

Response Due Date August 31, 2003

Quality Control

Proposed ISQC 1 “Quality Control for Audit, Assurance and Related Services Practices” and

Proposed Revised ISA 220 “Quality Control for Audit Engagements”

Issued for Comment
by the International
Federation of
Accountants



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REQUEST FOR COMMENTS

This exposure draft and accompanying explanatory memorandum of the International Auditing and Assurance Standards Board (IAASB) were approved for publication in May 2003. The proposed Standards may be modified in the light of comments received before being issued in final form.

Commentators' Guide

The IAASB welcomes comments on the exposure draft. In responding to the exposure draft, commentators are requested to refer to the relevant paragraphs within the proposed ISQC 1 "Quality Control for Audit, Assurance and Related Services Practices" and the proposed revised ISA 220 "Quality Control for Audit Engagements." The responses should include the reasons for the comments, including specific suggestions for any proposed changes to wording.

Comments should be submitted so as to be received by **August 31, 2003**, preferably by e-mail or on a computer disk, or in writing. All comments will be considered a matter of public record. Comments should be addressed to:

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

E-mail responses should be sent to: EDComments@ifac.org

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EXPLANATORY MEMORANDUM

Introduction

This memorandum provides background to, and explanation of, the proposed International Standard on Quality Control (ISQC) 1 “Quality Control for Audit, Assurance and Related Services Practices” and the proposed revised International Standard on Auditing (ISA) 220 “Quality Control for Audit Engagements” approved for exposure by the International Auditing and Assurance Standards Board (IAASB).

At present, the extant ISA 220 only deals with audits of historical financial statements and covers both the firm (but only in an audit of historical financial statements context) and the individual audit engagement. It addresses major quality control areas, but not in detail, and includes an appendix intended to be illustrative only.

The proposed ISQC 1 deals comprehensively with a firm’s¹ quality control practices in the areas of audit, assurance and related services. It places an obligation on a firm to establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances.

The proposed revised ISA 220 establishes standards and provides guidance on specific quality control procedures for audit engagements, including specific requirements for an engagement quality control reviewer to perform an objective evaluation of the compliance with applicable professional standards and of the appropriateness of the report for listed entities and others where considered appropriate in accordance with criteria to be set out by the firm’s policies.

The IAASB believes the proposed Standards will improve firms’ quality control practices over the provision of audit, assurance and related services. Engagement quality is expected to improve as a result of better quality control policies and procedures throughout a firm’s practice. However, the implementation of both ISQC 1 and revised ISA 220 may result in increased work effort by firms and engagement teams. Firms and professional bodies will need to consider the training requirements that may result from the proposed Standards.

The IAASB believes that issuing the proposed Standards simultaneously is necessary to clarify the overall quality control responsibilities and related activities, at both firm and engagement levels, and the manner in which the proposed Standards interrelate.

Both documents are intended to be read in conjunction with Parts A and B of the IFAC Code of Ethics for Professional Accountants (the IFAC Code).

Background to the Project

The IAASB decided to undertake a project to review its standards and guidance on quality control in response to increasing public demands in strengthening the quality of audits and firms’ quality control practices over the provision of audit, assurance and related services. The project was also undertaken in response to a number of initiatives by national standard setters to strengthen and improve standards and guidance relating to quality control. The IAASB believes that, in undertaking this project, it is moving towards its overall objective of improving engagement quality in the public interest.

¹ A firm is defined in the proposed Standards as a sole practitioner, partnership or corporation of professional accountants.

The original project plan was to update the extant ISA 220 to address quality control requirements at both the firm and engagement levels, with the scope restricted to audits of financial statements. However, a revised project plan was subsequently formulated to produce two separate quality control Standards, namely ISQC 1 at firm level and revised ISA 220 at engagement level. The rationale for that decision was to clearly segregate both levels of responsibility, i.e. firm and engagement, and that deficiencies in a firm's system of quality control do not, in and of themselves, indicate that a particular engagement was not performed in accordance with applicable professional standards. Conversely, deficiencies in individual engagements do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with applicable professional standards.

The proposed ISQC 1 represents the first of a new series of International Quality Control Standards. The ultimate goal of the project is to establish quality control standards for all engagements falling within the scope of IAASB engagement standards.

Significant Changes

Firms are required to comply with ISQC 1 whereas revised ISA 220 only applies to audit engagements. Significant changes introduced by each proposed Standard are set out below.

PROPOSED REVISED ISQC 1

Establishment of a System of Quality Control

The firm is required to establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances. The system of quality control is required to include documented policies and procedures addressing:

- Leadership and responsibilities within the firm;
- Ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance;
- Engagement quality control review; and
- Monitoring.

Firm Leadership and Responsibilities

There are new proposed basic principles and essential procedures regarding leadership and responsibilities within the firm to promote an internal culture that recognizes that quality is essential in performing engagements. There is a requirement that the firm's policies and procedures acknowledge that the chief executive officer (or equivalent) of the firm has ultimate responsibility for the firm's system of quality control. If the chief executive officer assigns operational responsibility for the system to one or more individuals, there is a requirement that the chief executive officer appoints a person or persons with sufficient and appropriate experience and ability and the necessary authority to assume that operational responsibility.

Ethics

The firm is required to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. The IAASB believes that it is appropriate to make explicit reference to the fact that the Standard is intended to be read in conjunction with the Code and to embed compliance with ethical requirements in the requirements for a firm's system of quality control. In this way, ethical requirements are given due weight and recognition. With regard to independence specifically, the firm is required to establish policies and procedures to provide it with reasonable assurance that the firm and its personnel maintain independence in circumstances where required by the IFAC Code and national pronouncements, whichever is more restrictive. It is also required to establish policies and procedures designed to provide it with reasonable assurance that it is notified of matters that may pose a threat to independence so that appropriate action can be taken to resolve such situations. The firm is also required to obtain, at least annually, confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the IFAC Code and national requirements.

Rotation of Engagement Partner

The firm is required to establish policies and procedures that require the rotation of the engagement partner after a specified period of time for all audits of financial statements of listed entities, in compliance with the IFAC Code and national pronouncements where these are more restrictive.

However, the IAASB believes that it is appropriate to also require firms to establish policies and procedures regarding engagement partner rotation for engagements other than financial statement audits of listed entities. Firms are required to set out criteria against which all financial statement audits of non-listed entities as well as assurance and related services engagements should be evaluated for the purpose of determining whether the engagement partner should be rotated. This is a significant change that introduces the possibility of rotation more widely than is currently required by the IFAC Code of Ethics.

The IAASB believes that consideration of engagement partner rotation is an important component of that part of a firm's system of quality control addressing independence issues. The IAASB recognizes that a requirement to formulate, and then comply with, policies and procedures setting out criteria for determining whether engagement partners should be rotated may be onerous for some firms. However, it believes that such a requirement is ultimately both appropriate and desirable in the public interest.

Acceptance and Continuance of Client Relationships and Specific Engagements

There are new proposed basic principles and essential procedures regarding acceptance and continuance of client relationships and specific engagements. Although firms may have had such quality controls in place for audit engagements, the proposed basic principles and essential procedures are new for other assurance and related services engagements.

Human Resources

The firm is required to establish policies and procedures to provide it with reasonable assurance that it has sufficient personnel with the competencies and commitment to ethical principles necessary to perform its engagements in accordance with professional standards. It is also required that the firm assigns an engagement partner and appropriate staff with the necessary competencies to undertake each engagement.

Engagement Performance

Specific principles and essential procedures are defined in this area in relation to the performance of engagements in accordance with professional standards and applicable regulatory and legal requirements, including requirements for policies and procedures related to consultation and differences of opinions. Particular attention is given to documentation and implementation of the decisions in these cases.

