



International Federation of Accountants

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Agenda Item

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Committee: IAASB

Meeting Location: New York

Meeting Date: February 16 – 18, 2004

Quality Control

Objectives of Agenda Item

To review and approve for issue:

- a) International Standard on Quality Control 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”; and
- b) International Standard on Auditing 220, “Quality Control for Audits of Historical Financial Information”.

Background

The IAASB issued the QC exposure drafts for public comment in May 2003. The exposure period closed on August 31, 2003 and 39 comment letters were received. At its meeting in Berlin, the IAASB debated the main issues raised by respondents during the exposure period, reviewed revisions to the EDs, and provided feedback for consideration by the Task Force.

Activities Since Last IAASB Discussions

The Task Force held a two-day meeting in January 2004 to discuss the feedback provided by the Board in Berlin and also changes proposed to the documents by the plain English editor, Bob Waller. The Task Force held a subsequent conference call a week later with the Chair and Staff of the Ethics Committee to agree the resolution of the remaining issues relating to ethics in the QC documents.

Issues

1. ETHICS

As discussed in Berlin, the Board did not agree with the Ethics Committee’s suggestion to redraft the requirement contained in paragraph 19 of the ISQC concerning independence on a more generic level and to delete the related guidance in paragraphs 20 – 28. The Task Force explained this decision to the Chair of the Ethics Committee, who accepted the Board’s position in light of the changes that have been made to the ISQC to eliminate inconsistencies with the IFAC Code of Ethics (“IFAC Code”). As directed by the Board, the Task Force also debated the Ethics Committee’s concern relating to paragraph 26 of the ISQC, which was perceived as introducing a presumption of mandatory rotation of engagement partners for engagements that are not listed audits. Whilst it was not the Task Force’s intention to introduce any such presumption, the Task Force concluded that it would be appropriate to align the requirements of paragraph 26 with paragraph 151 of Section 8 of the IFAC Code, given that the IFAC Code includes rotation of senior personnel for assurance engagements as a safeguard to threats to independence.

2. REASONABLE ASSURANCE

Whilst the Board had generally expressed a preference for deleting the definition provided for “reasonable assurance”, the Board directed the Task Force to consider whether the definition provided for “reasonable assurance” in the COSO Framework for Internal Control could be usefully adapted for the purposes of the quality control documents. The “definition” in the COSO Framework explains the concept of “reasonable assurance” as it relates to internal control in the following terms:

*“Internal control, no matter how well designed and operated, can provide only **reasonable assurance** to management and the board of directors regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that human judgment in decision-making can be faulty, persons responsible for establishing controls need to consider their relative costs and benefits, and breakdowns can occur because of human failures such as simple error or mistake. Additionally, controls can be circumvented by collusion of two or more people. Finally, management has the ability to override the internal control system.”*

After further debate, the Task Force concluded that this was not a definition per se and felt it would not be appropriate to describe “reasonable assurance” for quality control purposes in terms of a list of limitations. Accordingly, the Task Force concluded that it would be preferable not to provide a definition for the term.

3. DIFFERENCES OF OPINION

In relation to the matter of how differences of opinion should ultimately be resolved (ISQC paragraph 59), the Task Force had originally proposed that the firm’s policies and procedures would identify the person or persons, other than the engagement partner, with responsibility for the final resolution of the issue. The Board debated this proposal at some length in Berlin and considered how to reconcile this proposal with the fact that, in jurisdictions where the engagement partner is the signing partner, the engagement partner could not be asked to sign a report with which he or she had disagreed. The Board suggested that the Task Force consider wording that would communicate the principle that the firm should not issue the report until the matter was resolved, and leaving it to the firm to take whatever action was necessary in the circumstances to resolve the issue. After further debate, the majority of the Task Force agreed to the Board’s recommendation and amended the paragraph accordingly.

4. OBJECTIVITY OF THE ENGAGEMENT QUALITY CONTROL REVIEWER

ISQC paragraph 71(b) had originally provided that, to maintain the objectivity of the engagement quality control (“EQC”) reviewer, the reviewer would not participate in the performance of the engagement *or any other engagement involving the same client during the period under review*. The Board was concerned that this was unduly restrictive and asked the Task Force to reconsider the requirement to allow a degree of flexibility, especially for SMPs. The Task Force debated this, taking into account other safeguards that would be available to maintain the reviewer’s objectivity, and agreed in the majority to delete the restriction.

