and procedures through maintaining a wider awareness of good practices, thereby further helping them achieve the overall goal of lasting quality.

TIP 4: ASSESS THE NEED FOR OUTSIDE HELP

ISQC 1 acknowledges that smaller firms may have more limited internal resources and, therefore, may need outside help in order to meet the requirements of the standard. The standard identifies four areas where this may be the case—consultation, engagement quality control reviews, monitoring, and dealing with complaints and allegations—and provides guidance for identifying and deploying a suitable external party (see ISQC 1, paragraphs A40, A50, A68, and A72 respectively).

The independent monitoring requirement poses a unique challenge to smaller firms and sole practitioners. 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.

For some small firms, these requirements may automatically necessitate an external review or reduce the number of engagements capable of being reviewed internally. In the latter case, consider the application material in the standard (see ISQC 1, paragraphs A64–A67) and focus, ultimately, on deciding whether, as a result of the engagement selection, the monitoring process provides the firm with reasonable assurance that its QC policies and procedures are relevant, adequate, and operating effectively, as required by the standard.

Firms may consider making arrangements with other smaller firms or sole proprietors to perform a monitoring inspection of each others' files. This process need not be time consuming and will likely result in a beneficial sharing of ideas relating to quality improvement and engagement efficiency.

Whenever using outside help, take appropriate steps to confirm the external party's competence, independence, and confidentiality with them, preferably in writing and perhaps as part of a wider written communication setting out the full terms of the arrangement.

TIP 5: EDUCATION AND TRAINING

Firm-wide training on ISQC 1 will contribute positively to effective compliance. By providing firm-wide training, firms can deliver a consistent message to all and may use ISQC 1 to help promote the firm's wider commitment to quality and the use of best practices. Training programs also offer the opportunity to create awareness of any changes that need to be made to firm policies and procedures, along with guidance as to what the changes are, how the QC system has been updated, and how to implement the changes.

After an initial training session on changes to the QC system, consider follow-up and reinforcement through periodic reminders of personnel's responsibility to adhere to the firm's policies and procedures.

Firms might wish to consider using the *Guide to Quality Control for Small- and Medium-Sized Practices*¹ as a basis for in-house training.

SUMMARY

Compliance with ISQC 1 provides firms with the opportunity to promote a culture that places quality front and center. In turn, embedding such a culture within the firm will not only help fulfill the objective set out in the standard, but may also contribute to firms' ability to consistently meet stakeholder expectations.

IFAC RESOURCES

- International Center for Small and Medium Practices at www.ifac.org/SMP
 - Relevant links at www.ifac.org/SMP/relevant_links.php
 - Free quarterly e-newsletter at www.ifac.org/SMP/index.php#News
- IAASB Clarity Center at <http://web.ifac.org/clarity-center/index>
 - ISA Modules at <http://web.ifac.org/clarity-center/support-and-guidance#support-modules>
- *Guide to Quality Control for Small- and Medium-Sized Practices*, third edition is at <http://web.ifac.org/publications/small-and-medium-practices-committee>. The third edition was issued in August 2011.
- *Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities* is at <http://web.ifac.org/publications/small-and-medium-practices-committee>. This guide includes guidance on ISA 220, *Quality Control for an Audit of Financial Statements*. The second edition was issued in October 2010.
- Translations of the above publications, including Spanish and French translation of the *Guide to Quality Control for Small- and Medium-Sized Practices*, are at www.ifac.org/Translations/database.php.
- All IFAC publications, including those of the SMP Committee and IAASB, can be found under the Publications & Resources Section of the IFAC website at <http://web.ifac.org/publications>.

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