Engagement Quality Control Review

Such reviews are required for all financial statement audits of listed entities. Firms are required to set out criteria against which other audit, assurance and related services engagements should be evaluated to determine whether they should be subject to engagement quality control reviews. Criteria for making this determination include number and range of stakeholders, public interest element and special circumstances. An engagement quality control review includes an objective evaluation of the significant judgments made by the engagement team, conclusions reached in formulating the report and other matters that have come to the attention of the reviewer. The review involves discussion with the engagement partner, a review of the financial statements or other subject matter and the report, and, in particular, determining whether the report is appropriate. The actual extent and depth of review depend on the complexity and risk of the engagement as well as the experience of the engagement team.

These proposed basic principles and essential procedures may lead to more engagements undertaken by the firm being subject to the engagement quality control review process. There may also be personnel implications, for example, consideration of who is eligible to perform the engagement quality control review.

Monitoring

There are expanded basic principles and essential procedures relating to monitoring. Firms are required to establish policies and procedures to provide them with reasonable assurance that their quality control policies and procedures are relevant, adequate and complied with in practice. The monitoring process includes both ongoing consideration and evaluation of the elements of the system of quality control, and the periodic inspection of a selection of completed engagements, with the inspection cycle ordinarily spanning no more than three years. Further, firms are required to establish policies and procedures to provide them with reasonable assurance that they deal appropriately with formal complaints and allegations about whether the work performed in the areas of audit, assurance and related services fails to comply with applicable professional standards.

Documentation

Firms are required to establish policies and procedures to ensure that there is appropriate documentation to provide evidence of the operation of each element of their quality control systems.

PROPOSED REVISED ISA 220

Leadership and Responsibilities

The engagement partner is required to be responsible, on behalf of the firm, for the quality control of the audit engagement to which that partner is assigned, as well as for the promotion of a quality-oriented internal culture that is conducive to and promotes quality work on the engagement.

Ethics

The engagement partner is required to obtain an understanding of whether there are potential threats to compliance with relevant ethical requirements on the audit engagement to which that partner is assigned, as well as whether appropriate safeguards are in place to eliminate such threats or reduce them to an acceptable level. As for ISQC 1, revised ISA 220 explicitly embeds reference to the relevant ethical requirements set out in the IFAC Code. The IAASB believes that doing so ensures that relevant ethical requirements are appropriately recognised and addressed.

There are also expanded requirements with regards to independence on audit engagements, especially in relation to the engagement partner being responsible for evaluating threats to independence, addressing identified breaches in firm policies and procedures relating to independence that affect the audit engagements to which that partner is assigned, and documenting conclusions regarding independence.

Engagement Performance

The engagement partner is responsible for the direction and performance of the audit engagement in accordance with the professional standards and applicable regulatory and legal requirements. The engagement partner is also required to review working papers, before the auditor's report is issued, in order to be satisfied that they demonstrate that sufficient appropriate audit evidence has been obtained to support the conclusions reached. There is also a requirement for the engagement partner to encourage and facilitate appropriate consultation on difficult or contentious matters both within the engagement team and between the engagement team and others within or outside the firm.

Engagement Quality Control Review

There is a requirement for the engagement partner to ensure that there is an appropriate engagement quality control review process in place and an engagement quality control reviewer appointed for the audit of a listed client or other engagement meeting the firm's criteria for engagement quality control review, for which that engagement partner is responsible.

Monitoring

The engagement partner and engagement team members are required to communicate with the responsible parties within the firm regarding any formal complaints or allegations about whether the work performed on the engagement to which they are assigned fails to comply with applicable professional standards.

PROPOSED INTERNATIONAL STANDARD ON QUALITY CONTROL 1
QUALITY CONTROL FOR AUDIT, ASSURANCE
AND RELATED SERVICES PRACTICES
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This International Standard on Quality Control (ISQC) applies to a firm's system of quality control for its practices in the areas of audit, assurance and related services.

This ISQC contains basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.

To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the ISQC including explanatory and other material contained in the ISQC, not just that text which is black lettered.

In exceptional circumstances, it may be judged necessary to depart from this ISQC in order to more effectively achieve the objective of a system of quality control for a firm's practices in the areas of audit, assurance and related services. When such a situation arises, the firm should be prepared to justify the departure.

The Public Sector Perspective (PSP) issued by the Public Sector Committee of the International Federation of Accountants is set out at the end of an ISQC. Where no PSP is added, the ISQC is applicable in all material respects to the public sector.

Introduction

1. The purpose of this International Standard on Quality Control (ISQC) is to establish standards and provide guidance on a firm’s system of quality control for its practices in the areas of audit, assurance and related services. This ISQC is to be read in conjunction with Parts A and B of the IFAC *Code of Ethics for Professional Accountants* (the IFAC Code). Additional standards and guidance on quality control procedures for specific types of engagement are set out in other pronouncements of the International Auditing and Assurance Standards Board (IAASB). ISA 220 “Quality Control for Audit Engagements,” for example, establishes standards and provides guidance on quality control procedures for audit engagements.
2. **The firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances.**
3. A system of quality control is a process that consists of policies and procedures, including monitoring, designed to achieve the objectives set out in paragraph 2 above.
4. This ISQC applies to all firms; however, individual firms are free to develop differing policies and procedures suited to their particular circumstances provided they meet the requirements of this ISQC. The nature, timing and extent of those policies and procedures will depend on many factors, including the size and operating characteristics of the firm.

Definitions

5. In this ISQC, the following terms have the meanings attributed below:
 - (a) “Engagement partner” – the partner or other person with sufficient and appropriate experience and authority in the firm who has responsibility for the engagement and its performance, for issuing the report on the subject matter on behalf of the firm, and who is permitted by law, regulation or a professional body to act in the role in the relevant jurisdiction;
 - (b) “Engagement team” – the individuals involved in performing an engagement, including any experts employed or engaged by the firm in connection with that engagement;
 - (c) “Firm” – a sole practitioner, partnership or corporation of professional accountants;
 - (d) “Listed entity” – an entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body;
 - (e) “Network firm” – an entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally;
 - (f) “Partner” – any individual with authority, whether through office or otherwise, to bind the firm;
 - (g) “Personnel” – partners and staff;
 - (h) “Professional standards” – IAASB engagement standards and relevant ethical

requirements, which ordinarily comprise Parts A and B of the IFAC Code of Ethics for Professional Accountants and national ethical requirements;

- (i) “Staff” – individuals, other than the engagement partner, involved in performing engagements, including any experts employed or engaged by the firm in connection with that engagement;
- (j) “Suitably qualified external consultant” – an individual who possesses the competencies to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audit, assurance or related services engagements, or of an organization that provides relevant review services.

Elements of a System of Quality Control

6. **The firm’s system of quality control should include policies and procedures, appropriately documented and communicated, addressing each of the following elements:**
 - (a) **Leadership and responsibilities within the firm.**
 - (b) **Ethical requirements.**
 - (c) **Acceptance and continuance of client relationships and specific engagements.**
 - (d) **Human resources.**
 - (e) **Engagement performance.**
 - (f) **Engagement quality control review.**
 - (g) **Monitoring.**

Leadership and Responsibilities within the Firm

7. **The firm should:**
 - (a) **Promote an internal culture that recognizes that quality is essential in performing engagements;**
 - (b) **Develop, document and implement quality control policies and procedures;**
 - (c) **Communicate those quality control policies and procedures to all engagement teams and others within the firm who need to be aware of them; and**
 - (d) **Give positive recognition to compliance with its quality control policies and procedures, and set out an appropriate disciplinary framework for non-compliance with those policies and procedures.**
8. The internal culture of a firm is influenced by the “tone at the top” of that firm. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent messages and actions, from all levels of the firm’s management emphasizing the firm’s quality control policies and procedures, and the importance of:
 - (a) Performing work that complies with professional standards and applicable regulatory and legal requirements; and
 - (b) Issuing reports that are appropriate in the circumstances.