5. COOLING-OFF PERIOD AND ROTATION OF EQC REVIEWER

The Task Force had originally proposed in Berlin to delete the requirement for a cooling-off period before an EQC reviewer could take on the role of engagement partner for the same client, as well as the requirement for rotation of the reviewer where objectivity might be impaired. This was principally on the basis of comments received from the Ethics Committee indicating a

concern that such matters related in fact to independence and should be dealt with in the IFAC Code and not in the ISQC. Whilst the Board acknowledged the Ethics Committee's intention to deal with this issue in the IFAC Code, the Board suggested that the Task Force consider at least including a discussion of these matters in the ISQC. The Task Force drafted an amendment to paragraph 71 in response to the Board's suggestion. However, subsequently, there was strong objection from the Ethics Chair to the proposed amendment on the basis that this would be impinging onto the IFAC Code's domain. The Task Force therefore agreed not to include guidance on cooling-off and rotation of EQC reviewers in the ISQC, but agreed with the Ethics Chair that the Task Force Chair would formally communicate the IAASB's position on the issue to the Ethics Committee so that the issue would be addressed as a matter of priority in the IFAC Code.

6. ENGAGEMENT PARTNER RESPONSIBILITY WITH REGARD TO ETHICAL REQUIREMENTS

Paragraph 8 of the proposed revised ISA required that the "engagement partner should consider whether members of the engagement team have complied with relevant ethical requirements." The Board suggested that the Task Force reconsider this requirement since it was not clear what specifically the partner was expected to consider. The Board also suggested that the Task Force consider relaxing the requirement since it appeared that the engagement partner would be acting in the role of a compliance partner. After lengthy debate, the Task Force concluded that the requirement, as written, was appropriate, since all that could be expected of the partner in relation to ethical requirements was for the partner to give due consideration to the engagement team's compliance with ethical requirements. However, the Task Force agreed to amend paragraph 10 to be responsive to the Board's comments. Accordingly, the guidance now focuses on the need for appropriate inquiry and observation to occur, as necessary, amongst the engagement partner and the rest of the team throughout the audit. In addition, if matters were to come to the partner's attention through the firm's systems or otherwise that indicate non-compliance, the partner, in consultation with the firm, would determine the appropriate action.

7. OTHER NOTABLE CHANGES

In addition to the above, the Board asked the Task Force to consider the following suggestions in relation to the ISQC:

- a) *Consider whether the reference to "suitably qualified external consultant" could be changed to "suitably qualified external professional accountant." This was on the basis that the term "consultant" could be misinterpreted as referring to individuals offering general consultancy advice not related to accounting or auditing. The Task Force agreed but concluded that it would be preferable to change "consultant" to "person" since that individual would not necessarily be a professional accountant in all cases.*
- b) *In relation to paragraph 10(a), reconsider the reference to the "firm's management structure being designed to prevent commercial considerations from taking precedence over the quality of work performed." This was because it was not clear how this could be implemented in practice. The Task Force discussed this at some length and agreed that the intention of this bullet would be more clearly communicated by referring to the "assignment of the firm's management responsibilities" to prevent commercial considerations from overriding the quality of work performed.*
- c) *In relation to paragraph 51, reconsider the wording of the first sentence of the paragraph to make the intention clear that it is not expected that the engagement partner's work would be reviewed by more experienced team members. The Task Force agreed to reword the sentence*

in terms of review responsibilities being determined on the basis that more experienced team members review work performed by less experienced team members.

- d) *In relation to paragraph 83(b), consider making it clear that where systemic or repetitive deficiencies have been identified, the firm would be expected to take prompt corrective action.* The Task Force agreed that this would indeed be appropriate and changed the wording in this paragraph accordingly.

Material Presented

Agenda Item 2-A (Pages 29 – 56)	Marked-up draft: ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”
Agenda Item 2-B (Pages 57 – 70)	Marked-up draft: ISA 220, “Quality Control for Audits of Historical Financial Information”
Agenda Item 2-C (Pages 71 – 94)	Clean revised draft: ISQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”
Agenda Item 2-D (Pages 95 – 106)	Clean revised draft: ISA 220, “Quality Control for Audits of Historical Financial Information”
Agenda Item 2-E (Pages 107 – 110)	Conforming change to ISA 620, “Using the Work of an Expert”
Agenda Item 2-F (Pages 111 – 112)	Conforming changes to the Glossary and IAPS 1012, “Auditing Derivative Financial Instruments”

Action Requested

1. IAASB is asked to review and approve the proposed new ISQC 1 and revised ISA 220 for issue.
2. IAASB is asked to review and approve the proposed conforming changes to ISA 620, the Glossary and IAPS 12.