Such messages and actions encourage a culture that recognizes and rewards high quality work and compliance with the firm's quality control policies and procedures. They may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters or briefing memoranda. They are incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures. They are designed to:

- (a) Support and reinforce the firm's view on the importance of quality and how it is to be achieved; and
 - (b) Provide practical suggestions on how to achieve quality.
9. The development and documentation of quality control policies and procedures assist the firm by establishing a framework for meeting professional standards and applicable regulatory and legal requirements, and for issuing reports that are appropriate in the circumstances. Such a framework includes appropriate communications between the firm and engagement personnel.
 10. To assist in effective implementation, the firm communicates quality control policies and procedures to all personnel and others within the firm who need to be aware of them. Such communication includes a description of the quality control policies and procedures and the objectives they are designed to achieve.
 11. Positive recognition for compliance with the firm's quality control policies and procedures is achieved through methods that include:
 - Partner and staff appraisals; and
 - Promotion and remuneration policies.

An appropriate disciplinary framework for non-compliance with the firm's quality control policies and procedures sets out clear penalties for instances of non-compliance together with guidance on how and in what circumstances such penalties will be applied.

12. **The firm's policies and procedures should acknowledge that the chief executive officer (or equivalent) of the firm has ultimate responsibility for the firm's system of quality control. However, if the chief executive officer assigns operational responsibility for the system to one or more individuals, the chief executive officer should appoint a person or persons with sufficient and appropriate experience and ability and the necessary authority to assume that operational responsibility.**
13. Sufficient and appropriate experience and ability enable the person or persons responsible for the system of quality control to identify and understand quality control issues and develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

Ethical Requirements

14. **The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.**
15. Relevant ethical requirements relating to audit, assurance and related services engagements ordinarily comprise Parts A and B of the IFAC Code together with applicable national requirements where these are more restrictive. The IFAC Code establishes the fundamental principles of professional ethics which are:
 - (a) Integrity;

- (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) Confidentiality;
 - (e) Professional behavior; and
 - (f) Technical standards.
16. The IFAC Code identifies the main categories of threat to the fundamental principles and general and specific safeguards against those threats. Part B of the IFAC Code includes a conceptual approach to independence for assurance engagements that takes into account threats to independence, accepted safeguards and the public interest.
17. The firm's policies and procedures emphasize the fundamental principles, which are reinforced by, in particular, the leadership of the firm, education and training, monitoring and disciplinary processes. The significance of independence for assurance engagements is such that it is addressed separately in paragraphs 18 – 27 below.

Independence

18. **The firm should establish policies and procedures to provide it with reasonable assurance that the firm and its personnel maintain independence in circumstances where required by the IFAC Code and national pronouncements. Such policies and procedures should be designed to:**
- (a) **Enable the firm to identify and evaluate circumstances that may create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by the application of safeguards; and**
 - (b) **Provide reasonable assurance of compliance with the independence requirements specified in the IFAC Code and national pronouncements.**
19. **Such policies and procedures should include requirements for:**
- (a) **Engagement teams to provide the firm with relevant information about client engagements, including the scope of services provided to that client, to enable it to evaluate the impact, if any, on independence requirements;**
 - (b) **Personnel to notify the firm in a timely manner of matters that may pose a threat to independence, where applicable, so that appropriate action can be taken; and**
 - (c) **The accumulation and communication of relevant information to appropriate personnel in order to enable:**
 - (i) **The firm and its personnel to determine whether they satisfy relevant independence requirements;**
 - (ii) **The firm to keep up to date records relating to independence; and**
 - (iii) **The firm to take appropriate action regarding identified threats to independence on specific engagements.**
20. **The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements and appropriate actions are taken to resolve such situations. The policies and procedures should require:**

- (a) **Personnel to notify the firm in a timely manner of independence breaches of which they become aware;**
 - (b) **Prompt communication by the firm to the relevant engagement partner of identified breaches of the firm’s policies and procedures, where such breaches represent a threat to independence on engagements for which that engagement partner is responsible and that need to be addressed by the engagement partner; and**
 - (c) **Prompt communication by the engagement partner to the firm regarding the action taken to resolve the matter.**
21. Comprehensive guidance on threats to independence and safeguards, including application to specific situations, is set out in Section 8 of the IFAC Code. The policies and procedures required by paragraphs 18 – 20 above address the independence requirements of the IFAC Code and national requirements, including the following:
- The identification of threats to the independence of the firm and its personnel, including those arising from:
 - The provision of services by the firm;
 - Personal and business financial interests; and
 - Personal and business relationships.
 - The identification of relationships that exist between the firm and its network firms and client entities and their related entities that may reasonably be thought to bear on the firm’s independence and the objectivity of engagement teams, and the communication of such relationships to relevant engagement partners.
 - Action to be taken if threats to independence or breaches of the policies and procedures are identified.
 - Potential safeguards necessary to maintain independence, for example, the recording of relevant information about client relationships and engagements that require the firm or its personnel to be independent or that may impact on other engagements that require independence, in such a way that it is easily accessible to relevant personnel.
 - The identification and fulfillment of requirements for additional education on independence.
22. Notification to the firm of breaches of independence policies and procedures enables prompt communication, where appropriate, of relevant information to engagement partners and others in the firm who need to take appropriate action. The firm and the relevant engagement partner are then able to take the necessary actions. Such actions may include the following:
- Application of appropriate safeguards to eliminate the threats to independence or reduce them to an acceptable level.
 - Disciplinary action where the firm’s policies and procedures have been knowingly breached.
 - Education or other corrective action to guard against future breaches.
 - Withdrawal from the engagement.

23. **The firm should obtain, at least annually, confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the IFAC Code and national pronouncements.**
24. Confirmation may be in written or electronic form. By obtaining such confirmation, the firm demonstrates the importance that it attaches to independence and makes the issue current and visible for its personnel.
25. **The firm should establish policies and procedures:**
 - (a) **Requiring the rotation of the engagement partner after a specified period of time for all audits of financial statements of listed entities, in compliance with the IFAC Code and national pronouncements where these are more restrictive;**
 - (b) **Setting out criteria against which all other audit, assurance and related services engagements should be evaluated for the purpose of determining whether the engagement partner should be rotated after a specified period; and**
 - (c) **Requiring the rotation of the engagement partner for all engagements meeting the criteria established in compliance with (b) above.**
26. Using the same engagement partner on an audit engagement over a prolonged period may create a threat to independence or otherwise impair the quality of performance of the engagement. The IFAC Code recognizes that the threat to independence is particularly relevant in the context of financial statement audits of listed entities. Consequently, for such engagements, the IFAC Code requires the rotation of the engagement partner after a pre-defined period, normally no more than seven years, and provides standards and guidance on this matter. Other national requirements may establish shorter rotation periods.
27. Using the same engagement partner on engagements other than audits of financial statements of listed entities may also create a threat to independence or otherwise impair the quality of performance of the engagement. The firm considers whether it is appropriate to rotate the engagement partner for those engagements after a pre-defined period. Criteria that the firm considers when determining which engagements other than audits of financial statements of listed entities are to be subject to rotation of the engagement partner include the following:
 - The number and range of stakeholders who may use the subject matter of the report to make decisions.
 - The extent to which the subject matter and the report are of interest to the public, or may affect the public's confidence in public institutions or public administration.
 - The identification of specific circumstances or risks in an engagement.

Acceptance and Continuance of Client Relationships and Specific Engagements

28. **The firm should establish policies and procedures for acceptance and continuance of client relationships and specific engagements, designed to provide it with reasonable assurance that it undertakes or continues only those relationships and engagements where it:**
 - (a) **Has considered the integrity of the client and does not believe that the client lacks integrity;**
 - (b) **Is competent to perform the engagement and has the resources to do so; and**

- (c) **Can comply with ethical requirements, including those relating to independence where applicable.**

Such policies and procedures should be applied before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client.

29. With regard to the integrity of a client, the firm considers:
- (a) The identity and business reputation of the client's principal owners, key management and those charged with its governance;
 - (b) The nature of the client's operations, including its business practices;
 - (c) The client's attitude towards such matters as aggressive interpretation of accounting standards and the internal control environment; and
 - (d) Further information if necessary.

Information on these matters is obtained through, for example:

- Discussions with third parties, including existing or previous providers of professional accountancy services to the client.
 - Obtaining references from third parties such as bankers, legal counsel and industry peers.
 - Background searches of relevant databases.
30. Consideration of whether the firm has the competencies and resources to undertake a new engagement includes reviewing the specific requirements of the engagement and existing partner and staff profiles at all relevant levels, for example:
- Knowledge of relevant industries or subject matters.
 - Experience with relevant regulatory or reporting requirements, or the ability to gain the necessary skills and knowledge in an effective manner.
 - Sufficient staff with the necessary competencies.
 - Where necessary, the availability of experts.
 - Where applicable, the availability of individuals able to perform engagement quality control review.
 - Ability to complete the engagement within the reporting deadline.
31. The firm also considers whether accepting an engagement may give rise to an actual or perceived conflict of interest with existing clients. Where a potential conflict is identified, the firm considers whether it is appropriate to accept the appointment.
32. The decision on whether to continue a client relationship includes consideration of significant matters that have arisen during the current or previous engagements and their implications for the continuance of that relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary competencies.
33. Where the firm has obtained information that would have caused it to decline an appointment to an engagement had that information been obtained earlier, policies and procedures on the continuance of the engagement include consideration of:

- (a) The professional and legal responsibilities applicable in the circumstances, including whether there is a requirement to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
 - (b) The possibility of withdrawing from the engagement.
34. Policies and procedures on withdrawal from an engagement address issues that may include the following:
- Discussion with the appropriate level of the client’s management and those charged with its governance regarding the withdrawal from the engagement and the reasons for the withdrawal.
 - Consideration of whether there is a professional or legal requirement to report the withdrawal from the engagement and the reasons for the withdrawal to regulatory authorities.
 - Consideration of whether it may be in the interests of the person or persons who made the appointment or the intended users of the report for the firm to remain in place and consideration of the impact of the information on the procedures performed by the engagement team and the report, or other communication necessary in the circumstances.
 - Documentation of significant issues, consultations and the basis for the conclusions reached.

Human Resources

35. **The firm should establish policies and procedures to provide it with reasonable assurance that it has sufficient personnel with the competencies and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and applicable regulatory and legal requirements, and to enable the issuance of reports by the firm or engagement partners that are appropriate in the circumstances.**
36. Such policies and procedures address recruitment, performance evaluation, career development, promotion, compensation and the estimation of personnel needs in order to ascertain the number and characteristics of the individuals required for the firm’s engagements. The firm’s recruitment processes include procedures to help determine whether recruits are individuals of integrity who have the capacity to develop the competencies necessary to perform the firm’s work.
37. Competencies are developed through methods that may include the following:
- Professional education.
 - Continuing professional development.
 - Work experience.
 - Coaching by more experienced staff, for example, other members of the engagement team.
38. The firm’s performance evaluation, compensation and promotion procedures give due recognition and reward to the attainment of appropriate competencies and commitment to ethical principles. Partners and staff:
- (a) Are made aware of the firm’s expectations regarding performance;

- (b) Are provided with evaluation of, and counseling on, performance, progress and career development; and
 - (c) Understand that career advancement to positions of greater responsibility depends upon performance quality and that failure to adhere to the firm's policies and procedures may result in disciplinary action.
39. The firm assists in the development and maintenance of technical competencies by providing access to relevant information and support services. Firms may use a suitably qualified person or group outside the firm to provide the necessary technical resources.

Assignment of Engagement Teams

40. **The firm should assign an engagement partner to each engagement to take responsibility for that engagement on behalf of the firm. The firm should establish policies and procedures requiring that:**
- (a) **The identity and role of the engagement partner are communicated to key members of client management and those responsible for governance; and**
 - (b) **The engagement partner has both the necessary competencies and sufficient time to perform the role.**
41. **The firm should also assign appropriate staff with the necessary competencies to perform engagements in accordance with professional standards and applicable regulatory and legal requirements, and to enable the issuance of reports by the firm or engagement partners that are appropriate in the circumstances.**
42. The firm establishes procedures to assess the knowledge, skills and abilities of professional staff. The competencies considered when assigning engagement teams include the following:
- Understanding and practical experience of similar engagements through appropriate training and participation.
 - Understanding of professional standards and applicable regulatory and legal requirements.
 - Appropriate technical knowledge, including relevant information technology knowledge.
 - Knowledge of specific industries.
 - Ability to apply professional judgment.
 - Understanding of the firm's quality control policies and procedures.

Engagement Performance

43. **The firm should establish policies and procedures to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable regulatory and legal requirements, and that the reports that are issued by the firm or engagement partners are appropriate in the circumstances.**
44. Such policies and procedures address matters on which the firm seeks to establish consistency in the quality of engagement performance by its personnel. Often, this is accomplished by establishing written or electronic manuals, software tools or other forms of standardized documentation, and industry or specific subject matter guidance materials. Matters addressed include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
 - Processes for ensuring that applicable engagement standards are followed.
 - Processes of engagement supervision, staff training and coaching.
 - Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
 - Appropriate documentation of the timing and extent of the review.
 - Processes to keep all policies and procedures current.
45. It is important that all members of the engagement team understand the objectives of the work they are to perform. Appropriate team-working and training assist less experienced members of the engagement team in clearly understanding the objectives of the work they are assigned.
46. Supervision includes the following:
- Tracking the progress of the engagement.
 - Considering the competencies of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement.
 - Addressing significant issues arising during the engagement, considering their significance and modifying the planned approach as appropriate.
 - Identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
47. Work performed by members of the engagement team is reviewed by more experienced engagement team members or the engagement partner. Reviewers consider whether:
- (a) The work has been performed in accordance with professional standards and applicable regulatory and legal requirements and, where applicable, in accordance with the work program;
 - (b) Significant matters have been raised for further consideration;
 - (c) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
 - (d) The work performed supports the conclusions reached and is appropriately documented; and
 - (e) The objectives of the engagement procedures have been achieved.

Consultation

48. **The firm should establish policies and procedures to provide it with reasonable assurance that:**
- (a) **Appropriate consultation takes place on difficult or contentious matters;**
 - (b) **Sufficient resources are available to enable appropriate consultation to take place;**

(c) **Conclusions resulting from such consultations are documented; and**

(d) **Conclusions resulting from consultations are implemented.**

49. Consultation is discussion, at the appropriate professional level, with individuals within the firm or outside of it who have specialized expertise, in order to resolve a difficult or contentious matter.
50. Consultation uses the collective experience and technical expertise of the firm and reduces the risk of error. It also improves the application of professional judgment. The firm seeks to establish a culture in which consultation is recognized as a strength and encourages partners and staff to consult when they are considering a difficult or contentious matter.
51. Effective consultation requires that those consulted be given all the relevant facts that will enable them to provide informed advice, whether on technical, ethical or other matters. Consultation procedures are designed so that individuals with appropriate knowledge, seniority and experience within the firm (or, where applicable, outside the firm) are consulted on significant technical, ethical and other matters, and that the conclusions resulting from consultations are properly implemented and documented.
52. A firm needing to consult externally, for example, a small firm without appropriate internal resources, may take advantage of advisory services provided by other firms, professional and regulatory bodies, and commercial organizations that provide relevant services. In such circumstances, appropriate arrangements are made to safeguard client confidentiality.
53. The documentation of significant consultations is agreed by both the individual seeking consultation and the individual that was consulted, and is sufficiently complete and detailed to enable an understanding of:
 - (a) The issue on which consultation was sought; and
 - (b) The results of the consultation, including any decisions taken, the basis for those decisions and the manner in which they were implemented.

Differences of Opinion

54. **The firm should establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted and between the engagement partner and, where applicable, the engagement quality control reviewer. Conclusions reached should be documented and implemented.**
55. Such procedures encourage identification of issues at an early stage and provide guidelines as to the successive steps to be taken thereafter.
56. When a firm uses an external consultant to conduct an engagement quality control review, it recognizes that differences of opinion can occur and establishes procedures to resolve such differences, for example, by consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Quality Control Review

57. **The firm should establish policies and procedures that:**
 - (a) **Require the performance of an engagement quality control review for all audits of financial statements of listed entities;**

- (b) **Set out criteria against which all other audit, assurance and related services engagements should be evaluated for the purpose of determining whether an engagement quality control review should be performed in each instance;**
 - (c) **Require the performance of an engagement quality control review for all engagements meeting the criteria established in compliance with (b) above; and**
 - (d) **Require the completion of the engagement quality control review (including resolution to the satisfaction of the engagement quality control reviewer of issues raised, and after following, if necessary, the procedures for resolving differences of opinion) before the issuance of the report.**
58. The firm considers whether engagements other than audits of financial statements of listed entities require an engagement quality control review. Criteria that a firm considers when determining which engagements other than audits of financial statements of listed entities are to be subject to an engagement quality control review include the following:
- The number and range of stakeholders who may use the subject matter of the report to make decisions.
 - The extent to which the subject matter and the report are of interest to the public, or may affect the public’s confidence in public institutions or public administration.
 - The identification of specific circumstances or risks in an engagement.
59. The firm sets out in its policies and procedures:
- (a) The nature and extent of an engagement quality control review;
 - (b) Criteria for the eligibility of engagement quality control reviewers; and
 - (c) Documentation requirements for an engagement quality control review.

Nature and Extent of the Engagement Quality Control Review

60. **An engagement quality control review should include an objective evaluation of:**
- **The significant judgments made by the engagement team;**
 - **The conclusions reached in formulating the report; and**
 - **Other significant matters that have come to the attention of the engagement quality control reviewer.**
61. The engagement quality control reviewer’s work is designed to provide a basis to conclude whether any matters have come to the reviewer’s attention that would cause the reviewer to believe that the engagement was not performed in accordance with professional standards and applicable regulatory and legal requirements or that the report was not appropriate in the circumstances.
62. An engagement quality control review involves discussion with the engagement partner, a review of the financial statements or other subject matter and the report, and, in particular, consideration of whether the report is appropriate. It also involves, to the extent considered necessary by the engagement quality control reviewer, a review of selected working papers. The extent of the engagement quality control review depends on the complexity of the engagement, the risks associated with the engagement and the experience of the engagement team. It does not

reduce the responsibilities of the engagement partner. The scope of an engagement quality control review includes consideration of the following:

- The engagement team’s evaluation of the firm’s independence in relation to the specific engagement.
 - The significant risks identified and the responses to those risks.
 - The judgments made, particularly relating to significant risks.
 - Whether appropriate consultation has taken place on difficult or contentious matters and the conclusions arising from those consultations.
 - The significance and disposition of misstatements.
 - Whether appropriate matters have been considered for reporting to management and those charged with governance.
 - Whether the documentation reviewed reflects the work performed and supports the conclusions drawn as a result of that work.
63. The engagement quality control reviewer conducts the review in a timely manner throughout the engagement to allow for significant matters identified during the review process to be resolved to the reviewer’s satisfaction before the issuance of the report.
64. Where the engagement quality control reviewer makes recommendations that the engagement team does not accept and the matter is not resolved to the reviewer’s satisfaction, then the report is not issued until the matter is resolved by following the firm’s procedures for dealing with differences of opinion.

Criteria for the Eligibility of Engagement Quality Control Reviewers

65. An engagement quality control reviewer is a partner, other person in the firm, or suitably qualified external consultant with sufficient and appropriate experience and authority to perform an engagement quality control review.
66. **The firm’s policies and procedures on the eligibility of engagement quality control reviewers should address:**
- (a) **The technical qualifications required to perform the role; and**
 - (b) **The degree to which the engagement quality control reviewer can be involved with the engagement without compromising the role.**
67. The firm’s policies and procedures on the technical qualifications of engagement quality control reviewers address the technical expertise and experience necessary to perform the role. The determination of what constitutes sufficient and appropriate technical expertise and experience depends on the circumstances of the engagement. Where an engagement quality control review is performed for a financial statements audit of a listed entity, the engagement quality control reviewer is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.
68. Where sole practitioners and small firms identify engagements requiring engagement quality control review, a suitably qualified and experienced external consultant may be engaged to conduct that review. Alternatively, some sole practitioners and small firms may wish to establish arrangements with other firms to facilitate engagement quality control reviews. When using an

external consultant, or the services of an engagement quality control reviewer obtained from another firm, appropriate arrangements are made to safeguard client confidentiality. Such arrangements are set out in writing.

69. The firm's policies and procedures are designed to maintain the objectivity of the engagement quality control reviewer and the reviewer's independence from the engagement team. For example, the engagement quality control reviewer:
- (a) Is selected by a partner or other person with sufficient and appropriate experience and authority in the firm other than the engagement partner;
 - (b) Does not otherwise participate in the performance of the engagement;
 - (c) Does not make decisions on behalf of the engagement team;
 - (d) Did not participate in the performance of an audit, assurance or related services engagement involving the same client and with respect to the same subject matter for the preceding period or, in the case of an audit of financial statements of a listed entity, for a period of twenty four months before the start of the period covered by the current engagement; or
 - (e) Does not act as engagement partner in the performance of an audit, assurance or related services engagement involving the same client and with respect to the same subject matter for the period immediately following acting as engagement quality control reviewer, or in the case of an audit of financial statements of a listed entity, for a period of twenty four months following acting as engagement quality control reviewer.
70. The engagement quality control reviewer may be consulted by the engagement partner during the course of the engagement. Such consultation need not compromise the engagement quality control reviewer's eligibility to perform the role. Where the volume and nature of the consultation becomes significant, care is taken to maintain the reviewer's objectivity and independence from the engagement team. Where this is not possible, a replacement reviewer is appointed.
71. The firm's policies provide for the replacement of the engagement quality control reviewer where the ability to perform an objective review may be impaired, for example, where the engagement quality control reviewer has undertaken the engagement quality control review of a client for several years.

Documentation of the Engagement Quality Control Review

72. **Policies and procedures on documentation of the engagement quality control review should include evidencing:**
- (a) **The procedures required by the firm's policies on engagement quality control review have been performed;**
 - (b) **The completion of the engagement quality control review before the issuance of the report; and**
 - (c) **That there are no unresolved matters that have come to the attention of the engagement quality control reviewer that would cause the engagement quality control reviewer to believe that the engagement was not performed in accordance with professional standards and applicable regulatory and legal requirements.**

Monitoring

73. **The firm should establish policies and procedures to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and complied with in practice.**
74. The firm entrusts responsibility for monitoring to a partner or other person with sufficient and appropriate experience and authority in the firm to assume that responsibility. Monitoring of the firm's system of quality control is performed by competent individuals and includes both an ongoing consideration and evaluation of the elements of the system of quality control as set out in paragraph 6 above, and the periodic inspection of a selection of completed engagements.
75. Ongoing consideration and evaluation of the system of quality control includes the following:
- Analysis of:
 - New developments in professional standards and applicable regulatory and legal requirements, and the manner in which they are reflected in the firm's policies and procedures where appropriate;
 - Results of independence confirmations;
 - Continuing professional development and other training or education undertaken by personnel; and
 - Decisions related to acceptance and continuance of client relationships and specific engagements.
 - Determination of corrective actions to be taken and improvements to be made in the system.
 - Communication to appropriate firm personnel of weaknesses identified in the system or in the level of understanding or compliance therewith.
 - Follow-up by appropriate firm personnel such that necessary modifications are made to the quality control policies and procedures on a timely basis.
76. The inspection of selected individual engagements is performed on a cyclical basis. An inspection cycle ordinarily spans no more than three years. The selection of engagements for inspection includes at least one engagement for each engagement partner at least once in every inspection cycle. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, including the following:
- The size of the firm.
 - The number and geographical location of offices.
 - The results of previous monitoring procedures.
 - The degree of authority afforded to both personnel and offices.
 - The nature and complexity of the firm's practice and organization.
 - The risks associated with the firm's clients.
77. The inspection of individual engagements includes the selection of engagements, some of which are selected without prior notification to the engagement team. Individual engagements are inspected by individuals who were not involved in performing either the engagement or, where

applicable, the engagement quality control review. In determining the scope of the inspections, the firm may, where appropriate, have regard to the scope or conclusions of an external monitoring program.

78. Small firms and sole practitioners may wish to use the services of a suitably qualified external consultant or another firm to carry out engagement inspections and other monitoring procedures. Alternatively, they may wish to establish arrangements to share resources with other appropriate organizations and thereby facilitate monitoring activities.
79. The purpose of monitoring compliance with quality control policies and procedures for completed engagements is to provide an evaluation of:
 - (a) Adherence to professional standards and applicable regulatory and legal requirements;
 - (b) Whether the reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
 - (c) Whether the firm's quality control policies and procedures have been appropriately applied.
80. The firm evaluates the effect of significant deficiencies noted as a result of the monitoring process and determines whether they are either:
 - (a) Instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable regulatory and legal requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or
 - (b) Deficiencies that may indicate that further investigation and corrective action may be appropriate.
81. The firm's evaluation of deficiencies ordinarily will result in recommendations for appropriate courses of action. These actions may include the communication of the findings to those responsible for training and professional development, changes to the quality control policies and procedures, and disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.
82. Where the firm identifies deficiencies relevant to a specific engagement, these are communicated to the engagement partner and other appropriate individuals within the firm, together with appropriate remedial actions.
83. Where deficiencies are identified in that part of the firm's system of quality control comprising policies and procedures regarding independence, the firm communicates these findings to appropriate firm personnel promptly, and takes immediate steps to remedy the situation.
84. Where the results of the monitoring procedures indicate that a report may be inappropriate, the subject matter was inaccurate or procedures were omitted during the performance of the engagement in question, the firm considers what further action is appropriate in compliance with relevant professional standards and applicable regulatory and legal requirements. It also may wish to obtain legal advice.
85. Appropriate documentation relating to monitoring:
 - (a) Sets out monitoring procedures, including the procedure for selecting completed engagements for review;

- (b) Records the results obtained from the evaluation of the other elements of the system of quality control;
 - (c) Provides an evaluation of:
 - (i) Adherence to professional standards and applicable regulatory and legal requirements;
 - (ii) Whether the reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
 - (iii) Whether the firm's quality control policies and procedures have been appropriately applied; and
 - (d) Identifies the deficiencies noted, evaluates their effect, sets out the basis for determining whether further action is necessary and details that action where applicable.
86. The firm communicates information on the results of the monitoring process of its system of quality control on at least an annual basis. The information is communicated to the chief executive officer of the firm (or equivalent), engagement partners and other staff as appropriate. It includes the following:
- A description of the monitoring procedures performed.
 - The conclusions drawn from the monitoring procedures.
 - Where relevant, a description of systemic or repetitive deficiencies and of the actions taken to resolve or amend those deficiencies.
87. Some firms operate as part of a network and may apply some or all of their monitoring procedures on a network basis. Where firms within such networks place reliance on such systems, appropriate communication takes place on the results of the monitoring process on at least an annual basis.

Complaints and Allegations

88. **The firm should establish policies and procedures that provide it with reasonable assurance that it deals appropriately with formal complaints and allegations about whether the work performed by the firm in its practices in the areas of audit, assurance and related services fails to comply with professional standards and applicable regulatory and legal requirements.**
89. Complaints and allegations may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.
90. The firm investigates complaints and allegations in accordance with established policies and procedures under the supervision of a partner not otherwise involved, and takes appropriate action to respond, including involving legal counsel as necessary. Complaints, allegations and the responses to them are documented.

Documentation

91. **The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.**

92. The manner in which such matters are documented is for the firm to determine. Factors to consider when determining the form and content of documentation evidencing the operation of each of the elements of the system of quality control include the following:
- The size of a firm and the number of offices.
 - The degree of authority afforded to both personnel and offices.
 - The nature and complexity of the firm’s practice and organization.
93. Documentation is retained for a period of time sufficient to permit an evaluation of the extent of the firm’s compliance with its system of quality control by those performing monitoring procedures or as required by applicable law or regulation.

Effective Date

94. This ISQC is effective beginning January 1, 2005.

Public Sector Perspective

1. *The general principles contained in ISQC 1 are applicable to the auditors of public sector entities.*
2. *Some of the terms used, such as “engagement partner” and “firm,” should be read as referring to their public sector equivalents. In addition, the term “listed entity” should be read to include all public sector entities.*
3. *In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, considerations regarding the acceptance and continuance of client relationships and specific engagements, as set out in paragraphs 28 – 34 of ISQC 1, may not apply.*
4. *Similarly, the independence of public sector auditors may be protected by statutory measures, with the consequence that certain of the threats to independence of the nature envisaged by paragraphs 18 – 27 of ISQC 1 are unlikely to occur.*

PROPOSED REVISED INTERNATIONAL STANDARD ON AUDITING 220
QUALITY CONTROL FOR AUDIT ENGAGEMENTS
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International Standards on Auditing (ISAs) are to be applied in the audit of financial statements. ISAs are also to be applied, adapted as necessary, to the audit of other information and to related services.

ISAs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.

To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the ISA including explanatory and other material contained in the ISA, not just that text which is black lettered.

In exceptional circumstances, an auditor may judge it necessary to depart from an ISA in order to more effectively achieve the objective of an audit. When such a situation arises, the auditor should be prepared to justify the departure.

ISAs need only be applied to material matters.

The Public Sector Perspective (PSP) issued by the Public Sector Committee of the International Federation of Accountants is set out at the end of an ISA. Where no PSP is added, the ISA is applicable in all material respects to the public sector.

Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on specific quality control procedures for audit engagements. This ISA is to be read in conjunction with Parts A and B of the IFAC *Code of Ethics for Professional Accountants* (the IFAC Code).
2. **The engagement team should implement quality control procedures that are applicable to the individual audit engagement.**
3. Under International Standard on Quality Control (ISQC) 1 “Quality Control for Audit, Assurance and Related Services Practices,” a firm of professional accountants has an obligation to establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the auditor’s reports issued by the firm or engagement partners are appropriate in the circumstances.
4. Engagement teams:
 - (a) Comply with quality control procedures that are applicable to the audit engagement;
 - (b) Provide the firm with relevant information as set out in paragraphs 16 and 22 below; and
 - (c) Rely, where appropriate, on the firm’s systems, for example in relation to the recruiting and formal training of human resources and accumulation of information in order for the firm and its personnel to determine whether relevant independence requirements are satisfied.

Definitions

5. In this ISA, the following terms have the meanings attributed below:
 - (a) “Engagement partner” – the partner or other person with sufficient and appropriate experience and authority in the firm who has responsibility for the audit engagement and its performance, for issuing the auditor’s report on behalf of the firm, and who is permitted by law, regulation or a professional body to act in the role in the relevant jurisdiction;
 - (b) “Engagement team” – the individuals involved in performing an audit engagement, including any experts employed or engaged by the firm in connection with that audit engagement;
 - (c) “Firm” – a sole practitioner, partnership or corporation of professional accountants;
 - (d) “Listed entity” – an entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body;
 - (e) “Network firm” – an entity under common control, ownership or management with the firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as being part of the firm nationally or internationally;
 - (f) “Partner” – any individual with authority, whether through office or otherwise, to bind the

firm;

- (g) “Personnel” – partners and staff;
- (h) “Professional standards” – IAASB engagement standards and relevant ethical requirements, which ordinarily comprise Parts A and B of the IFAC Code of Ethics for Professional Accountants and national ethical requirements;
- (i) “Staff” – individuals, other than the engagement partner, involved in performing an audit engagement, including any experts employed or engaged by the firm in connection with that audit engagement;
- (j) “Suitably qualified external consultant” – an individual who possesses the competencies to act as an engagement partner, for example a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audit engagements or of an organization that provides review services.

Leadership and Responsibilities

- 6. **The engagement partner should be responsible on behalf of the firm for the quality control of, and the promotion of a quality-oriented internal culture on, each audit engagement to which that engagement partner is assigned.**
- 7. The engagement partner sets an example regarding audit quality to the other members of the engagement team throughout all stages of the audit engagement. Ordinarily, this example is provided through messages to the engagement team and through the actions of the engagement partner. Such messages and actions emphasize:
 - (a) The importance of:
 - (i) Performing work which complies with professional standards and applicable regulatory and legal requirements;
 - (ii) Compliance with the firm’s quality control policies and procedures as applicable; and
 - (iii) Issuing auditor’s reports that are appropriate in the circumstances; and
 - (b) The fact that quality is essential in performing audit engagements.

Ethical Requirements

- 8. **The engagement partner should obtain an understanding of whether there are:**
 - (a) **Potential threats to compliance with relevant ethical requirements; and**
 - (b) **Appropriate safeguards in place to eliminate potential threats or reduce them to an acceptable level.**

Such an understanding should be documented. Where unresolved issues are identified, these should be communicated to relevant firm personnel and resolved as appropriate.

- 9. Relevant ethical requirements relating to audit engagements ordinarily comprise Parts A and B of the IFAC Code together with applicable national requirements where these are more restrictive. The IFAC Code establishes the fundamental principles of professional ethics which are:

- (a) Integrity;
 - (b) Objectivity;
 - (c) Professional competence and due care;
 - (d) Confidentiality;
 - (e) Professional behavior; and
 - (f) Technical standards.
10. The IFAC Code identifies the main categories of threat to the fundamental principles and general and specific safeguards against those threats. Part B of the IFAC Code includes a conceptual approach to independence that takes into account threats to independence, accepted safeguards and the public interest.
 11. Consideration of compliance with ethical requirements occurs first during client or engagement acceptance procedures. Inquiry and discussion regarding ethical matters between the engagement partner and other members of the engagement team occur throughout the audit engagement as appropriate.
 12. The engagement partner, together with members of the engagement team as appropriate, document the extent of inquiries and discussions that have taken place, including:
 - Identified potential threats and safeguards adopted;
 - The manner in which any issues arising have been resolved; and
 - A conclusion on compliance with ethical requirements.

Independence

13. **The engagement partner is responsible for concluding on compliance with independence requirements applicable to the audit engagement.**
14. In concluding on compliance with independence requirements applicable to the audit engagement, the engagement partner is entitled to rely on that part of the firm's quality control system comprising policies and procedures regarding independence, unless informed otherwise by the firm, individuals within or outside the firm, or the client.
15. **The engagement partner should:**
 - (a) **Obtain sufficient information regarding the engagement, including the scope of services provided to the client by the firm or, where applicable, other network firms, in order to evaluate whether there are potential threats to independence;**
 - (b) **Evaluate information regarding identified breaches, if any, of its independence policies and procedures that represent a threat to independence for the audit engagement and that need to be addressed;**
 - (c) **Take appropriate action to eliminate such threats or reduce them to an acceptable level by the application of safeguards, or if not possible, to withdraw from the engagement;**

- (d) **Communicate promptly to the firm regarding the action taken to resolve the matter; and**
 - (e) **Document conclusions regarding independence.**
16. **Engagement teams should provide the firm with relevant information to enable the functioning of that part of the firm’s system of quality control relating to independence. Engagement teams should notify the firm in a timely manner of independence breaches of which they become aware.**
 17. If the most recent information circulated as a result of the firm’s monitoring process indicates that deficiencies have been found in either the design or operation of the policies and procedures regarding independence, the engagement partner:
 - (a) Ascertains whether the specific deficiencies noted by the monitoring review relate to the audit engagement in question; and
 - (b) Considers whether the measures adopted by the firm to rectify the situation are sufficient in the context of that audit engagement.
 18. Where, in the judgment of the engagement partner, there is a threat to independence regarding the audit engagement for which it might not be possible to adopt safeguards that eliminate the threat or reduce it to an acceptable level, the engagement partner consults within the firm to determine the appropriate action to be taken, which may include withdrawing from the audit engagement. Such discussion and conclusions are documented.

Acceptance and Continuance of Client Relationships and Specific Audit Engagements

19. **The engagement partner should be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and specific audit engagements have been followed, and should document conclusions reached in this regard.**
20. The engagement partner may or may not have been involved in the acceptance or continuance decision-making process regarding the audit engagement. Regardless of whether the engagement partner was involved in that decision, the engagement partner reviews the procedures performed and concludes as to whether the decision remains appropriate.
21. Acceptance and continuance of client relationships and specific audit engagements include consideration of the following:
 - The competence of the engagement team to undertake the engagement.
 - The independence of both the firm and the engagement team.
 - The integrity of the principal owners, management and those charged with governance of the entity.
 - Communication with the existing or previous auditor.
 - Conflicts, if any, with existing clients.
 - Proposed use of other auditors’ work.
 - The firm’s ability to meet the reporting deadline.

- Identified significant risks associated with accepting the client or the engagement.

Where issues have been identified, the manner in which they have been resolved is documented.

22. The decision on whether to continue a client relationship includes consideration of significant matters that have arisen during the current or previous audit engagement and their implications for the continuance of that relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess the necessary competencies.

Assignment of Engagement Teams

23. **The engagement partner should be satisfied that the engagement team collectively has the necessary competencies to perform the audit engagement in accordance with professional standards and applicable regulatory and legal requirements, and to enable the issuance of an auditor's report that is appropriate in the circumstances.**
24. The necessary competencies expected of the engagement team as a whole include the following:
 - Understanding and practical experience of similar engagements through appropriate training and participation.
 - Understanding of professional standards and applicable regulatory and legal requirements.
 - Knowledge of auditing, accounting, tax and information technology at the appropriate level.
 - Knowledge of specific industries.
 - Ability to apply professional judgment.
 - Understanding of the firm's quality control policies and procedures.

Engagement Performance

25. **The engagement partner is responsible for the direction and performance of the audit engagement in compliance with professional standards and applicable regulatory and legal requirements, and for the issuance of an auditor's report that is appropriate in the circumstances. This responsibility includes the following:**
 - **Risk assessment and planning procedures.**
 - **Performance of further audit procedures.**
 - **Supervision.**
 - **Documentation.**
 - **Review.**
 - **Reporting.**
 - **Communicating with those charged with governance of the client entity.**
26. Direction of the audit engagement involves the members of the engagement team being informed of their responsibilities, the nature of the entity's business, risk-related issues, problems that may arise and the detailed approach to the performance of the engagement. The engagement team's responsibilities include the maintenance of an objective state of mind and an

- appropriate level of professional skepticism, and the performance of the work delegated to them in accordance with the ethical principle of due care. Members of the engagement team are encouraged to raise questions they may have with more experienced team members. Appropriate communication occurs both within the engagement team and with the client.
27. It is important that all members of the engagement team understand the objectives of the work they are to perform. Appropriate team-working and training assist less experienced members of the engagement team to understand the objectives of the work assigned to them.
 28. Supervision includes the following:
 - Tracking the progress of the audit engagement.
 - Considering the competencies of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the audit engagement.
 - Addressing significant issues arising during the audit engagement, considering their significance and modifying the planned approach as appropriate.
 - Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.
 29. Work performed by members of the engagement team is reviewed by more experienced team members or the engagement partner. Reviewers consider whether:
 - (a) The work has been performed in accordance with professional standards and applicable regulatory and legal requirements and, where applicable, in accordance with the work program;
 - (b) Significant matters have been raised for further consideration;
 - (c) Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
 - (d) The work performed supports the conclusions reached and is appropriately documented; and
 - (e) The objectives of the engagement procedures have been achieved.
 30. **Before the auditor’s report is issued, the engagement partner should review the working papers in order to be satisfied that they demonstrate that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued.** Although the review may not cover all working papers, it covers critical areas of judgment, especially relating to difficult or contentious matters identified during the course of the engagement, significant risks and other areas which the engagement partner considers important. The engagement partner documents the extent and timing of the review. Matters arising from the review are resolved to the satisfaction of the engagement partner.
 31. Where there is a change of engagement partner during the course of the current audit engagement, the new engagement partner undertakes a review of the work performed to the date of the change. The review procedures are sufficient to satisfy the new engagement partner that

the work performed to the date of the review has been planned and performed in accordance with professional standards and applicable regulatory and legal requirements.

32. Where more than one partner is involved in the conduct of an audit engagement, it is important that the responsibilities of the respective partners are clearly defined and understood by the engagement team.

Consultation

33. **The engagement partner should encourage and facilitate appropriate consultation on difficult or contentious matters both within the engagement team and between the engagement team and others within or outside the firm. The conclusions resulting from such consultations should be documented. The engagement partner is responsible for determining that conclusions resulting from consultation have been implemented.**
34. Effective consultation requires that those consulted be given all the relevant facts that will enable them to provide informed advice, whether on technical, ethical or other matters. Where appropriate, the engagement team consults individuals with appropriate knowledge, seniority and experience.
35. In certain circumstances it may be appropriate for the engagement team to consult outside the firm, for example, where the firm lacks appropriate internal resources. In such circumstances, they may take advantage of advisory services provided by other firms, professional and regulatory bodies or commercial organizations. In such circumstances, appropriate arrangements are made to safeguard client confidentiality.
36. Where disputes arise during consultation, the engagement team follows the firm's policies and procedures for dealing with and resolving differences of opinion.

Engagement Quality Control Review

37. **For audits of listed entities, or in other circumstances where the firm's criteria require that an engagement quality control review be performed for an audit engagement, the engagement partner should:**
- (a) **Determine that an engagement quality control reviewer has been appointed; and**
 - (b) **Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.**

The engagement partner does not issue the auditor's report until the completion of the engagement quality control review, including resolution to the satisfaction of the engagement quality control reviewer of issues raised.

38. For an audit engagement where, at the start of the engagement, the firm's criteria do not require the performance of an engagement quality control review, the engagement partner is alert for changes in circumstances during the engagement that would require the performance of an engagement quality control review.
39. **An engagement quality control review should include an objective evaluation of:**
- (a) **The significant judgments made by the engagement team;**

- (b) **The conclusions reached in formulating the auditor’s report; and**
- (c) **Other significant matters that have come to the attention of the engagement quality control reviewer.**

40. The engagement quality control reviewer’s work is designed to provide a basis to conclude whether any matters have come to the reviewer’s attention that would cause the reviewer to believe that the audit engagement was not performed in accordance with professional standards and applicable regulatory and legal requirements or that the auditor’s report was not appropriate in the circumstances.
41. An engagement quality control review involves discussion with the engagement partner, a review of the financial statements and the auditor’s report. It also involves, to the extent considered necessary by the engagement quality control reviewer, a review of selected working papers. The extent of the engagement quality control review depends on the complexity of the audit engagement, the risks associated with the engagement and the experience of the engagement team. It does not reduce the responsibilities of the engagement partner. The scope of an engagement quality control review includes consideration of the following:
 - The engagement team’s evaluation of the firm’s independence in relation to the specific audit engagement.
 - The significant risks identified and the responses to those risks.
 - The judgments made, particularly relating to significant risks.
 - Whether appropriate consultation has taken place on difficult or contentious matters and the conclusions arising from those consultations.
 - The significance and disposition of misstatements.
 - Whether appropriate matters have been considered for reporting to management and those charged with governance.
 - Whether the documentation reviewed reflects the work performed and supports the conclusions drawn as a result of that work.
42. Additional information on engagement quality control reviews is included in ISQC 1, paragraphs 57 – 72.

Monitoring

43. In accordance with ISQC 1, the firm’s system of quality control includes monitoring of quality control policies and procedures. The engagement partner considers the results of the monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms, and considers whether deficiencies noted in that information may have an impact on the audit engagement in question. A deficiency in the firm’s system of quality control may or may not, in and of itself, indicate that a particular audit engagement was not performed in accordance with professional standards and applicable regulatory and legal requirements or that the auditor’s report was not appropriate in the circumstances.
- 44 **The engagement partner or engagement team should communicate with the responsible parties within the firm regarding any formal complaints or allegations about whether the**

work performed fails to comply with professional standards and applicable regulatory and legal requirements.

Effective Date

45. This ISA is effective for audits of financial statements for periods commencing on or after January 1, 2005.

Public Sector Perspective

1. *The general principles contained in ISA 220 are applicable to auditors of public sector entities.*
2. *Some of the terms used in this ISA such as, “engagement partner” and “firm,” should be read as referring to their public sector equivalents. In general, public sector entities, like listed entities, may be of significant public interest. Many of the requirements applicable to the audit of listed entities are, therefore, likely to be relevant to the audit of public sector entities*
3. *In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the considerations regarding the acceptance and continuance of client relationships and specific engagements, as set out in paragraphs 21 – 22 of this ISA, may not be relevant.*
4. *Similarly, the independence of public sector auditors may be protected by statutory measures. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to ensure compliance with the spirit of paragraphs 13 – 18. This may include, where the public sector auditor’s mandate does not permit withdrawal from the engagement, disclosure of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.*
5. *Paragraph 24 sets out competencies expected of the engagement team. Additional competencies may be required in public sector audits, dependent upon the terms of the mandate in a particular jurisdiction. Such additional competencies may include an understanding of the applicable reporting arrangements, including reporting to parliament or in the public interest. The wider scope of a public sector audit may require the financial statements audit to include, for example, some aspects of performance auditing and a comprehensive assessment of the arrangements for ensuring legality and preventing and detecting fraud and corruption.*